Allianz Life Insurance Company of North America

PREMIUM FINANCE

Glossary of terms used in premium financing

These are essential terms and concepts you'll want to understand. If you need more clarification, **contact your financial professional.**

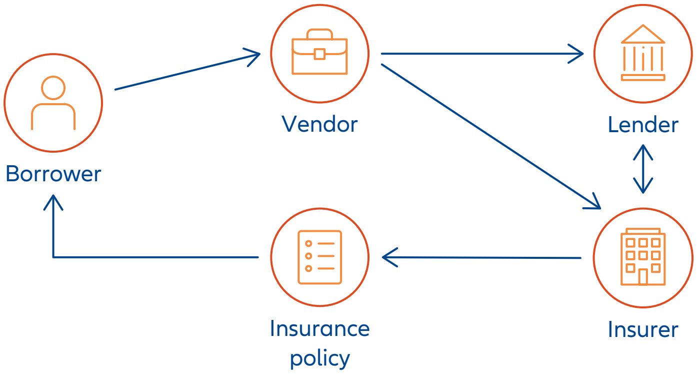
PEOPLE/ENTITIES INVOLVED

Borrower: The entity to which the bank loans the money for paying the insurance premiums. It may be an individual, a company, or a trust. They are also the insured and owner of the life insurance policy.

Vendor: A premium finance vendor serving as the main intermediary between the client, the insurance company, and the bank. The vendor is responsible for proper policy and loan design, maintenance of the contract, and communication with the bank, insurer, and client. It is very important to be working with a vendor that aligns with your needs. You must work with an Allianz approved vendor.

Lender: The facility that is loaning the money to pay the life insurance premiums. It is typically a bank that has experience with premium financing, but can also be private financing. Allianz must approve any bank as part of their program.

Insurer: The entity providing the large-value life insurance policy, such as a fixed index universal life (FIUL) insurance policy.



CSI-542 (R-11/2023)

COMMON TERMS

Annual qualification: The borrower must maintain a financial profile that is acceptable to the lending bank in order for the bank to renew the loan (see Loan renewal process).

Annual review: Typically performed as part of the bank loan renewal process, the annual review compares the performance of the insurance policy and the bank loan against the insured/owner's needs (which may have changed since the previous review). Adjustments to the policy or bank loan terms may then be made.

Bridge financing: The insured/owner initially pays the premiums of a life insurance policy, with the intent that the money for the premiums will be borrowed from a bank in the future. There can be several reasons to use bridge financing; these include an expiring underwriting offer from the insurance carrier, an expected future cash flow for the client, or needing more time to set up the bank loan.

Collateral assignment of life insurance policy: In most cases, the policy serves as the primary means of collateral to secure the bank loan. At issue, ownership of the policy is assigned to the bank. The collateral assignment limits the owner's rights within the policy until the bank is repaid and the assignment is released.

Exit strategy: A method for repaying the money borrowed from the third party that was used to pay the life insurance premiums. Repayment of the bank loan can come from the life insurance policy itself (via cash value or the death benefit), other assets, or a combination of those.

Full recourse loans: A debt obligation that is owed regardless of the borrower's personal and financial situation. With full recourse, the lender can take whatever assets it wants to satisfy the borrower's debt.

Interest out-of-pocket: A type of premium finance design where the client is responsible for paying the entire bank loan interest that is due annually. This amount will increase as long as new premium is borrowed.

Irrevocable Life Insurance Trust (ILIT): A living trust that is set up to own a life insurance policy. There may be estate tax benefits to using an ILIT to own a life insurance policy. Consult your tax advisor.

Letter of credit (LOC) or credit letter: This letter from a bank guarantees that a buyer's payment to a seller will be received on time and for the correct amount. Some banks permit the use of a LOC as collateral.

Loan designs: Loan designs combine the life insurance policy projections and the bank loan projections. There are several assumptions used in loan designs that are not guaranteed, such as future bank loan interest rates, future life insurance policy charges and credits, and the future availability of bank loans. Stress tests, which should show the loan interest at varying interest rates and life insurance at varying crediting rates, can help to demonstrate the impact should these assumptions not unfold as they are shown in the current proposal. Loan designs differ from vendor to vendor, but usually contain the following elements:

