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Using a Life Insurance Policy as Collateral for a Small Business Loan

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Are you thinking about applying for a small business loan? The 7(a) loan program, offered by the U.S. Small Business Administration (SBA), is most likely what your lender will use to get you the funding you seek because your lender is guaranteed to be repaid.¹

The 7(a) loan program includes several categories of small business loans, and each type of loan has specific requirements.² For standard 7(a) loans over \$350,000, the SBA requires lenders to collateralize the loan, “to the maximum extent possible” — and quite often that means borrowers end up using a life insurance policy to secure the loan.

Even if you intend to apply for a loan of less than \$350,000, your lender might still require you to have life insurance in certain situations, such as if you don’t meet the minimum acceptable credit score or the loan is not fully secured by other collateral. Another situation would be if the business depends on your active participation (assuming you are the owner).

The following types of businesses are considered to be dependent on the owner's participation:

- Single-member limited liability companies, or LLCs
- Single-shareholder C or S corporations
- Sole proprietorships
- Some partnerships (e.g., physician and law practices)

There are also specific types of loans under the 7(a) program — such as an SBA Express, Export Express, or CAPLine — that might require you to make a collateral assignment for a loan of less than \$350,000. In general, if you meet the SBA’s acceptable minimum credit score requirements, a collateral assignment probably won’t be necessary.



The SBA uses what is called the FICO[®] LiquidCredit[®] Small Business Scoring ServiceSM (SBSS) score to determine whether your business meets the loan program’s minimum credit score requirements. A combination of consumer credit bureau data, business bureau data, your personal financials, and data from your application are used to calculate your SBSS score.³

The minimum SBSS credit score is adjusted periodically. As of late August 2019, the minimum SBSS score for 7(a) small loans was 140. You can check [the SBA’s website](#) for the current minimum.

Understanding ‘Collateral Assignment’

When a collateral assignment is made on a life insurance policy, the death benefit or cash value of the policy is used to help secure a loan. What that means is if the borrower defaults on the loan or dies before it is repaid, the lender collects the proceeds of the policy, up to the amount that is still owed, and the borrower’s beneficiaries receive the rest.

Whether you’ll be required to make a collateral assignment depends on several factors, such as your personal credit (if you are an owner of the business), how much other collateral you can provide, and whether the SBA will guarantee the loan.

Typically, a collateral assignment is structured as follows:

- The borrower must be the owner of the policy.
- The lender is the designated assignee.
- The borrower is the designated lende.
- The lender can collect up to the amount needed to repay the loan.
- The collateral assignment terminates after the loan is paid in full.

As long as the policy remains active, the lender has the right to collect the proceeds of any benefit or rider that is part of the policy, to the extent of the lender’s interest. If the policy becomes inactive for any reason, the lender can collect any cash value, policy surrender value, or returned premiums.

How to Get a Collateral Assignment

In many cases, insurers will provide a collateral assignment on an existing policy. Sometimes it depends on the type of plan you have. You can ask your agent or the insurance company whether your plan offers collateral assignments. If it does, request a [collateral assignment form](#). It’s a straightforward document that both you and the lender will need to sign.

Some insurers don’t have standard collateral assignment forms. Many of those that do not will still accept third party forms created by the policy owner’s attorney or by the lender. Your client should check with the lender to find out if they have a preferred form, and the client should also talk over with the client’s own lawyer about whether to use that form — or develop the client’s own.

A few insurers may not accept collateral assignments at all. In those cases, the client should get advice from his/her own lawyer about the best approach to providing needed security for the loan. The client might consider:

- Replacing coverage with a new carrier that does accept collateral assignments.
- Negotiating with the lender to see if another method of collateral might be substituted.
- Make the lender the entire beneficiary of the policy, and re-work the designation as the loan balance decreases.



Uninsurable Borrowers

Borrowers who are unable to get a life insurance policy may find that being uninsurable affects the amount they can

borrow, the terms of their loan, and their eligibility for an SBA-backed loan. If the insurer determines that you are uninsurable, you must provide the lender written documentation from a licensed insurance company or agent confirming your uninsurability. Some lenders will accept email as the required documentation, while others may want a letter.

If you're applying for a 7(a) small loan (under \$350,000), or an SBA Express or Export Express loan, your lender is permitted to follow an internal written policy it uses for similarly sized commercial loans that aren't guaranteed by the SBA — except when the loan isn't fully secured, or the continuation of your business depends on your active participation.

It's important to note that even if you're not eligible for an SBA-backed loan, you could still get a loan from a bank or lender that isn't guaranteed by the SBA.

The Amount of Life Insurance Needed to Secure an SBA loan

According to the SBA, the amount and type of collateral available to repay the loan can be factored in when determining the appropriate amount of life insurance. The amount and length of coverage has to be proportionate to the loan — which means it doesn't need to be greater than the terms of the loan. For example, if you're applying for a \$500,000 loan that's to be paid off over 10 years, you won't need more than a 10-year, \$500,000 term insurance policy.

The following types of collateral can be used to secure an SBA loan:

- Property
- Equipment
- Inventory
- Cash
- Accounts receivable
- Other debt and the liquidation order
- Personal guarantees

As noted earlier, for SBA 7(a) small loans (under \$350,000), as well as SBA Express and Export Express loans, life insurance is required if you don't meet the

SBA's minimum acceptable credit score and the loan isn't fully secured by collateral. (Please note that that you do have the option to personally guarantee the loan by using your personal assets to secure it.)



Types of Life Insurance Used for Small Business Loans

Either a term or permanent policy can be used to secure your small business loan. Keep in mind that the policy has to remain in force for the full term of the loan, so be sure the premiums are low enough that you can keep the policy active. If you miss a payment or the policy lapses, you will be in violation of the terms of the loan and the lender will be notified.

Often, term policies are the best option for SBA loans because they cost anywhere from five to 20 times less than a permanent policy. If you're applying for a 10-year term loan, you'll need at least a 10-year term insurance policy.

Getting a Policy in Time to Qualify for an SBA Loan

It can take anywhere from 1 – 90 days to get approved for life insurance, depending on your medical history and whether you're required to take a medical exam.

Since most SBA loans are less than \$500,000, a no medical exam policy is a popular option. **Sagicor Life Insurance Company** offers the opportunity to bypass the medical exam requirement for plans up to \$1 million. Most insureds are approved within 10 days — some are even approved instantly upon application submission.

Your life and business move quickly, and Sagicor can move with the speed of your business.

This article was written by Brian Greenberg, CEO of [True Blue Life Insurance](#).

Source Information:

¹<https://www.sba.gov/partners/lenders>

²<https://www.sba.gov/partners/lenders/7a-loan-program/types-7a-loans>

³<https://www.sba.gov/partners/lenders/7a-loan-program>

Link to full SOP document: https://www.sba.gov/sites/default/files/2017-12/SOP%2050%2010%205%28J%29_Technical%20Corrections%20%28FINAL%29_1.pdf

Link to current SBSS score: <https://www.sba.gov/partners/lenders/7a-loan-program>

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