



Premium Financing

Funding solutions that facilitate finely tuned estate plans.



Using the Capital Maximization StrategySM



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Using the Capital Maximization Strategy

As a successful individual who has accumulated significant assets, you may have a need for life insurance in your estate plan. However, finding the liquid assets to purchase a large insurance policy is not always a simple thing to do. Your cash may be tied up in your business, real estate or long-term investments. Your life insurance can be owned by an Irrevocable Life Insurance Trust (ILIT)¹ to avoid estate tax on the death benefit, but funding an ILIT may involve making large gifts that may be subject to gift taxes. For many people, the solution is to implement a life insurance premium financing plan.

What is Premium Financing?

Premium financing allows individuals who have a life insurance need to defer using their liquid assets to fund a life insurance policy. In a premium financing arrangement, you (or your trust or corporation) can take out a loan from a third-party lender to pay the premiums on a life insurance policy. Premium financing can significantly reduce out-of-pocket costs as well as gift tax costs on large life insurance policies.

Candidates for Premium Financing

The candidates for premium financing are usually individuals who are age 55 or older, whose net worth is approximately \$5 million or more, and who would need a life insurance policy with a minimum annual premium of \$100,000 or more. These individuals may be business owners, or may have the majority of their assets tied up in other investments. The return on the investments is usually greater than the interest rate on the loan for life insurance. If you fit this profile, then you may want to consider premium financing using the Capital Maximization Strategy.

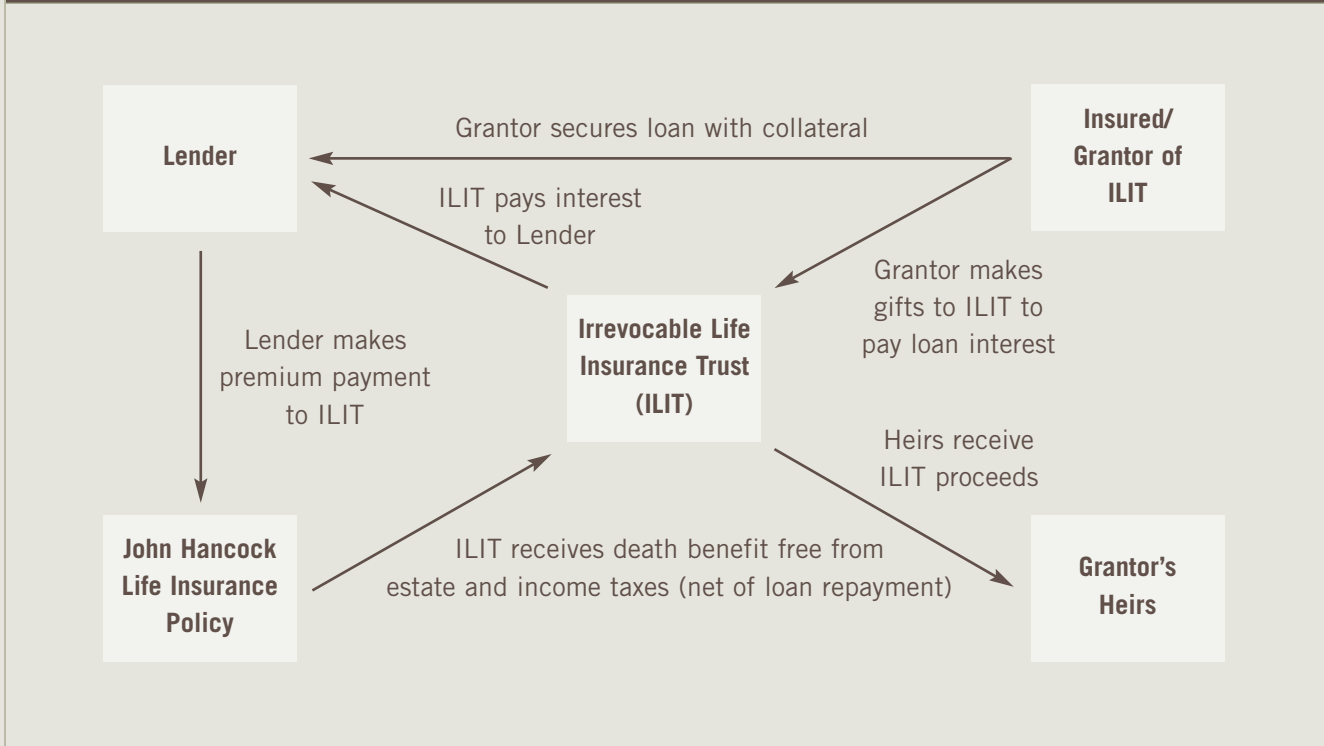
What is the Capital Maximization Strategy?

