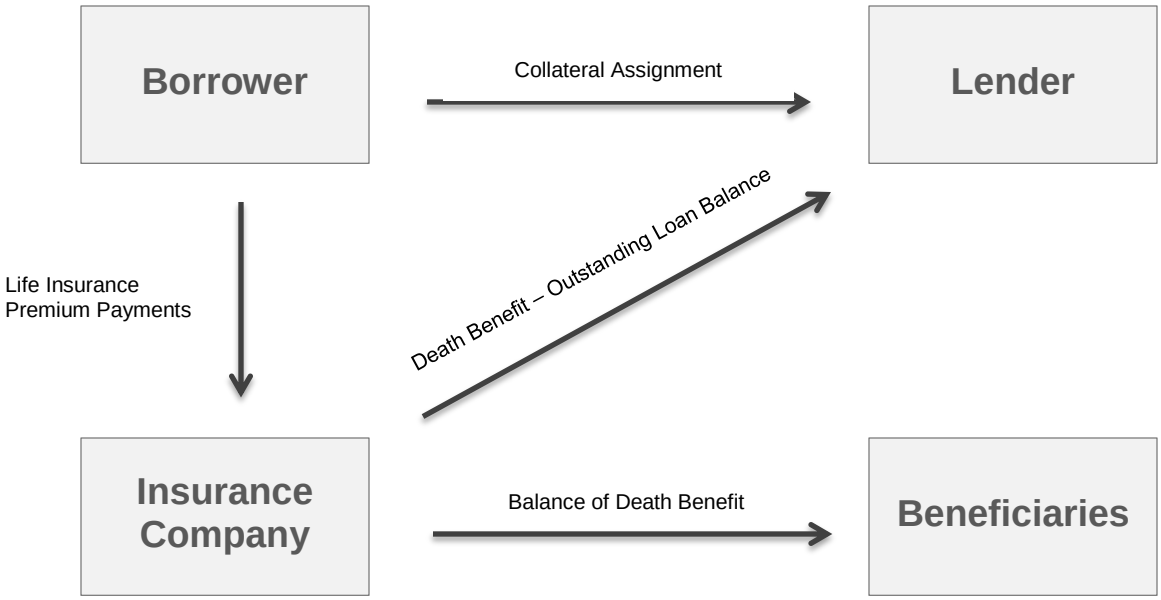
LIFE INSURANCE COLLATERAL ASSIGNMENTS

Problem:

Banks and other third party lenders commonly require borrowers to purchase a life insurance policy naming the lender as beneficiary as a way of securing repayment of a loan. However, upon the death of the insured, if the death benefit paid exceeds the amount owed under the loan, the lender could collect a significantly higher payment than it was entitled to receive.

Solution:

A collateral assignment allows a borrower to assign to a lender, from the life insurance death benefit, the precise amount owed under a loan as of the insured's date of death. The death benefit amount exceeding the outstanding loan balance is paid to the insured's named beneficiary(ies) under the life insurance policy. This method ensures the lender will not receive a windfall from the life insurance death benefit.



Case Study

Bob secures a $500,000 business loan from XYZ Bank. The Bank requires Bob to personally guarantee the loan and to purchase a life insurance policy to ensure the loan is repaid if Bob dies during the loan term.

Bob purchases a 10 year level term life insurance policy with a $500,000 death benefit and names his wife as the sole beneficiary of the policy. He adds a collateral assignment, in favor of XYZ Bank, as a means of securing the loan.

Bob dies six years later and $200,000 is still owed to the bank under the loan as of the date of his death. The bank will be paid the precise remaining amount owed under the loan ($200,000) and his wife will be paid the remaining amount of death benefit ($300,000).