David Mandell:

Hello, this is David Mandell. Welcome to the podcast. Today's podcast is a little bit different than those we've done so far, for a couple of reasons. Number one, we're going to focus on a specific planning topic, rather than an interview with a physician or an expert on their journey and advice. I wanted to do this, because there's a very powerful planning opportunity for physicians today, as we record this in November 2020, that will not last indefinitely. It will probably be around, for the foreseeable future, a matter of a year or two. My partner Jason and I have already written on this topic and recorded some webinars on it, and we've gotten a lot of interest from physicians on this topic.

I wanted to do a podcast specifically on this as it is timely. So, that's the first kind of change to what those of you who have regularly been listening, will hear today. And then, the second change is the expert is someone I know and probably you know well if you are an OJM follower: My partner, Jason O'Dell, co-founder of the firm. So, I'm excited about this topic. I take advantage of it already and I want to get this information out to people.

So the title today is *Leveraging Today's Historically Low Interest Rates*, which many of you may be aware of in wealth planning. Focusing on premium financed life insurance as the part when I bring Jason on to speak about. So before I introduce Jason and we shift and get into the specifics on premium financed life insurance, I want to step back and talk about where we are today in November, 2020. And some of the other techniques that one could use to leverage today's low interest rates.

So as we sit here in mid-November 2020, a week before Thanksgiving, we're at historically low rates. They may have ticked up just a slight amount in the last couple of weeks from what I can see, but still overall, historically low, really advantageous. And that's on purpose. That's a government program intended by the Fed to keep low rates, which benefit the economy in a lot of ways. Obviously they make it easy for banks to loan money at low rates, so people can take advantage of that. But yet the banks can still be profitable. They allow big business to have access to capital, to potentially hire, and grow, and do things that stimulate the economy at very low cost of capital.

And for professionals, high income individuals, and really anybody, there are a number of ways to take advantage of these low interest rates. The first one that we outlined in the longer webinar that Jason has done and in our article, which again, feel free to email either of us, contact us through the site, we'll get you that if you haven't seen them, or links to the webinar, or the article. But the most common way people take advantage of that, which I recently did myself, is to refinance existing loans. Most common would be the home mortgage, home equity line, or second mortgage.

We still are at historically low rates in the mortgage area, from a 30-year fixed to more floating rates, because prime, LIBOR, etc. are so low. And so a lot of people have done that. What you really want to do is look at what are the closing costs involved, and see how long you can get a breakeven on that, vis-a-vis a lower interest rate, and whether it extends the term or not. Again, we get into more of the specifics in the longer webinar and in the article, but for a lot of folks, it makes sense to refinance and lower their interest costs, lower their cost of capital over the period. And it's a long-term savings. Now that's concept number one.

Concept number two is kind of the same as concept number one, but doing it at the business or the practice, meaning you may have loans at the practice if you own your own practice. If you're part of a group you may have working capital loans, or maybe you did some kind of expansion, or maybe there's some loans that you needed to take out to buy into a practice, etc. Some of you may still have student loans, perhaps. So any of these, now's the opportunity to be looking at, is there a way to reduce my interest rate, and lower my payments and what are the costs to do that? And do that same kind of financial analysis.

Now in the article, or in the longer webinar, concept number four is the following. And then number three is premium financed life insurance. So I'll talk about number four and then we'll bring Jason on talk about number three. So number four is estate planning. And as we sit here, the presidential election is done, but we still don't know about the Senate. And if the Senate becomes Democratic, where the Democrats have all three parties, we may have a reduction in the estate tax exemption, which has already, scheduled to sunset, already in the middle of the decade to come back to from where it is. So there's certainly more estate planning that's going to be needed for a lot of clients and estate tax planning, if nothing is done. And it may be that those rates, those exemptions come back. So estate planning becomes more important for physicians.