One of the largest life insurance premium financing programs is with A.I. Credit and the Capital Maximization Strategy (CMS). The Capital Maximization Strategy (CMS) is designed for use in the estate and business-planning marketplace where there is a need for life insurance, yet the funds to pay the premiums can be better used elsewhere. Under the CMS approach, you can borrow funds from a third party lender (A.I. Credit) to pay for life insurance premiums.² The financing allows you to leverage a new life insurance policy by paying only interest and maintaining your other investments.

How does CMS Premium Financing work?

With the CMS approach, the potential insured applies for premium financing after he/she has been underwritten for a life insurance policy. Once A.I. Credit approves the insured for a loan, it will finance the annual premiums on the life insurance policy and the policyowner (usually a trust) will only have to pay interest annually. The life insurance policy and other liquid assets are used for collateral against the loan. The loan may be repaid in a lump sum, in installments over time, or at the death of the insured.

ILIT is the Owner



How is a CMS loan typically structured?

A CMS loan must meet the following requirements:

1. The insured must be underwritten for a new life insurance policy and qualify financially for premium financing.
2. The borrower will pay interest annually at the beginning of the year.
3. The loan interest rate is reset every year, depending on the one-year LIBOR. The loan is collateralized by the insurance policy and will also require a secondary form of collateral.
4. A.I. Credit takes a collateral assignment in (potential) cash surrender value and the death benefit of the financed policy.
5. The client signs a personal guaranty on the loan.

How is the interest rate determined on a CMS loan?

A.I. Credit calculates interest based upon the one-year London Interbank Offered Rate (LIBOR) to which it adds a spread of 175 to 300 basis points.³ It is important to note that the one-year LIBOR is not fixed, and may be different from the initial rate used in the illustrations. The spread that A.I. Credit uses is fixed, and will not change during the loan period. The loan interest rate will be adjusted on an annual basis, depending on the one-year LIBOR.

What type of collateral can be used?

In addition to the life insurance policy, A.I. Credit usually needs a secondary form of collateral to secure the premium financing. Assets that can be used for collateral include cash and cash equivalents, marketable securities, a letter of credit, existing life insurance policies, and certificates of deposit (CD). Marketable securities such as stocks and variable life insurance policies are usually discounted 50% to account for fluctuations in the market value.

Uses of CMS Premium Financing

The CMS Program requires that the borrower be an entity, such as a trust, corporation, or partnership. Individuals can only be borrowers in the CMS program in California or New York. Although CMS premium financing is often used for estate planning purposes, it can also be used in other situations such as 1035 exchanges to new policies, non-qualified deferred compensation, buy-sell agreements, and key person life insurance. A.I. Credit does not do premium financing for borrowers domiciled in Florida but can finance premiums for insureds that live in Florida as long as the borrower (trust or other entity) is located in another state.

Who is A.I. Credit?

A.I. Credit is a member company of American International Group, Inc. (AIG), a U.S.-based international insurance organization. A.I. Credit is the largest premium finance company in North America and has been providing premium financing to the insurance industry for almost 30 years.



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1. Trusts should be drafted by an attorney familiar with such matters in order to take into account income and estate tax laws (including the generation-skipping tax). Failure to do so could result in adverse tax treatment of trust proceeds.
2. A.I. Credit Corporation is not an affiliated company of John Hancock.
3. It is important to note that LIBOR is not fixed and may be different from the initial interest rate in the illustrations. The monthly LIBOR from March 1995 through March 2005 ranged from a low of 1.09% (March 2004) to a high of 6.44% (December 2004). Over this ten-year period, with the current interest rate spreads, the interest rate on a loan would have ranged from a low of 2.84% (with a 175 basis point charge) to a high of 9.44% (with a 300 basis point spread), with an average rate of 4.38%. A final CMS illustration is required to ensure that the client understands the financing terms.