ADVANCED MARKETS INSIGHT

Third Party Premium Financing

M Financial Group's Advanced Markets Insights are designed to help clients understand sophisticated planning strategies and their applications.

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What is Third Party Premium Financing?

Third Party (or "Commercial") Premium Financing is the borrowing of funds from a financial institution for the purpose of funding a life insurance contract. The borrower may be an individual, a trust, or a business. The primary benefit of premium finance is the ability to obtain needed life insurance coverage without liquidating other assets.

Loan Elements

Lenders offer a variety of programs to fit different situations. Each program will have the following standard elements, which will vary among lenders:

- Minimum Net Worth Requirements
- Financial Documentation Requirements
- Origination Fees
- Loan Term
- Interest Rate and Payment Options
- Prepayment Penalties
- Collateral Requirements

Minimum Net Worth Requirements

Premium financing is intended for wealthy individuals with a presumed familiarity with more sophisticated arrangements and investments. Each program has a minimum net worth requirement, which can be as low as $1,000,000 and up to $25,000,000 or more.

Financial Documentation

Lenders will request verification of financial net worth from multiple sources. Minimally, current tax returns and financial statements will be required.

Origination Fees

Some programs will charge an origination fee for establishing the loan. This can be a flat fee or a percentage of the total loan amount. In many situations, the origination fee can be added to the loan balance.

Loan Term

Most premium finance programs available today offer a loan term between 1 and 10 years. Often, the borrower will be allowed to re-qualify for the loan at the end of the term and establish a new loan with new terms.

Interest Rate & Payment Options

Premium finance programs most often use a benchmark rate plus a "loan spread".

Usually, the benchmark rate used is either Prime (the lending rate most commonly used by U.S. Banks) or LIBOR (the London Interbank Offered Rate), an internationally accepted lending rate published daily by Thomson Reuters on behalf of the British Bankers' Association. The loan spread varies from lender to lender, but typically falls between 1.5 and 4.0%.

Interest rates that are tied to a benchmark rate are usually variable, and are reset on at least an annual basis. Some loan programs offer a fixed rate for the life of the loan, and may use a different method for determining the interest rate.

Interest may be allowed to accrue and become due at the end of the loan term. More commonly, loan interest is paid at the end of each year of the loan.

Prepayment Penalties

Some programs will charge the borrower a penalty fee if the loan is repaid prior to the end of the term.

Collateral Requirements

The primary collateral for the loan is almost always the cash surrender value of the policy. Additional collateral is required and must be in a form acceptable to the lender. This can include cash or cash equivalents such as a letter of credit, certificate of deposit, or securities. In some instances, a less liquid form of collateral, such as real estate, may be acceptable.

Considerations

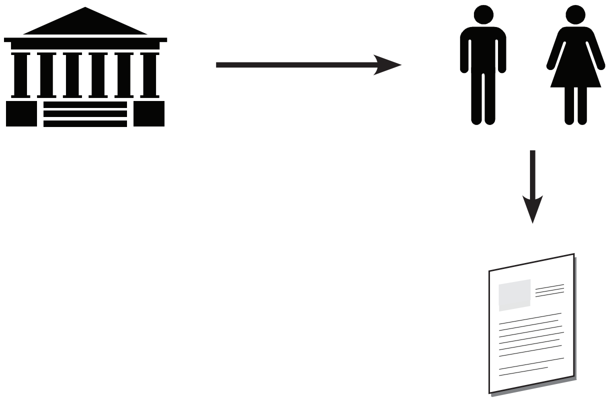
- Should the value of collateralized assets decrease, the lender may require additional collateral from the borrower.
- The lender has the right to call the loan at the end of the term.
- If the interest rate index used for the loan benchmark rises, the total interest charge on the loan will also rise. The life insurance could be subject to forfeit if the borrower is unable to keep up with the interest payments on the loan.
- Downgrades in the credit rating of the carrier may result in the lender terminating the premium finance arrangement at renewal and/or call the collateral for the loan.
- The illustrated performance of a life insurance policy is based on a series of assumptions. Should actual conditions be less favorable for the policy, the growth of cash value within the policy may suffer. As a result, the lender might require additional collateral to be posted.

Exit Strategy

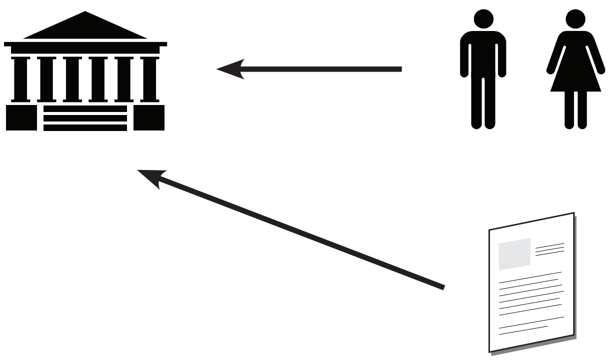
When entering into a premium finance arrangement, it is wise to have a definitive plan on when and how the loan will be repaid. If the intent is to use the cash value or death benefit from the policy to repay all or a portion of the loan at a future date, the policy should be carefully monitored to ensure that it is performing as expected. A contingency strategy should also be developed which may involve the possible planned liquidation of other assets to repay the loan.

Premium Financing

1. A lender makes a loan to a borrower to fund a life insurance policy.

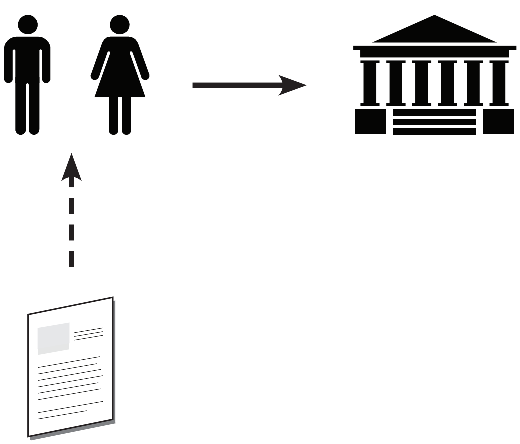


2. The cash values in the policy are assigned as collateral to the lender. The borrower may be required to provide additional collateral for the difference between the loan balance and the cash values of the policy.



During Life

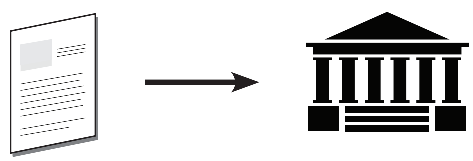
The borrower repays the loan (possibly using Life Insurance Policy Cash Values).



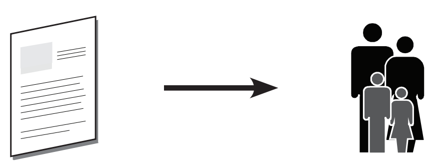
OR

At Death

1. Death Benefit proceeds are used to repay the loan.



2. Balance of the Death Benefit is paid to the heirs.



For More Information

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