

Premium Financing Producer Presentation

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Disclosure

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What is Premium Financing?

- Premium Financing is a sophisticated strategy that allows high net-worth individuals who need a large amount of life insurance to use an alternative method for paying premiums.

What it is not

- It is not a way to find premium dollars when the ability to pay premiums does not exist
- It is not a simple strategy and all risks of leverage should be fully disclosed

Benefits of Premium Financing

- Reduces liquidity needs
 - Purchase life insurance without liquidating other investments or otherwise changing normal cash flow
- May produce a positive interest rate arbitrage
- Can help maximize estate planning and gift tax strategies (i.e. gift-tax leveraging technique)

Gift Tax Leveraging

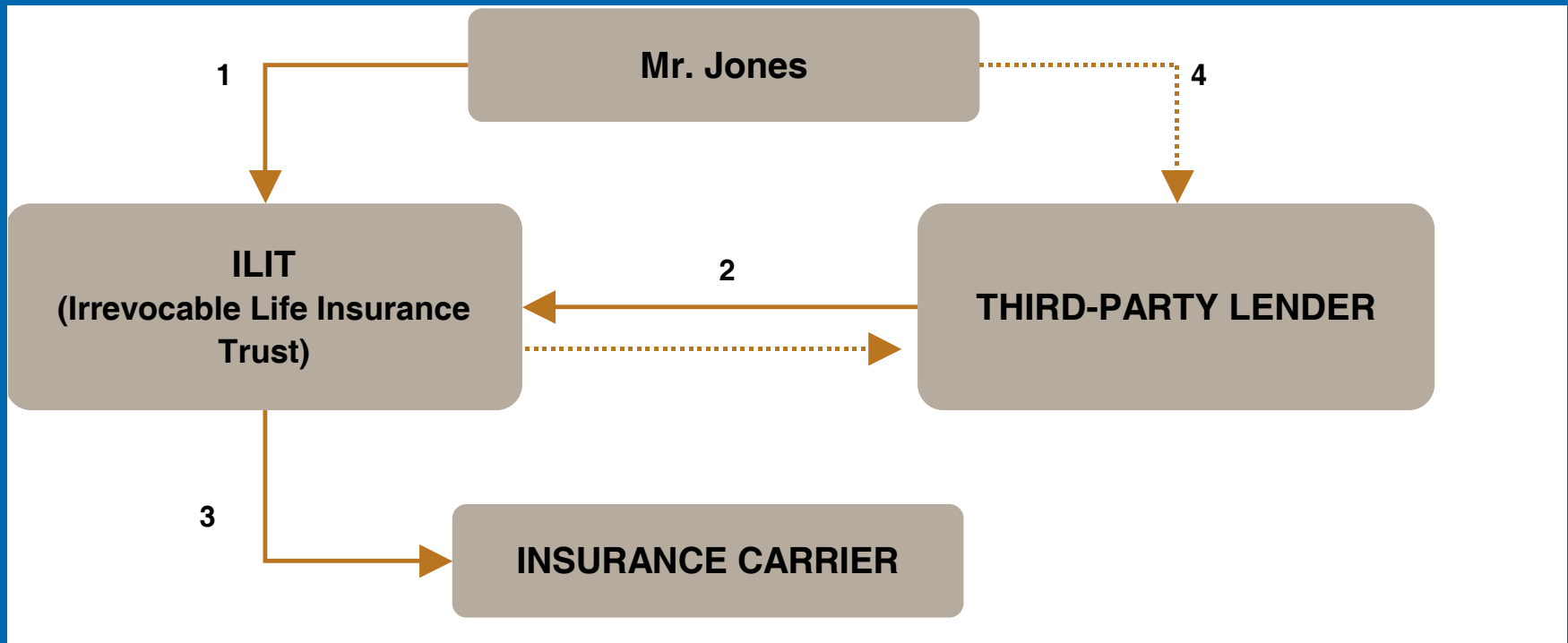
- In large cases where the policy is owned outside the insured's estate, premium financing can eliminate the need to gift the entire premium
 - Only the loan interest may need to be gifted annually
 - The loan interest may create gifting issues if it exceeds available exclusions and exemptions
- Capitalizing (i.e. accruing) interest increases the gifting leverage
 - No need to gift premium or loan interest

How does it work?

Case Study – Mr. Jones

- Net Worth - \$20 million
- Desire to increase inheritance
- Limited excess cash flow
- Does not want to sell existing assets
- Annual exclusions already committed
- Lifetime exemptions already used

