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LIFE INSURANCE

# Premium Financing 101



Insurance products are issued by:  
John Hancock Life Insurance Company (U.S.A.),  
Boston, MA 02116 (not licensed in New York)  
and John Hancock Life Insurance Company of  
New York, Valhalla, NY 10595.

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# Client Profile: Premium Financing



- High net-worth with large insurance need
- Ability to pay for premiums
- Understands leveraging concepts
- Has alternative uses of cash
  - May not have cash-flow to fund premiums and/or
  - Does not want to liquidate assets
- Estate Planning Needs:
  - Does not want to incur gift taxes
- Motivated by internal rates of return\* and estate planning objectives
- Does not want to liquidate assets

\* The Interest Rate that gets applied to the cash flow to equal to a designated amount at the end period.

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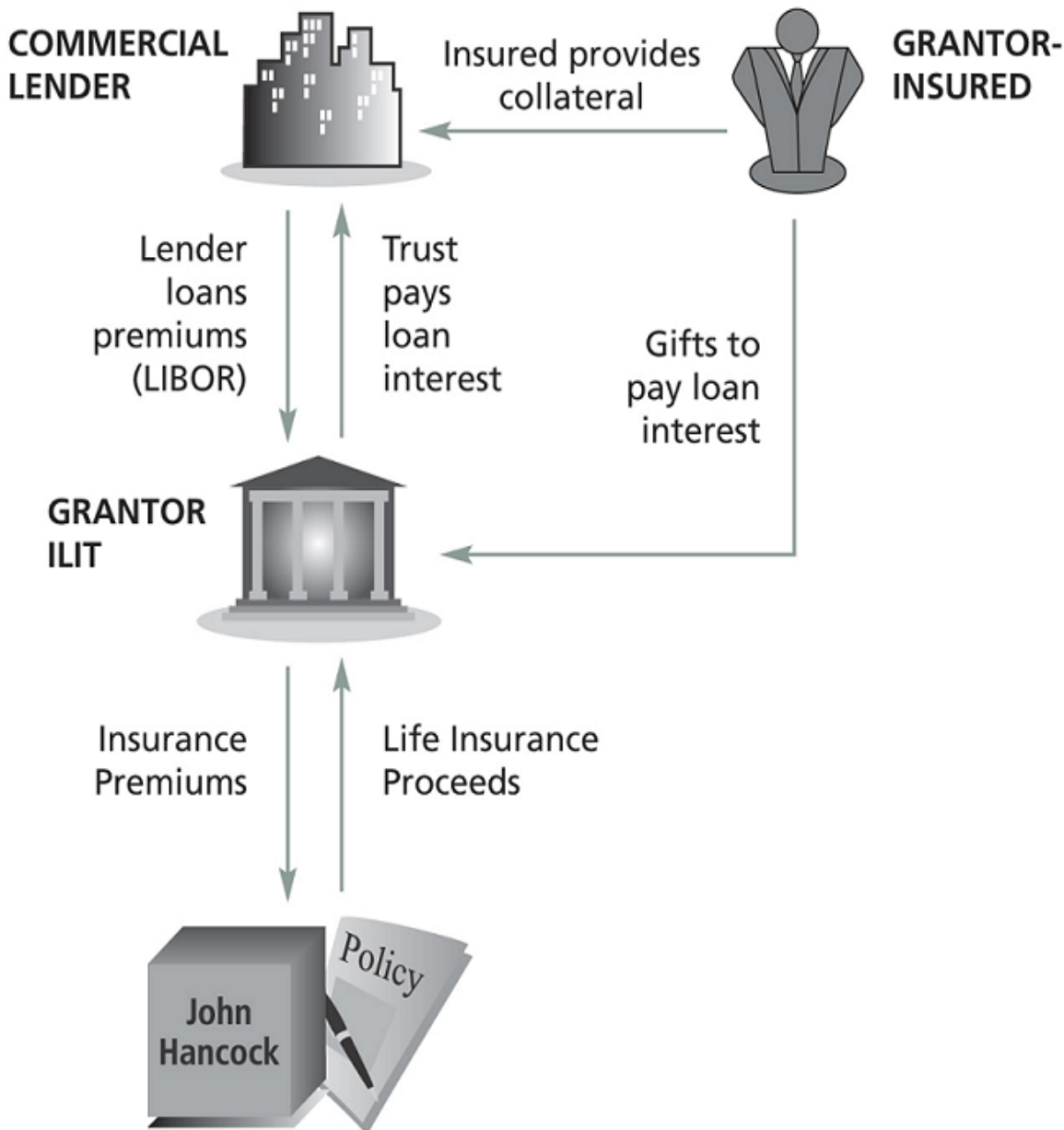
# What is Premium Financing?