- **Annual loan rate:** The rate of interest for the bank loan for a given year. These are usually not guaranteed and may be different than projected.
- **Cumulative loan balance:** The total amount of the loan owed to the bank.
- **DB/CV net of loan:** The death benefit (DB) and cash value (CV) of the life insurance policy remaining after the bank loan has been paid off.
- **Interest due:** The amount of interest that the bank is assumed to charge. This amount is not guaranteed and may be different than projected.
- **Loan payoff/loan exit:** This is an assumption about the amount of the bank loan and the timing of when it will be repaid, and is not the same as the loan maturity found on the loan term sheet/promissory note. Many factors influence the repayment of the bank loan, including the policy performance, loan performance, and the client's financial situation.
- **Origination fee/arrangement fee:** Some bank loans require a setup fee. This amount is shown on the loan design and can have several different names. The setup fee can be paid directly by the insured, or rolled into the loan balance.
- **Out-of-pocket:** The amount of interest that the borrower must pay out of pocket to the lender. This amount is not usually guaranteed and may be different than projected.
- **Peak collateral:** The maximum required collateral shown on a bank loan design. This amount is based on the assumption in the loan design. Based on actual results, the peak collateral could be higher or lower than shown.
- **Required collateral:** The difference between the amount of the bank loan and the illustrated value of the life insurance policy. Vendors perform this calculation according to the bank standards. Permitted collateral may include liquid assets, illiquid assets, or letters of credit.

Loan renewal process: As most bank loans are annual, a vital part of maintaining the bank loan involves gathering the documents required by the bank in a timely manner, 60-90 days prior to the policy anniversary. This service is performed by the premium finance vendor.

Loan term sheets/promissory notes: These (or other written agreements) set forth the terms of the loan being financed for payment of life insurance premiums. The terms of the loan vary from vendor to vendor and from lender to lender. Terms should be read carefully. They may include:

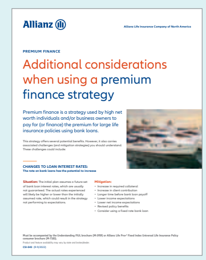
- **Bank loan rate benchmark:** The basis for the loan rate, as described in the loan term sheet or the promissory note. SOFR, PRIME, and U.S. Treasury rates are all commonly used benchmarks.
- **Default:** This section describes what happens in the event that the loan interest (or loan principal) is not paid on schedule and/or the amount of collateral is insufficient to secure the bank loan. A breach of this nature may allow the lender to foreclose on the loan collateral and result in the surrender of the life insurance policy.
- **Facility/loan capacity/forward commitment amount:** The total amount the lender agrees to lend over the life of the loan. It is often equal to the total premiums projected to be paid to the insurance company, but may be smaller if the insured is contributing a portion of the premiums.
- **Interest rate spread/interest rate margin:** The portion of the agreement that describes the interest rate. It is usually expressed as an amount over a certain benchmark index – such as SOFR, PRIME, or U.S. Treasuries. There are often minimum interest rates. Some lenders offer loans that have fixed interest rates and do not reference a benchmark index.
- **Prepayment:** The lender's rules governing how the insured can make an early repayment of the loan. The lender may charge a prepayment penalty for the repayment of a loan prior to maturity.

Low point letter: A document that Allianz produces at the request of the vendor that is used in the loan renewal process. This document indicates the amount that the issuing insurance company will pay upon the surrender of the life insurance policy during the specified time period.

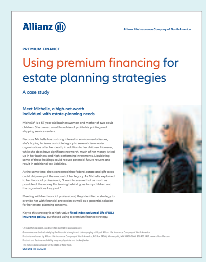
Non-recourse loans: Bank loans that do not require the borrower to have to guarantee the loan with any personal collateral. Typically, the bank loan is repaid at death from the death benefit. Most non-recourse loans are not permitted today, as these types of loans led to stranger- or investor-owned life insurance (STOLI or IOLI) where there was no financial interest in the insured's death.

Stress tests: Projections generated with assumptions that are less favorable than current assumptions, for the purpose of showing ways in which the program could deliver results that differ from initial projections; and ensuring that the client is financially capable of coping with those results. As an example, a projection may be generated showing higher bank loan rates, lower policy credited rates, higher policy expenses, or any combination of these and other assumptions.

FOR MORE INFORMATION on premium financing, including related risks, please refer to **Additional considerations when using a premium finance strategy** (CSI-543) and **Using premium financing for estate planning: A case study** (CSI-540).


Allianz
Additional considerations when using a premium finance strategy

CSI-543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Using premium financing for estate planning strategies

CSI-540

This strategy is not appropriate for everyone, and you should consult with your tax advisor to discuss your specific situation.

Policy loans and withdrawals will reduce the available cash value and death benefit and may cause the policy to lapse, or affect guarantees against lapse. Withdrawals in excess of premiums paid will be subject to ordinary income tax. Additional premium payments may be required to keep the policy in force. In the event of a lapse, outstanding policy loans in excess of unrecovered cost basis will be subject to ordinary income tax. If a policy is a modified endowment contract (MEC), policy loans and withdrawals will be taxable as ordinary income to the extent there are earnings in the policy. If any of these features are exercised prior to age 59½ on a MEC, a 10% federal additional tax may be imposed. Tax laws are subject to change, and you should consult a tax professional.

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