

PREMIUM FINANCING INTELLIGENCE · PAPER 2 OF 3

# Under the *Hood*

Structure, Risk, and Fiduciary Defensibility in Premium-Financed Life Insurance

---

## EXECUTIVE SUMMARY

Paper 1 in this series argued that financing an estate's death-benefit liquidity — rather than funding it from invested capital — preserves the principal's compounding and the advisor's book. That is the case for the strategy. This paper is about whether you can defend it.

Premium financing is a leveraged structure. It carries lending risk, interest-rate risk, collateral risk, and policy-performance risk, and it depends on a trust architecture and an exit that have to be right from the start. A structure that ignores those realities is indefensible in a due-diligence setting — and rightly so. A structure that names them, models them, and manages them is something an advisor can stand behind. This paper opens the hood: how a financed case is built, where the risks actually live, and what disciplined design does about each one.

## THE CREDIBILITY PRINCIPLE

*Credibility in this market comes from naming the risks first. A firm that leads with upside and buries the mechanics is selling. A firm that leads with the mechanics is advising.*

# How a Financed Case Is Actually Built

---

Strip away the jargon and a premium-financed life insurance case has four moving parts that have to fit together. Understanding how they connect is the precondition for evaluating the risk.

## 1. The policy

A permanent life insurance policy is designed to deliver the death benefit the estate needs and to build cash value that will matter later — both for collateral and for the exit. Policy design is not incidental to a financed case; it is the foundation the rest of the structure stands on. Crediting assumptions, funding pattern, and carrier selection all flow from how the case is engineered, not from a default illustration.

## 2. The loan

A lender advances the premiums. The borrower is typically a trust rather than the individual, the loan accrues interest at a rate tied to a short-term benchmark, and the arrangement is reviewed and renewed on a defined cycle. The loan is what keeps the principal's capital invested — and it is also the source of the structure's primary risk, because its cost moves with rates and its terms reset at renewal.

### 3. The collateral

The lender is secured. The policy's cash value serves as primary collateral; in the early years, before cash value has accumulated, the lender typically requires additional posted collateral from the borrower. As cash value builds, that outside collateral requirement is designed to decline. The collateral arrangement is where an under-designed case most often surprises a client, and where honest modeling earns its keep.

### 4. The trust

The policy is generally owned by an irrevocable trust — most commonly an ILIT — so the death benefit passes outside the taxable estate. The trust is the borrower, the policy owner, and the beneficiary structure all at once. Get the trust architecture wrong and the estate-tax efficiency that justified the whole exercise can be lost.

#### THE POINT

*These four parts are interdependent. You cannot evaluate the loan without the policy, the collateral without the cash-value curve, or the tax outcome without the trust. Disciplined design treats them as one system — which is exactly why a default illustration is not a plan.*

## Where the Risk Actually Lives

Every objection a serious advisor raises about premium financing maps to one of four risks. None of them is a reason to avoid the strategy. Each is a reason to demand disciplined design. The table below pairs each risk with what rigorous case construction does about it; the sections that follow take the two that matter most in depth.

THE RISK	HOW DISCIPLINED DESIGN MANAGES IT
<b>Interest-rate &amp; renewal risk</b> — the loan's cost rises with benchmark rates and resets at renewal.	Model the structure across a range of rate paths, not one assumed rate; design funding and cash value so the case absorbs higher-cost periods.
<b>Collateral risk</b> — outside collateral may be called if cash value lags or values move.	Stress-test the cash-value curve; size early-year outside collateral honestly; show the client the call, not just the base case.
<b>Policy-performance risk</b> — crediting underperforms the illustration.	Design to conservative, not headline, crediting assumptions; pressure-test the policy independent of the sales illustration.

## THE RISK

## HOW DISCIPLINED DESIGN MANAGES IT

**Structural & tax risk** — trust, ownership, or MEC missteps undo the tax outcome.

Build the ILIT and ownership correctly from inception; design around MEC limits; coordinate with the client's estate counsel.

## Interest-Rate and Renewal Risk

---

This is the risk every advisor names first, and correctly. Because the loan cost is tied to a short-term benchmark, a financed case is exposed to the rate environment in a way a paid-up policy is not. When benchmark rates rise, the cost of carrying the loan rises with them, and because the loan is reviewed and renewed periodically, the terms themselves can change.

The wrong way to handle this is to illustrate a single, optimistic rate and call it a plan. The right way is to model the structure across a range of rate paths — including sustained higher-rate environments — and to design the policy funding and cash-value accumulation so the case remains sound when borrowing is expensive, not only when it is cheap. The question a disciplined desk answers is not “what does this look like if rates behave?” It is “what does this look like if they don't, and at what point does the client need a decision?”

### DEFENSIBLE VS. INDEFENSIBLE

*An indefensible case shows one rate and one outcome. A defensible case shows the client the range, marks where the structure comes under pressure, and names the actions available if it gets there.*

## Collateral Mechanics

---

Collateral is where the abstract becomes concrete for the client. The lender is secured primarily by the policy's cash value, but in the early years — before that cash value has accumulated — the lender typically requires additional collateral posted from outside the policy. As the cash value builds over time, that outside requirement is designed to decline and, in a well-built case, eventually fall away.