- Loan to purchase life insurance
- Non-amortizing loan
- Leverages insurance assets
- Annual premiums are funded based on borrower's creditworthiness

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# COMMERCIAL PREMIUM FINANCING



1. Lender makes loans to ILIT  
Tax-free liquidity
2. ILIT purchases policy on Grantor(s)
3. Policy serves as collateral
4. Grantor guarantees loan  
Equivalent to tax-free gift
5. Grantor gifts loan interest only  
Gift taxes may apply
6. Fluctuating LIBOR rate
7. Loan is repaid from policy proceeds
8. Exit strategy during lifetime needed

# Benefits of Premium Financing



- Can reduce gift taxes for funding large policies
- Can provide better IRR
- Allows borrowers to leverage their assets, without liquidating

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# Premium Financing Requirements



- Minimum \$5 million net worth,
  - \$100,000 minimum annual premium
- Non-variable products only
- Financing of MECs is not advised
- AI Credit is the only lender that is currently approved
- Other lenders must be approved by Advanced Markets

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# Premium Financing Applications



- Estate Liquidity, Gift Tax Leverage
- Key Person, Deferred Compensation, Buy-Sell Arrangements
- Split Dollar Rollout
- Family Limited Partnerships (FLP's) and Limited Liability Companies (LLC's)
- 1035 Exchanges and Term Conversions

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	Private Split Dollar	Private Financing	Premium Financing	Dual Loan Planning
<b>Lender</b>	Mom/Dad	Mom/Dad	Bank	Mom/Dad <b>and</b> Bank
<b>Description</b>	Mom/Dad pays annual term costs or Table 2001 rates <sup>1</sup> and Trust pays the difference	Intra-family Loan Transaction <sup>2</sup>	Approved third-party lender (AI Credit, or other bank) provides loan for purchasing life insurance	Combining different loan arrangements to minimize loan interest cost (Private vs. Premium)
<b>Loan Interest Rate or Annual Cost of Financing</b>	Economic benefit cost	Applicable Federal Rate (AFR): short-term (0–3 years), mid-term (3–9 years) or long-term (9+ years)	LIBOR + spread (typically)	Rates linked to each type of loan arrangement
<b>Gift Tax Impact</b>	Minimizes gift taxes because loans are NOT gifts	Minimizes gift taxes because loans are NOT gifts	Minimizes gift taxes because loans are NOT gifts	Minimizes gift taxes because loans are NOT gifts
<b>How It Works</b>	Mom/Dad as lender provides liquidity to pay large premiums on needed policy	Mom/Dad as lender provides liquidity to pay large premiums	Lender provides liquidity to pay large premiums on needed policy	Provides liquidity while potentially minimizing loan interest costs
<b>Benefits</b>	Minimizes gift tax costs	Minimizes gift tax costs	No need to liquidate taxable assets to fund liquidity needed for premiums	Minimizes gift taxes and reduces the need to liquidate taxable assets to fund premiums
<b>Collateral</b>	Policy	Not required but may be advisable	Policy and/or other liquid assets	Collateral requirements of commercial lender
<b>Potential Generation-Skipping Transfer Tax (GSTT) Impact</b>	GSTT exemption should be allocated to gift of economic benefit amount	GSTT exemption should be allocated to gifts of interest	GSTT exemption should be allocated to gifts of interest	GSTT exemption allocated to gifts of interest

# Standard Loan Structure : Premium Financing



- Third party lender offers funds to qualified borrowers to pay life insurance premiums
- Balloon structure/interest paid annually
- Floating rate/fixed spread
- Some lenders may offer a fixed interest rate

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# Standard Loan Guidelines: Premium Financing



- Generally, no fees, points, or prepayment penalties
- Secured lending
- Collateral interest in the life insurance policy and additional collateral in liquid assets may be needed

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# Loan Collateral: Premium Financing



- Typically, insurance policy secures the loan
- Collateral types:
  - Liquid collateral
    - Cash/cash equivalents
    - Marketable securities (50% discount for stocks)
    - Letters of credit
    - Existing life insurance policies
    - Cash values may be a source of collateral
- Personal guaranty is generally required

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# Interest Payment Options



- Interest in advance (beginning of year)
- Interest in arrears (end of year)
- Deferred interest (for specific time periods)
- Interest rates may be adjusted annually or may be a fixed rate
- Size of premium usually impacts spread on interest rate

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# Plan Design



- Each product should be considered, depending on the needs of the client – Performance and Accumulation UL can provide strong cash value
- Guarantees are important
- Shorter premium stream should be considered
- Deferred interest should be used only in limited circumstances

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# Best Practices



- Loan interest should not be deferred for more than 5-10 years
- Exit strategy should be considered at plan inception
- Return of Premium (ROP) rider should be added to policy
- Cash value enhancement (CVE) rider should be considered; may reduce collateral requirement



# What To Consider : Premium Financing



- Loan Repayment goes to third-party lender
- Rate typically linked to LIBOR plus spread
  - Can be much higher than a personal note (AFR)
  - Rate is subject to fluctuations
- Gift of loan interest may become subject to gift taxes
  - If loan principal becomes too large
- Collateral requirements
- Loan guarantee
- Loan interest not deductible
- Cost of Return of Premium rider (ROP)

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# Loan Repayment Options



- Typically, loan will be repaid from the policy death benefit (with the Return of Premium rider)
- Exit Strategies during the insured's lifetime
  - Repayment from policy cash value and/or
  - Trust side fund or
  - GRAT or CLT
- Partial or full repayment of principal– generally no prepayment penalties