And one of the common ways to do estate tax planning, or ways to build in flexibility with estate tax planning is to make loans between family members, because you can decide to pay them back, or you can forgive them. It gives a lot of flexibility. Again, because we don't have slides here, I'm not going to get into real specifics as we do in the webinar where Jason goes through a slide or two. But the concept is you can loan money to family members and the IRS sets every month, what's called the AFR, the applicable federal rate. That's basically the minimum rate that you need to charge to make those loans be bona fide. And that's tied to whatever the rates are in general, because they want to make sure, if you're loaning money to grandkids, or you're loaning money to your kids, or vice versa, that there's enough interest being paid and it's not a disguised gift.

And so they come out every month with three AFRs, short term, which is a loan of maturity less than three years, medium term, which is three years to nine years and long term, which is greater than nine years. So if we do a trust and we want to make a loan to that today in November, 2020, we know what rate that needs to be charged between family members in that planning so that loan is respected. The AFRs for November, 2020, which didn't change very much at all from October, maybe a couple hundredths of a point, likely won't change again too much for the foreseeable future. The short term rate, under three years was 0.13%. So you can loan money to a family member, as long as it's going to be paid back in less than three years at 0.13%. That's legitimate.

If it's a medium term loan, three to nine years, it's a 0.39%. Just incredibly low. And then long term, so this could be a 30-year loan. You make a loan to a trust and they can pay it back with life insurance, and do a lot of things to move assets around and avoid any gift or estate tax. The long-term rate, which is anything beyond nine years right now is 1.17%, incredible.

So you have these really powerful gift and estate tax opportunities right now, to do planning. And Jason does a good job of doing this in the webinar showing that you don't really have to totally commit to the plan by making loans. Meaning, you can make the loan and then decide, okay, I want it to get paid back to me or they can in the future, decide to forgive pieces of that loan, or I could decide to pay that loan with life insurance, et cetera.

So there's a lot of things that you can do to put in motion now, and really what these low rates allow, a lot of clients, which they're doing, and estate tax planning attorneys are really busy right now in the fourth quarter of 2020. Putting things in place like this with the loan rates so low, and it still gives flexibility to families. So they're not locked in to giving assets away forever. They're tying it into loan rates so they can decide, kind of push it into the future, but at least lock in today's low rates for potentially decades.

So that's really three of the four: 1) Personal home mortgage refinances, 2) other business and personal loan refinances, and 3) taking advantage of the low AFRs in intra-family estate planning loans. And now we're going to get to number four, which is using historically low rates today in your wealth planning to take advantage of a particular tool or strategy, which is premium financed life insurance. With that, I will bring on my partner, Jason O'Dell.

So before we get Jason, I'm going to introduce his bio. Many of you know him already, if you're listening to this podcast, because you may be a follower of OJM.

Jason, as I said, is the co-founder of OJM group with me and one of the partners. He has his BA from the Ohio State University and a master's in financial planning from the College for Financial Planning. He has been a financial consultant, investment advisor, and insurance specialist for more than 25 years, working with physicians and other high net worth clients. He is a coauthor of more than a dozen books, including *Wealth Planning for the Modern Physician*, the namesake of this podcast, *Wealth Management Made Simple*, and the CME piece we have, *Risk Management for the Practicing Physician*. He's been recognized by *Medical Economics* as one of the best financial advisors for doctors for 10 years over his career. And he serves on the AALU, which is a national life insurance organization, board of directors, and is member of the Financial Planning Association and the Cincinnati Estate Planning Council. Jason, welcome to the podcast.

Jason O'Dell:

Thank you, David. Appreciate it.

David Mandell:

So we've gone through three of the four topics of how folks can leverage the interest rates that I know you've covered in more depth in the webinar. So now let's get into the specifics on premium financed life insurance. Before we get into the premium financed part of it, from a life insurance point of view, why would a physician be interested in using life insurance as an asset class? And within that, what's the difference between what we know as permanent insurance versus term insurance? Give us a little background.

