Episode #238: Premium Finance 101: Risk vs. Reward

Video Transcription

Hello, my name is Adam Reyna, and I'd like to thank you for attending today's "Money Script Monday."

So today we're talking about a very interesting topic that most consumers have never even heard of. It's "Premium Financing a Life Insurance Policy."

The reason this is a great topic is that I've heard so many people in the past telling me, "Yeah, I want the life insurance," but they don't want to pay the premium for it.

So, my goal today is to show you how to use OPM, other people's money, to pay for what I like to call the Swiss Army Knife of planning. And it's an indexed universal life insurance policy.

Whether your goal is to protect your family, be your own banker, estate planning, tax-free income, insurance planning for your business, or simply diversify and protect your money, this concept is perfect for you. So with that said, let's go ahead and get started.

Now, before we go over the board behind me, let me try and set the stage a little bit here. So I want you to raise your hand if you're a little uncertain about the future of the economy. If your hand is up, don't worry. You're not alone.

My hand and a lot of other people's hands are up right now with a lot of the uncertainty out there. But the question is why? So I think we've all felt the effects of inflation that's been running red hot due to the supply chain disruption, the Fed is going to likely raise the rates multiple times this year, which causes lots of volatility in the stock market and your investment accounts. And finally, traditionally safe alternatives to stocks bonds have had one of the worst starts to the year since the 1980s.

All right. So the question now is, where do your hard-earned dollars have a safe place to go? So a good answer is, well, with the life insurance company, and specifically in cash value life insurance. Okay.

We have to remember, though, that everyone wants the benefits of life insurance, but nobody really wants to pay for it, right? So income premium finance life insurance. As a quick reminder, IUL is a life insurance policy built for cash accumulation.

You pay an after-tax premium, it builds up tax-deferred cash, and eventually, there's enough cash in the policy that you can use for tax-free income, large capital purchases, investing, business planning, that list really goes on.

Okay. So with that said, let's talk about premium finance 101 and take a look at the board here. So with premium finance, instead of paying premium directly to the insurance company, you will pay a contribution to a lender. Okay.

That lender then pays the premium for you to the insurance company as a loan. Eventually, there's enough cash value in the life policy to pay the lender back using the cash value from your policy and now your life insurance policy is free and clear from the lender to be that Swiss Army Knife of planning. Okay. So now let's look at the board.

So a couple of key metrics here are the death benefit and income, the premium, your out-of-pocket contribution, the collateral, and leverage. So if you tell us how much you want to contribute, how much leverage you want, and your goal, then we can go and design a plan to meet your objectives. All right.

So, on our vertical axis there, we have the good stuff. It's your reward. It's the benefits that you get that we already mentioned, your death benefit or tax-free income. And then on our horizontal axis here, we have our risk spectrum, but this isn't like the normal risk though that you're used to because remember, we already said the insurance policy is a great place to put your assets right now.

This risk is not in the same category as the stock market or inflation risk. This risk is defined as the possibility that your life policy does not exceed the borrowing rate. Put another way, we're not able to sustain positive arbitrage between the loan rate and the earned interest, but no, we only need to earn about 2%, 2.5% above our borrowing rate for this plan to be successful depending on the amount of leverage that you use.

All right. So then our diagonal line is your premium, which is typically correlated to the amount of leverage used. The more premium paid into the policy, the more rewards you get. If you notice, in the lower portion of the self-funded area, we have the lowest amount of risk but also the lowest reward.

You do get compensated for the amount of risk that you're willing to take with lots of rewards. So the blue line here is your out-of-pocket contribution to the lender. It stays constant. As your out-of-pocket starts to go up, so can the premium and ultimately your output, which is more death benefit or income. If we keep your out-of-pocket the same and increase the leverage, your output can go up as well.

If we do this, there's a chance though that you may need post-gap collateral. The gap collateral is roughly the difference between the cumulative loan and the cash value and the life insurance policy.

Notice as we increase the premium and keep your out-of-pocket the same, we are increasing leverage on the policy which can reap great rewards for you. If we stay around the three times leverage, we don't need any collateral, and as we go above the three times leverage, there may be that need for the gap collateral, which is totally fine.

And when collateral is used correctly, it can reap a lot of rewards as well. Those who understand leverage and premium finance can keep their out-of-pocket low and reward very high. They are essentially getting the benefit of life insurance without having to pay the full sticker price.

All right. So in this example, this person was going to have an all-in budget of 500,000. If they use leverage, they could potentially get $5 million into the life insurance policy, and even 10 times the amount of income and death benefit if they go all the way up the spectrum.

The entire premium finance plan is based on your goals and the amount of leverage you're comfortable with.

If you wanna pay cash for your policy, it can still easily meet your objectives, but as we just showed, those that understand the leverage and how to use other people's money can take the same out-of-pocket premium that we're going to use to pay cash for their policy, leverage it up 3 times, 5 times 10 times the amount of premium in the policy, and then reap 10 times the reward.

Whether it be death benefit for your family or business or tax-free income in retirement, we can help you accomplish your goals.

Remember, when we have uncertain times in our economy, inflation is high, markets are volatile, and our insurance companies are doing well, cash value life insurance can be a safe haven for your hard-earned dollars.

And with the correct use of leverage and other people's money, we can accomplish much more with your same out-of-pocket budget.

I hope you found this informative, and we look forward to working with you. Thank you.