

PREMIUM FINANCING INTELLIGENCE · PAPER 1 OF 3

# The Liquidity *Trap*

Why Estate Protection Shouldn't Cost Your Client Their Invested Capital

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## EXECUTIVE SUMMARY

For a principal with a large, illiquid estate, the decision to fund death-benefit liquidity is rarely framed honestly. It is presented as a premium to be paid — when in practice it is capital to be removed from the very assets that built the estate. Selling appreciated holdings, drawing down a business, or unwinding real estate to pay premiums interrupts compounding, can realize avoidable gains, and forces a timing decision the principal would never make on the merits.

There is a second path. Premium financing funds the protection while the principal's capital stays invested. This paper makes the case for liquidity preservation as the default lens for estate-protection conversations with substantial estates — and explains why, for the advisor, it is the rare insurance conversation that protects assets under management rather than eroding them.

## The Liquidity Problem Hidden in Every Large Estate

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Most substantial estates are not substantially liquid. The wealth sits in an operating business, in concentrated equity, in commercial or appreciated real estate, in partnership interests — holdings that produce return precisely because they are not sitting in cash. That is by design. It is also the source of a problem that surfaces at the worst possible moment.

When the estate transfers, it can face obligations that demand cash: transfer and settlement costs, the equalization of inheritances among heirs when the marquee asset cannot be neatly divided, the buy-out of a co-owner, or simply the replacement of wealth that was always meant to pass intact. The estate is large. The estate is also, at that moment, short of liquidity. A death benefit is the most efficient instrument ever devised to deliver cash exactly when an estate needs it. The question is never whether the protection has value. The question is how to pay for it.

## The Conventional Path and Its Hidden Cost

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The conventional answer is to fund premiums from capital — sell something, or divert cash flow that would otherwise stay invested. On a small policy this is a rounding error. On the scale these estates require, it is not.

Three costs compound, and none of them appear on the premium notice:

- **Lost compounding.** Every dollar pulled out to pay a premium stops working. Over the years a policy is funded, the foregone growth on liquidated capital can rival the premium outlay itself — a cost the principal pays silently and never sees itemized.

- **Realized gains and tax friction.** Liquidating appreciated assets to raise premium dollars can trigger capital gains and disturb a carefully managed tax position, turning a planning decision into an avoidable tax event.
- **Forced timing.** Funding premiums from capital means selling on a schedule set by the policy, not by the market or the business. The principal becomes a forced seller — the one posture every disciplined investor is built to avoid.

#### THE TRAP

*The conventional path treats the premium as the cost. The real cost is everything the liquidated capital would have earned, the tax friction of raising it, and the discipline surrendered by selling on someone else's timetable.*

## Reframing the Decision: Finance the Premium, Preserve the Capital

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Premium financing changes the question from “which assets do we sell to pay for this?” to “how do we put this protection in place without disturbing the portfolio at all?” In a financed structure, a lender funds the policy premiums. The principal’s capital stays invested, compounding uninterrupted, tax position intact. The estate gains the liquidity instrument it needs while the balance sheet that produced the estate keeps doing its work.

This is the literal meaning of liquidity preservation: the protection is funded, and the principal’s liquidity — their invested, productive capital — is preserved. For the right estate, the comparison is not premium versus no premium. It is invested capital that keeps working versus invested capital that is liquidated and lost to opportunity cost.

## What Liquidity Preservation Looks Like in Practice

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A financed structure is engineered, not bought. At a conceptual level, a lender advances the premiums, the policy is typically owned by an irrevocable trust so the death benefit sits outside the taxable estate, and the arrangement is collateralized and designed with a defined path to retire the loan. Each of those elements — the lending terms, the collateral, the trust architecture, the exit — carries real considerations that a serious advisor will want to examine closely. They are the subject of the next paper in this series.

What matters at this stage is the reframing. The estate-protection decision is not a choice between paying a premium and going unprotected. It is a choice about where the premium dollars come from — and whether the principal’s capital is interrupted or left intact to compound.

#### THE REFRAME IN ONE LINE

*The conventional structure asks the estate to surrender capital to buy protection. A financed structure lets the estate keep the capital and finance the protection.*

## Where the Advisor Fits

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For the independent advisor, this is an unusual insurance conversation — because it does not begin by asking the client to remove assets from your management. Conventional insurance funding pulls capital out of the portfolio; liquidity preservation is built specifically to leave it in. The advisor who introduces this lens is not handing the relationship to an insurance vendor. They are bringing a capital strategy to the client and keeping both the relationship and the assets.

That is the heart of liquidity preservation: it preserves the client’s invested capital, and it preserves the advisor’s book. The mechanics that make it defensible — structure, collateral, rate and renewal risk, the exit — are where a disciplined design desk earns its keep, and where this series turns next.

### Bring us the case.

If you have a client whose estate is large, illiquid, and currently facing the conventional liquidate-to-fund decision, the Goheen 48-hour case design desk will model the structure, stress-test it, and return a plain-English analysis you can put in front of your client. We are your back-office premium finance desk — a capital strategy partner, not an insurance agent.

*Paper 2 in this series — Under the Hood — examines the structure, risk, and fiduciary defensibility of premium-financed life insurance in full.*

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