Jason O'Dell:

We'll get into a lot of why permanent life insurance has some significant advantages and why physicians would want to utilize it. But just in terms of the difference in life insurance types, we've got two main categories of life insurance – permanent life insurance and term life insurance. Term is for a period of time. It's very inexpensive. It's used in most cases, early on in physicians' careers to satisfy the unlikely event of a premature death. And they need large amounts of death benefit to provide for loved ones or family. Term insurance is also used to satisfy obligations that individuals or people might have for borrowing money from a lender. And they want to make sure that if the individual were to die prematurely, that there's money there to pay off the outstanding debt obligation. So most of the time you're using term insurance, so there's no value. It's cheap. It's usually level for a period of time. The premium payment is level. 10, 15, 20, 30-year level period of time and has its appropriate place.

Permanent insurance, on the other hand, has value built up in something we call the cash value. Permanent insurance is an umbrella over lots of different types of insurance. And there are lots of different kinds of permanent life insurance. How that cash value grows is what makes each of those permanent types of life insurance different from each other. Now, why would a physician be interested in life insurance as an asset class? Well, they'd be interested in it for a couple of reasons.

Number one, you have an asset class in 20 or 21 states that has creditor protection or is exempt by a state statute, your area of expertise, David. You've got that big benefit. You've got a tax benefit with life insurance where monies that go in in the form of premium payments are after-tax dollars, but money that goes in a cash value grows tax free, and also can be withdrawn from the policy, if properly structured, tax free as well. So you have money growing tax free and coming out tax free, just like, as an example, a Roth IRA. The way I look at cash value life insurance, in terms of how the monies grow inside the cash value, think of a Roth IRA, grow tax free and come out tax free. So you've got asset protection and you've got tax benefits. This is why it makes it such a great asset class for people to consider.

David Mandell:

Absolutely. I know I always mention to clients, or even in the podcast, things I've done myself. I mentioned earlier that I recently refinanced my home, and I know you and I both have term insurance as part of certain parts of our company. And we also personally have cash value insurance. And what attracted me to it, the asset protection, the tax-free growth, the tax-free access is probably what is attracting other clients.

Jason… how does, in general, that cash value grow? I know clients have some different options, right? And that's what is the difference in different types of policies. So just give us a couple of minutes on how the cash value grows in those policies.

Jason O'Dell:

Yes. So that's what separates permanent life insurance policies from one another, is exactly that. It's how does the cash value grow? So there are a few types. There's whole life insurance, which is most commonly known or referenced in articles and written about in newspapers or blogs. That's one type of permanent insurance. There's universal life, there's equity indexed universal life, there's variable life insurance, and there's also private placement life insurance. Whole life insurance is, the cash value grows is based on a dividend that the insurance company declares and that's how the cash value of a policy grows. The owner of the insurance policy has no control over that dividend. It's set by the insurance company. And typically the dividends that have been credited, historically have been a lot higher than where they are today. Still doesn't mean this product doesn't make sense, but dividends that insurance companies have declared recently have been going down historically over the last 25 years. An average dividend today is in the five-and-a-half to six-and-a-half percent range right now, today.

David Mandell:

That's not bad when you consider it's tax free and it's coming out tax free.

Jason O'Dell:

Absolutely. The key that you have to consider on whole life insurance though, is the expense side of the equation, the cost of insurance charges tend to be a little bit higher on whole life insurance than they do on the other types like universal life. Universal life, similar to whole life, instead of a dividend, it's an interest rate that’s credited to the policy, has a little bit more flexibility, has flexibility with cost of insurance charges in the sense that you can get death benefit a little bit lower to support the premium that's going into it. But again, the owner of the policy has no control over how the money is invested. It's set by the insurance company, no control over it.

