



USING LIFE INSURANCE AS LOAN COLLATERAL



Many Unity clients are seeking innovative ways to optimize their assets and unlock liquidity. One often overlooked avenue is leveraging participating life insurance policies as assets for lending. This strategy can offer policyholders a unique blend of security, flexibility, and financial growth. Let's delve into how participating life insurance policies can be utilized as a valuable asset to facilitate lending.

Participating life insurance policies are a type of permanent life insurance that combines a death benefit with a cash value component. Unlike term life insurance, which provides coverage for a specific period, participating life insurance policies offer coverage for the insured's entire life, as long as premiums are paid. These policies also accumulate cash value over time, which can be accessed by the policyholder through withdrawals or policy loans.

The cash value component of participating life insurance policies serves as a unique asset class. Unlike traditional investments such as stocks or real estate, the cash value of a life insurance policy can provide steady and predictable growth, often with tax advantages. Additionally, participating policies have the potential to earn dividends, further enhancing their value over time.

Policyholders can leverage the cash value of their participating life insurance policies to secure loans in **two ways**:

1. Policy Loans

Policy loans allow policyholders to borrow against the cash value of their insurance policy. These loans typically have favorable terms, as the cash value serves as collateral, reducing the lender's risk. Policy loans offer quick access to funds without the need for credit checks or lengthy approval processes. Moreover, they often come with lower interest rates compared to other forms of borrowing.

2. Leveraging Third-Party Loans Collateralized by Policy Cash Value

Alternatively, policyholders can leverage the cash value of their participating life insurance policies to secure loans from financial institutions. These loans are collateralized by the policy's cash value, providing lenders with security and reducing the risk associated with the loan. Similar to policy loans, third-party loans offer quick access to funds and may come with favorable terms and lower interest rates compared to traditional forms of borrowing.



USING LIFE INSURANCE AS LOAN COLLATERAL



BENEFITS OF BOTH OPTIONS:

- **Quick Access to Funds:** Both policy loans and third-party loans collateralized by policy cash value offer policyholders quick access to funds without the need for extensive approval processes.
- **Favorable Terms:** Both options typically come with lower interest rates compared to other forms of borrowing, making them cost-effective solutions for accessing liquidity.
- **Preservation of Policy Benefits:** Borrowing against the cash value of a participating life insurance policy allows policyholders to retain the death benefit and potential dividend earnings, ensuring that the policy's intended benefits for beneficiaries remain intact.
- **Tax Advantages:** Policy loans and third-party loans collateralized by policy cash value are not considered taxable income, providing potential tax advantages over other forms of borrowing. Depending on the use of the borrowed funds, interest may also be deductible against income tax.

POLICY LOANS:

Pros:

- **Quick Access to Funds:** Policyholders can access funds quickly and conveniently by borrowing against the cash value of their insurance policy. This can be particularly useful in emergencies or when immediate liquidity is needed.
- **No Impact on Credit Score:** Since policy loans are borrowed against the cash value of the insurance policy, they usually do not affect the policyholder's credit score.
- **Favorable Terms:** Policy loans often come with lower interest rates compared to traditional unsecured loans, making them a cost-effective borrowing option.
- **Preservation of Policy Benefits:** Policy loans allow policyholders to retain the death benefit and potential dividend earnings, ensuring that the policy's intended benefits for beneficiaries remain intact.

Cons:

- **Impact on Policy Performance:** Borrowing against the cash value of a participating policy reduces the amount of capital available for investment, potentially affecting the policy's growth potential and dividend earnings.



USING LIFE INSURANCE AS LOAN COLLATERAL



- **Risk of Policy Lapse:** Failure to repay the loan or interest charges could lead to the lapse of the insurance policy, resulting in the loss of coverage and potential tax consequences.
- **Interest Charges and Fees:** Policy loans accrue interest charges, which can compound over time if not repaid promptly. Additionally, some policies may impose administrative fees or other charges associated with borrowing.

Key Takeaway

Participating life insurance policies offer a unique opportunity for policyholders to leverage their assets for lending purposes. By accessing the cash value within these policies, individuals can secure low-interest loans while preserving the policy's death benefit and potential dividend earnings. However, it's crucial for policyholders to weigh the benefits against the risks and carefully consider their individual financial circumstances before utilizing this strategy. With proper planning and management, participating life insurance policies can serve as valuable assets for facilitating lending and achieving financial goals. Contact your Unity advisor if you're considering lending involving an insurance policy.

LOANS FROM A THIRD PARTY:

Pros:

- **Higher Loan Amounts:** Third-party loans collateralized by policy cash value may offer higher loan amounts compared to policy loans, providing greater access to funds.
- **No Impact on Policy Performance:** Since third-party loans are not directly tied to the policy's cash value, they do not affect the policy's growth potential or dividend earnings.
- **Diversification of Lenders:** Third-party loans allow policyholders to diversify their borrowing sources, reducing reliance on the insurance company for financing needs.

Cons:

- **Credit Check and Approval Process:** Third-party loans typically require a credit check and may involve a more extensive approval process compared to policy loans, potentially delaying access to funds.
- **Risk of Policy Surrender:** Defaulting on a third-party loan collateralized by policy cash value could still lead to the surrender of the insurance policy if the outstanding loan balance is not repaid, resulting in the loss of coverage and potential tax consequences.