

# PREMIUM FINANCING - A LOAN FOR LIFE (INSURANCE)

Jeffrey Kirk

What is premium financing? Premium insurance financing enables high net worth individuals (**HNWI**) to obtain life insurance at minimal cost by arranging financing from a lender to cover the policy premiums. HNWIs are unlikely to want to liquidate assets to pay for such premiums and therefore opt for premium financing. The underlying need for the life insurance may vary, for instance, it may be due to estate planning purposes, a corporate buyout or the need for key person insurance.

The basics of premium financing are:

- a HNWI may settle an irrevocable life insurance trust (**ILIT**) or may utilise an investment holding company - to act as borrower, policy owner and policy beneficiary (**Borrower**);
- a lender bank (**Bank**) provides premium loan financing to the Borrower;
- the Borrower utilises the loan to purchase a life insurance policy (**Policy**) from a life insurance carrier (**Insurer**);
- there may be an arrangement between the Insurer and the Bank whereby the policy premium may be held by the Bank and utilised by the Insurer for making investments. The Insurer and the Bank may enter into a discretionary management agreement in relation to these premiums; and
- as security, at the very least, the Bank will require an assignment from the Borrower to its rights under the Policy in favour of the Bank.

## WHICH BANKS, WHICH INSURERS & WHAT LIFE INSURANCE PRODUCTS?

Our recent experience has shown that premium financing is an exponentially growing financial technique. In the Asian market, which is undergoing a boom in the number of HNWIs, we have seen the largest growth. We work with a host of private banks based and operating in Asia that offer premium financing.

The Insurer issuing the Policy is often a Bermuda domiciled life Insurer underwriting business through its Asia-based offices. Ordinarily, the Policy will be Bermuda law governed and as a result the assignment will be Bermuda law governed. There are certain requirements under the various Bermuda insurance laws (in addition to any requirements stipulated in the Policy) that must be complied with for the assignment to be valid. These legislative requirements include that the Insurer must be provided with notice of the assignment and that any irrevocable named beneficiary in the Policy must consent to the assignment. Bermuda statutes provide that the priority of security interests granted under any assignment of a life insurance contract is subject to the Life Insurance legislation, which determines priority by the order in which written notice of the assignment to the Insurer.

The Bermuda Insurer may be incorporated as a segregated accounts company (**SAC**) and that specific Policy products or tranches of life insurance business are held within individual segregated accounts. Such companies are not unique to Bermuda, but they are not as common as regular incorporated companies. SACs allow for separate segregated accounts to be created, where each account will hold a separate set of assets and liabilities, which are legally separated from the assets and liabilities of another segregated account. This segregation is a statutory creature, and does create separate bodies corporate. The assets and liabilities of one segregated

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account only relate to that segregated account. Therefore a creditor of a segregated account, only has a claim to that segregated account and no other segregated accounts of the SAC.

Whilst the segregated account concept has been tested and upheld in the Bermuda courts, the assistance of local legal counsel would be necessary to determine whether such other jurisdictions would recognise this concept.

### INVESTMENT OPTIONS AND OPPORTUNITIES FOR THE HNWIS AND PROTECTING THE BANK'S INTERESTS

In our experience a HNWNI will often use an investment holding company to act as Borrower, and often such a company is incorporated in the British Virgin Islands (**BVI**).

Assuming that the Policy is an investment-linked policy with no stipulated absolute death benefit, than the advantage of using a BVI company or an ILIT is that the HNWNI may have a direct involvement in the decision as to which underlying assets and investments that the Policy will invest into. Assuming the Insurer is agreeable and, for instance, has entered into a discretionary management agreement with the Bank, the HNWNI is then in a position to direct how the premiums are invested.

Where a BVI company acts as Borrower, the assignment can be registered as a charge in the BVI against its assets. BVI companies are required to register any charges created over its assets in a register of charges (**Private Register**). The Bank should insist that it is provided with a certified copy

of the Private Register showing the particulars of registration of the assignment. Further, an application may be made to the BVI Registrar of Corporate Affairs (**Registrar**) to register details of the assignment in the Register of Registered Charges (**Public Register**). There is no time limit when the particulars of the assignment must be entered into the Private or Public Register and failure to enter the particulars will not affect the validity of the assignment. However, registering the assignment at the Public Register does determine priority of the security interest created by the assignment. Either the Bank (through its BVI legal counsel) or the BVI company borrower (through its registered agent) can register the assignment in the Public Register. As this registration may affect the Bank's priority, we would recommend that its BVI legal counsel attends to this registration.

### THE FUTURE OF PREMIUM FINANCING

With the continuing growth of premium financing there is a good likelihood that substantially more focus will fall on these transactions in the future and their deployment will increase. This is likely to translate into greater competition between lender Banks in the future and corresponding pressure on interest rates and fees levied. Similarly, long-term insurers globally are aware of the attraction of having their life products being utilised in premium financing arrangements and are therefore likely to want to be able to expand their future product offering.

It has been our experience that the Banks and the Insurers are increasingly seeking the advice and services of offshore counsel and other professionals in protecting their interests in their specialised premium financing platforms and products, including both the Bermuda and BVI aspects.

### CONTACT

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