Indexed universal life is sort of the new kid on the block. And when I say new kid, it’s new in the last 25 years, not new in the sense of the last few years. In this type of product, the cash value is growing based on an index, like the S&P 500, the Dow Jones, the NASDAQ, the Euro Stock, with some caveats. What I mean by caveats is they're looking at the S&P 500 as an index, but your account or your cash value is growing if the S&P 500 goes up, you're going to be capped on the upside. So if it goes up 12%, you may have a cap of nine or 10. Each of these caps are set by insurance companies and are different from insurance company to insurance company. On the downside, it's usually a floor of zero. Sometimes it's a

1% floor. So if the S&P goes down 20%, you would get a 0% or 1% return and any amount in between. So if the S&P goes up seven, you would get seven if you're in that band.

The advantage of this is you get the upside of the S&P or the index you're mirroring, with a cap, obviously, but you don't have the downside of that particular index. So you get a lot of advantages where zero is your stop, where negative, you don't have to worry about. And so a lot of clients like this particular product and this type of cash value life insurance, because of that downside protection. Where variable life insurance is different in that you actually select from a list of underlying investments, like your 401(k) plan where you're picking from a list of mutual funds. And however those underlying mutual funds perform, that's how your cash value grows. Both positive and negative. So if the underlying investment drops 20%, your cash value goes down by 20%.

And the final one is private placement life insurance. Private placement is where you're putting huge sums of money, minimums are required, typically $5 million of premiums over a period of time are required to go into a product. And inside these particular products, there are various underlying investments, including private equity and hedge funds and so forth that you can invest in under a lot of strict rules and guidelines. This is something we see on occasion for some clients, but it's used very infrequently because of the high minimum contributions that are required.

David Mandell:

Makes sense. So one of the things for the listeners… we've got some really good chapters that Jason oversaw in the book *Wealth Planning for the Modern Physician*, on the idea of using this asset class, or not. Evaluating it is something that we've been helping clients figure out for 25 years.

Where we want to focus now is what's the real opportunity with these low interest rates? And one of the things that that people can do, and this is what we'll shift to is use other people's money. Meaning the fact that interest rates are so low, we've already gone through three ways that's beneficial. Now let's talk about that asset class. If you want to drill down and learn more, get the book, obviously, because the lessons there are really long-term and what these products are and how they work. We have some great examples of doing it well and not doing it well, and pitfalls to avoid and all that.

So now let's focus on, there are these asset classes you can use – cash value life insurance, asset protection, tax free growth, if properly managed, tax free access, but I don't want to use my money. It would be nice to understand how I could, like buying a home, use cash, but like buying a home, I could actually finance it. And maybe that's a better decision, especially if rates are low. Tell the listeners a little bit about what premium finance is, and why perhaps it's attractive today and a little bit about that.

Jason O'Dell:

Sure. Premium financing is using a lender or a bank's money to pay your life insurance premium. Premium financing has been around in the property casualty environment for a long time. This is where the concept really originated from, where people had these large property and casualty premiums. They would go out and borrow money to pay the property and casualty premiums to the insurance company, and they'd have a finance charge that would be on that. And so the idea came: What if we took that concept and moved it to life insurance, but we borrowed money from a lender and we paid an interest-only payment back to that lender for the term of the loan? We didn't have any early pre-payment penalties, so we could pay that loan off again at any time that we wanted, and we borrowed significant sums of money, large amounts of money. When I say large amounts, hundreds of thousands of dollars, if not millions of dollars, paid an interest only payment, but we put that into a life insurance policy.

At today's low interest rate environment, it makes this pretty attractive. If you can borrow today at 2.35%, and you could borrow $1 million, that's $23,500 of interest payment a year in that particular example. You could put that million dollars into an insurance policy that could grow tax free and come out tax free, where you pull money out of the life insurance contract to pay off the loan at some point in the future. Would it make economic sense, or what would the economics look at behind doing that if you had an interest-only payment? So you're just leveraging, to your point, other people's money at the low interest rate environment, to borrow, to put it into a policy that's growing tax free and coming out tax free in the future.