# CMS/ AI Credit Program



- AI Credit is an experienced premium financing lender
- Three main options for premium financing
- Fixed rates and other options available
- There is a 20% commission split on CMS II Options A and B; no commission split on CMS I

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# Example Of Loan Structures : CMS Program



	<b>CMS I</b>	<b>CMS II Option A</b>	<b>CMS II Option B</b>
Net Worth Requirement	\$5,000,000	\$10,000,000	\$5,000,000
Interest Timing	Advance, Arrears, Deferred	Advance, Arrears, Deferred	Advance, Arrears, Deferred
Minimum First Year Premium	\$100,000	\$200,000	\$100,000
Maximum years to defer interest	10	5	5
Minimum Age	None	62	None
Maximum Loan	Subject to underwriting	50% of net worth subject to financial underwriting	50% of net worth subject to financial underwriting
Interest Rate	1 year LIBOR plus spread of 175-300 basis points	1 year LIBOR plus spread of 290-310 basis points	1 year LIBOR plus spread of 225-325 basis points
Prepayment Penalty	None	2% of loan for first 7 years - certain state restrictions apply	2% of loan for first 7 years - certain state restrictions apply
Collateral Requirements	100% of loan secured by policy cash value as well as liquid assets	If the cash value of the policy is greater than 50% of the outstanding loan, no external collateral is required (except if interest is deferred, then additional collateral will be needed to secure the interest). If the cash value of the policy is less than 50% of the outstanding loan, 25% of the outstanding loan is required.	If the cash value of the policy is greater than 75% of the outstanding loan, no external collateral is required (except if interest is deferred, then additional collateral will be needed to secure the interest). If the cash value of the policy is less than 75% of the outstanding loan, 75% of the outstanding loan is required.
Interest Rate Reduction	N/A	With 100% collateral, standard CMS I rates apply (175-300 basis point spread)	With 100% collateral, standard CMS I rates apply (175-300 basis point spread)

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# State Restrictions for AI Credit



- AI Credit cannot currently loan to borrowers located in AK, ID, FL, KY, MT, NC, RI, SC, SD and VA and Puerto Rico.
- The borrower must be an entity (trust, corporation or partnership) except in the following states: AL, AZ, AR, CA, CO, CT, DC, GA, HI, IL, IN, IA, KS, LA, ME, MD, MA, MI, MN, MS, MO, NE, NJ, NY, ND, OH, OK, TX, UT, VT, WI and WY. In these states, the borrower can be an individual or an entity.

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# Loan Underwriting Process



- Package of financial information should be sent directly to A.I. Credit.
- A.I. Credit will begin reviewing the loan information after John Hancock has made a tentative offer.
- A.I. Credit will send (via email) the loan offer and loan documents directly to the agent/client.



# Loan Submission Package to A.I. Credit



- Completed and signed credit application
- Signed life insurance policy illustration
- Financial statements (personal & entity)
- Tax returns for last 3 years
- Brokerage statements
- Organizational documents of borrower – trust agreement, partnership agreement, split dollar agreement (if applicable)

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# Case Study: Inez Friedman



- Business Owner (age 75) who wants to keep her assets invested and appreciating.
- Needs to buy life insurance coverage for estate liquidity purposes.
- Wants to cut down on out of pocket and gift tax costs.
- Assets are mainly closely held business stock and real estate.

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# The Solution



- Inez's Trust will apply for a \$10 million Protection UL-G policy on her life with an annual premium of \$435,068 for all years.
- She will pay interest each year in advance.
- She can apply her gift tax exemption and five annual exclusions to the gifts to the trust.
- The loan principal will be paid off from the death benefit.

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# The Solution



- Inez can keep her assets and business invested and also reduce her annual outlay and increase her IRR by doing premium financing.
- In this example, the average interest rate is assumed to be 6% over an extended period of time.
- The policy will have the Return of Premium rider on it, to cover the repayment of the loan at Inez's death.
- Inez is Preferred, NonSmoker, Illinois resident

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# The Numbers



Year	Annual Outlay for Non-Financed Premium	Annual Outlay for Financed Policy	Net Death Benefit for Non-Financed Policy	Net Death Benefit for Financed Policy	IRR for Non-Financed Policy	IRR for Financed Policy
1	\$296,861	\$26,104	\$10,000,000	\$10,000,000	3269%	38,208%
5	\$296,861	\$130,521	\$10,000,000	\$10,000,000	72%	176%
10	\$296,861	\$261,041	\$10,000,000	\$10,000,000	21%	45%
15	\$296,861	\$391,562	\$10,000,000	\$10,000,000	10%	18%

This is a supplemental illustration. Not all benefits and values are guaranteed. The assumptions on which the non-guaranteed elements are based are subject to change by the insurer. Actual results may be more or less favorable.



# Summary



- By using premium financing, Inez can reduce the amount of gifts that she has to make her trust and increase her internal rate of return.

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**For more information, please  
contact your John Hancock  
Regional Director or call the  
Advanced Markets Group at  
1-888-266-7498, option 3.**

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# Disclosures



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