Two things have to be true for this to hold. First, the cash value has to accumulate roughly as designed; if policy performance lags, the crossover where outside collateral is released moves further out. Second, the outside collateral itself has to be durable; if it consists of assets whose value can fall, a market decline can coincide with a collateral call at the worst moment. Honest design models both — it shows the client the early-year outside collateral requirement plainly, stress-tests the cash-value curve, and confirms the posted

collateral can withstand a down market. The failure mode in this strategy is rarely the death benefit. It is an outside collateral call the client was never shown.

## The Trust and Estate-Exclusion Architecture

---

The reason to finance an estate's liquidity is to deliver tax-efficient death benefit. That efficiency depends almost entirely on ownership. If the insured owns the policy, the death benefit can be pulled back into the taxable estate — defeating the purpose. So the policy is generally owned by an irrevocable trust, which is also the borrower on the loan and the structure through which benefits pass to heirs.

Done correctly, the ILIT keeps the death benefit outside the taxable estate while housing the financing arrangement cleanly. Done carelessly, it creates problems that surface years later: gifting mechanics that don't support the premium or interest flows, administration that isn't maintained, or a structure that drifts out of alignment with the client's estate plan. This is the part of the case that belongs in close coordination with the client's estate counsel — not improvised by an insurance vendor. A design desk's job is to build the financing to fit the trust the attorney intends, and to flag where the two must be reconciled.

## The Exit

---

A financed case is not designed to be carried forever. There is a defined path to retire the loan, and that path should be visible from day one. Depending on the structure, the loan may be repaid from accumulated policy cash value, from the death benefit itself, or from a planned outside event — but the exit is a design input, not an afterthought. The first question a disciplined desk asks about any financed case is how it ends. A structure that cannot answer that question clearly is not finished being designed.

### THE DISCIPLINE TEST

*Ask any premium-finance proposal three questions: What happens if rates stay high? What does the client owe in outside collateral, and when? How and when does the loan get retired? A proposal that answers all three is designed. One that doesn't is a sales illustration.*

## What This Means for the Advisor

---

None of these risks is exotic. They are the ordinary risks of a leveraged structure, and they are manageable — but only with design that treats them as the main event rather than the fine print. For the advisor, the practical implication is simple: the strategy is defensible when the case is built by a desk that models the

downside, shows the client the pressure points, and coordinates with counsel on the trust. It is indefensible when it rests on a single illustration and an optimistic rate.

That distinction is the entire value of a disciplined premium-finance desk. It is the difference between recommending a structure you can stand behind in a due-diligence meeting and recommending one that can blow up a client relationship. Paper 3 in this series turns to the advisor's own economics — how liquidity preservation protects assets under management and deepens the client relationship.

### **Pressure-test a real case.**

Bring us a client situation and the Goheen 48-hour case design desk will model the structure across rate paths, lay out the collateral schedule, and return a plain-English risk summary you can defend in a due-diligence setting. We stress-test before we recommend. We are your back-office premium finance desk — a capital strategy partner, not an insurance agent.

## IMPORTANT DISCLOSURES

**Insurance:** Life insurance products, including Indexed Universal Life (IUL), are insurance contracts issued by licensed life insurance carriers. Policy performance — including crediting rates, cap rates, participation rates, and cost of insurance charges — is not guaranteed. Past performance is not indicative of future results. Products are subject to underwriting approval and vary by state. Loans and withdrawals reduce policy cash value and death benefit and may have tax consequences. Goheen Insurance acts as a licensed insurance broker. Nothing herein constitutes an offer or solicitation to purchase any insurance product.

**Premium Finance:** Premium financing involves borrowing from a third-party lender to fund life insurance premiums. This strategy carries significant financial risk, including variable loan rates tied to SOFR, collateral requirements, margin call exposure, and the possibility that policy cash values may be insufficient to repay the loan. The arbitrage between loan costs and policy crediting rates is not guaranteed and may produce negative outcomes. Suitability must be evaluated on an individual basis by qualified legal, tax, and financial professionals. Hypothetical illustrations are for educational purposes only and do not represent actual client outcomes.

**Tax & Legal:** Nothing herein constitutes legal or tax advice. Tax information reflects current law as of the date of publication. Tax law is subject to change. Consult a qualified attorney and tax advisor regarding your specific circumstances before implementing any estate planning strategy.

**Investment:** Goheen Insurance — A Simplicity Company — is not a registered investment adviser and does not provide investment advice. This publication is for informational and educational purposes only. References to market rates, indices, or economic conditions are provided for context only and do not constitute investment recommendations. Past market performance does not guarantee future results.

---

**Goheen Capital** is a brand name of Goheen Insurance, a Simplicity Group company. This material is intended for U.S. financial professionals and the clients they serve. It is educational in nature and is not an offer, solicitation, or recommendation of any product or strategy.