During Mr. Jones' lifetime



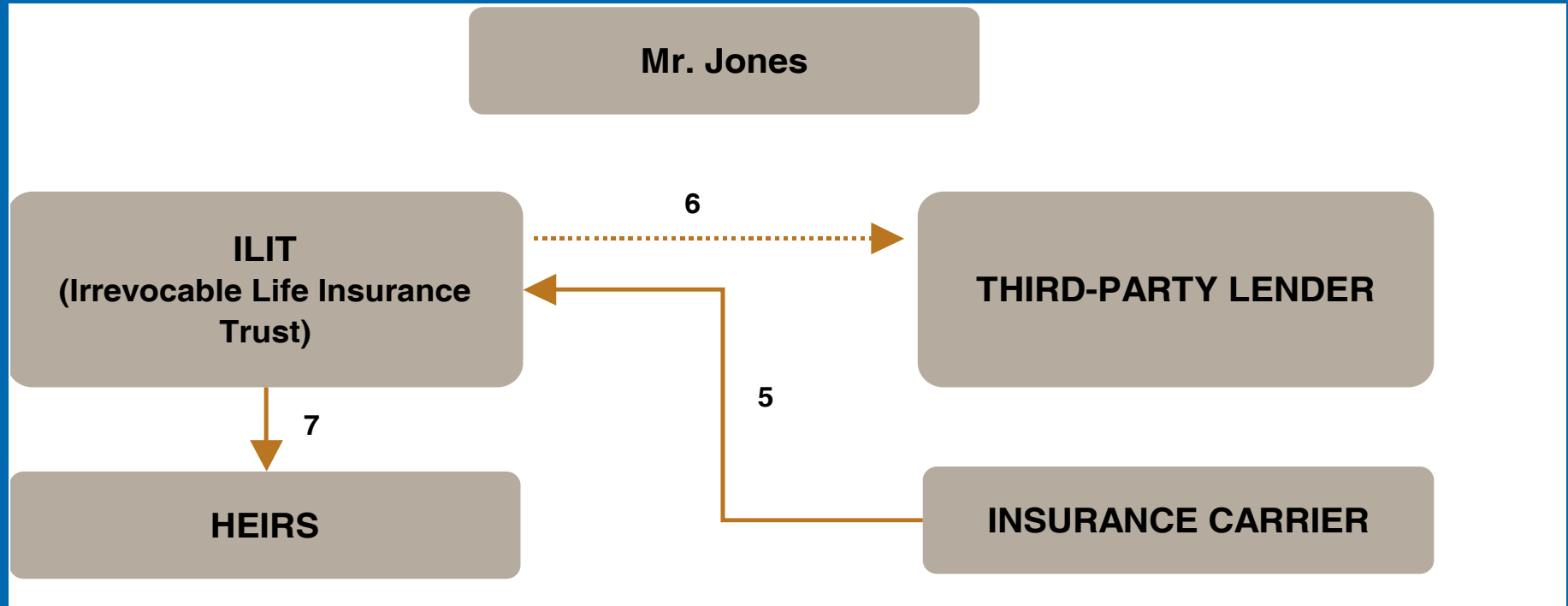
1. Since Mr. Jones has established his need for life insurance, he makes informal inquiries to determine if insurance and bank financing can be obtained on a favorable basis. He establishes the ILIT, and the trustee obtains insurance on Mr. Jones.

2. The lender advances funds to the ILIT to pay premiums. The trustee pledges the life insurance policy as primary collateral for the loan.

3. With the borrowed funds the ILIT pays the premiums on the life insurance policy to the insurance carrier.

4. Generally, Mr. Jones would provide supplemental collateral as additional security for the loan.

At Mr. Jones' death



5. The insurance carrier pays the death proceeds to the ILIT.
6. The loan and accrued interest, if any, are repaid to the lender; this assumes the principal and interest have not been repaid prior to death.
7. The ILIT distributes the net proceeds to the heirs per the terms of the trust.

Risks

➤ Loan Interest Rate Risk

- Interest rates may only be locked in for a limited period of time (e.g., 1 – 10 years)
- A rise in rates could result in additional collateral, less net death benefit, etc.
- Capitalization (accrual) of interest potentially exacerbates these risks
 - Total death benefit required could result in financial underwriting or reinsurance issues
- Interest rates will fluctuate over time
 - Use realistic rates for illustration purposes (stepped rates)

Risks *(continued)*

➤ Policy Crediting Rate Risk

- Crediting rate may lag behind interest rate changes
- Crediting rate can be less than interest rate (interest rate inversion)

➤ Collateral Call Risk

- In the event of a loan default, supplemental collateral could be called

Risk Tolerance

- Careful consideration should be made to determine if this concept is suitable
- Advisors should be involved from the beginning of the process to help determine if this is an acceptable risk
- If low risk tolerance exists, possible exit strategies should be explored for the premium financing arrangement

Possible Exit Strategies

- Rollout via death benefit
 - Generally advisable for clients over age 80
- Rollout via policy values
 - “May” be viable if interest is paid annually and is not accrued
- Rollout via outside funds within 10 – 15 years
 - Outright gifts
 - Existing assets already held by policy owner
 - GRAT (Grantor Retained Annuity Trust)
 - Charitable Lead Trust

Miscellaneous Issues

➤ MECs

- Modified Endowment Contracts should be avoided if the policy will be used as collateral. An assignment of a MEC policy is a taxable event to the extent of gain (I.R.C. Section 72(e)(10) & (e)(4)).

➤ Variable Life Products

- SEC rules prohibit a broker/dealer from directly or indirectly arranging for financing for the purpose of purchasing equities (SEC rule 11(d)(1))

➤ Guarantee of another's debt

- Giving a guarantee is possibly a gift
- Payment in event of default is definitely a gift

Miscellaneous Issues *(continued)*

➤ Interest deductibility

- Individual taxpayers generally cannot deduct personal loan interest
- Businesses can deduct interest pursuant to Code Section 162 if it is a reasonable and necessary expense
 - Code Section 264 will disallow a deduction if the loan is used to purchase life insurance and the business has an interest in the policy
- Neither individuals nor businesses should deduct interest payments on loans used to pay premiums without consulting their tax experts