David Mandell:

That makes sense. I mean, just high level, you mentioned whole life paying out 4 to 5%. And if the rates are 2 to 3% to borrow, there's some potential arbitrage there. I've got an equity indexed policy, and we know even in this tumultuous year of 2020, what the S&P has done and what it's done over the last five years, it doesn't happen every year. But if there's a floor and a cap on that, that even may make it even more potentially viable because I'm not worried about a big down here, right? So choosing, obviously, not only the loan terms and rates, but also the product to kind of reduce your downside is obviously important. I know that's what you work with clients doing. What kind of clients are typically doing this? This is a pretty niche thing. So what kind of clients are you typically saying this really makes sense for and is a right fit?

Jason O'Dell:

Yeah, so that's a great point because this is certainly a concept a lot of people are very interested in, but it really does fit a more select type of makeup of a client. Normally we're seeing clients that have incomes above $1 million that are using this, and net worths north of $5 million is where it makes sense. The reason that that's important to look at it is because if you're borrowing these large sums of money, the lender's willing to loan at such a low interest rate today because they're getting a collateral assignment on the cash value of the policy from a AAA rated insurance company that's worth billions of billions of dollars, if not hundreds of billions of dollars, these insurance companies. So they're willing to loan at such low rates because they know they've got a great collateral assignment from a very good institution, like an insurance company.

If you go to that same lender and say, "Hey, I want to buy this piece of property. Will you give me 2.3% interest rate?" The lender is going to say no, because that's a different animal, different financing structure. When we look at this, the right client is someone that understands leverage, that has high net worth and makes a significant income, because if interest rates do go up, you got to be able to sustain the cashflow to pay that interest payment if it goes up, you got to be able to make that interest payment to the lender. Really, you're looking at clients above a million dollars of income, normally, and a net worth of $5 million or greater. Those are the right types of clients to look at this particular strategy.

David Mandell:

Right. And we've seen clients and I know we've had clients who've had this in place for eight, 10 years. Some of them paid it off early because they've done well with other investments. And now, they have no loan on that asset. And it's done extremely well for them. It's been a big part of their wealth planning. How do clients typically, if people are listening to this, how do they make decisions? And tell us about a process, obviously at the end, we give them contact information to contact you or me, but how do people typically evaluate making this decision? What goes into that?

Jason O'Dell:

So the way that we build the economic model out to try to show clients, is we look at a number of different things. We look at what is the current interest rate, and how does that look running a *pro forma*? And we look at an increasing interest rate. So more than likely, interest rates are going to go up at some point in time, probably not in the near future, but at some point. We run the modeling and stress test an increasing or rising interest rate. We know that our out-of-pocket expense is that interest payment that's due to the lender, right? So we look at taking that interest payment, and instead of giving it to a lender, as an example. We assume what we don't do a premium financing structure, and we take that interest payment and put it into an after-tax investment account, and we earn a rate of return.

How does that look in terms of how much money we can pull out of that investment? As compared to if we did do the premium financing, our out-of-pocket is that interest payment. What does that look like in terms of dollars we can pull out of the life insurance contract? And we compare and contrast those, again, stress testing them, then looking at a rising interest rate environment, looking at a rate of return on the underlying cash value at 5-1/2% or 6%. Looking at it, the after-tax investment could earn 7 or 8%. If it could earn that and have to just pay taxes on it, how does that look in terms of a distribution that can come out of that particular one? So those are the factors that we're building out and modeling and analyzing for clients so that when they look at this, they can look at, "Hey, what are some of the risks associated with this?" Certainly, rising interest rates are obviously a big risk.

Their other risk is, "What if the underlying cash value doesn't grow at an assumed rate of return and grows less than based on? So you've got to stress test that as well. So you're trying to look at all these different factors to make a decision. But what I would tell you is you would do this analysis with any other investment that you're looking at doing anyway. So this is no different than if I was going to buy a surgery center, I was going to look at buying a commercial piece of property, or I was going to invest in a particular underlying asset class, like a large cap or whatever. You're building out analysis and assumptions, and you're looking at it. This is the same thing. This is an asset class, you want to look at it and treat it like an asset class. When you get into it, you want to monitor it regularly like you're doing every other holding in your portfolio.

David Mandell:

That's right. And I know you have annual meetings and sometimes it's more than that. And certainly it's keeping an eye on this, like you said, like any other asset class. And we've been doing this. We've had clients maybe go back 10 years, but just tying into the theme as we wrap up, how would you characterize interest rates today in premium financing versus where they've been? And do we have that same kind of excellent opportunity that we have in some of these other areas that we mentioned refinancing, et cetera? Have you seen rates lower now than they've been?

Jason O'Dell:

So right now rates are one of the lowest that they, if not, they might be the lowest that they've ever been historically. And so that certainly makes this particular tool more of a conversation piece today. But what I also would tell you is if you go back in the nineties and you look at normally the interest rate's tied to LIBOR plus some certain amount, 1%, 1-1/2%, with a minimum floor. So we're at 2.35% or 2.25 or 2%, that's normally the floor that a lender is saying, "Hey, that's our minimum amount we would charge in an interest rate. We won't go below that."

But you can go back and historically, look back in the early nineties, we were at, say, 8%, 8-1/2% percent on borrowing rates. But I also, if you go back, I tell clients this all the time. You go back and look, what was your checking account crediting back then? What could you get a money market account from? So even in a rising interest rate environment, which we will have at some point in time, normally the other vehicles that you can still be in, like a checking account or money market account, are going to go up too. So right now, certainly this low borrowing thing makes a lot of sense. And it's talked about a lot, but even with a rising interest rate, we can go back and say, "Hey, it goes up." But all the other investments normally would go up lock and step with an increase in interest rates, as well as still giving you an arbitrage.

The biggest thing that I already mentioned that you got to worry about, is that interest payment, that ability to continue to carry that with rates, cashflow, exactly. That's a good point. You got to be able to cashflow it. And that's the thing that you worry about if it got to 10%, right? Would you want to do it? But to your point, a lot of clients have made decisions throughout the course of the years that we've done this, that they might pay off the loan early, no prepayment penalty. So they pull money from another asset class and they pay that loan off if the rate were to go higher, they don't want debt anymore, or they're getting closer to retirement, they say, "I'm just going to pay this off."

Two ways to pay it off. You can just pay it off with cash from another investment, or you can pull money from the cash value and pay the loan off that way as well. Normally, when you do that, you're looking at paying that loan off somewhere after north of the 10th year, usually the 12th, 13th, 14th year, you're pulling money out of the cash value of the policy for the economics to really make sense.

David Mandell:

You could do a piece of both, meaning, let's say you got to five years, you can take some out of the cash and some out of other assets, pay it off, and then let it grow and enjoy it. Obviously, this ties into the theme of today, which is we've got, for the foreseeable future, extremely low rates. This sounds like we know it still can make sense if rates rise, but for those of you out there who may have heard of this, or maybe hadn't, but you can qualify for the parameters that Jason had mentioned, we'd love to talk with you about that. Certainly, Jason would. His email is odell@ojmgroup.com. Obviously, if you're listening to this on our site, you can play around on ojmgroup.com and see his bio and contact him from there.

And again, like he said, I think the first thing in general, on any of this, even refinancing your mortgage, is a financial model. Does it make sense? I mean, are the closing costs more than, or less than what you're going to, if you can stick in the new interest rate? And it's the same thing at a bigger level with premium financing. So thanks, Jason, for being on. I think it was a great topic today.

Jason O'Dell:

Thank you.

David Mandell:

And to all the listeners, stay tuned. We hope to have you listen to our next podcast. Thank you very much.