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Related Reports

Criteria:
A.M. Best's Ratings & the Treatment of Debt

Rating Funding Agreement-Backed Securities

Commercial Paper Methodology

Rating Analysts

Emmanuel Modu, Managing Director & Global Head of Insurance-Linked Securities
+1 (908) 439-2200 Ext. 5356
Emmanuel.Modu@ambest.com

Elmo W. Chin, Assistant Vice President
+1 (908) 439-2200 Ext. 5227
Elmo.Chin@ambest.com

This criteria report was updated as part of the annual review process. No substantive changes were made to the prior edition.

This criteria report can be found at *www.ambest.com/ratings/methodology*

Rating Life-Related Premium Financing Loan Securitizations

Premium financing, utilized primarily by high-net-worth individuals or companies, can provide a cost-effective means to fund the premiums of life insurance policies purchased for estate planning or business purposes. Individuals who finance the payment of premiums on their life insurance policies typically have significant personal assets that they do not want to liquidate to pay such premiums. By borrowing to pay the life insurance premiums, the insureds free capital that can be used more efficiently elsewhere.

In a typical premium financing transaction, the required premium payments of a life insurance policy are financed through the issuance of a loan. Under the terms of the loan, the lender is committed to fund one or more premium payments. The loan can be long term, ranging from one year to the life of the policy. The proceeds of the loan can be used by the borrower for a variety of purposes relating to the acquisition of a new or pre-existing life insurance policy, including to:

(1) pay policy premiums,

(2) refinance an existing loan,

(3) pay certain fees/expenses related to the loan, or

(4) pay interest costs related to the loan.

The life insurance policy, along with any required collateral, is transferred to an irrevocable life insurance trust (ILIT), the assets of which are insulated from the estate of the individual establishing the trust (the grantor).

The premium financing lender requires the borrower to secure its life insurance premium financing loan with collateral and/or assets, which typically include: a collateral assignment of the life insurance policy and its death benefits; the cash surrender value; and other assets as required by a lender. In the event of an early termination of a premium finance loan before the death of the insured, the policy cash surrender value and other assets serve as the primary source for repayment of the loan. Other assets generally are needed to supplement the cash surrender value, because in the early policy years, there is typically a shortfall between the loan balance and the cash surrender value of the policy. Such shortfalls must be filled by additional assets pledged as collateral by the insured or policy owner. The additional collateral acceptable to the lender typically consists of liquid assets such as cash, certificates of deposit, cash equivalents or letters of credit (LOCs) issued by highly rated financial institutions. Over time, the additional collateral requirements may be reduced if the policy cash surrender value grows.

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In the event of the death of the insured, the premium financing lender is repaid from the life insurance proceeds. The lender's collateral assignment on the policy secures its right to repayment of the outstanding loan balance before the remaining proceeds are paid to the policy beneficiaries. Since a collateral assignment is placed on the policy, the policy owner cannot surrender the policy or access the cash value without the approval of the collateral assignee (the lender). The insurance company that issued the life policy typically provides an acknowledgement and agreement letter stating the insurer is aware that the assignee has extended a loan to the owner, which loan is secured in whole or in part by the policy. In addition, the insurer may provide assurances including: (1) the lowest cash surrender value that is payable by the insurer (assuming scheduled premium payments are made) and (2) lowest amount (return of premium) that would be paid by the insurer if the insurer were to deny a claim or contest the policy.

This methodology primarily addresses the securitization of pools of premium financed loans. The loans are aggregated, securitized and sold to investors in the form of notes, which are essentially collateralized by direct senior obligations of insurance companies (such as death benefits and cash surrender values); senior obligations of other entities providing collateral support; and liquid assets.

The reader should be aware that this document refers to traditional premium financing loans as opposed to the non-recourse premium financing loans popularized by the life settlement industry several years ago. In such non-recourse premium financing loans, the collateral for the loans generally consists of the death benefits associated with the insurance policies since cash surrender values are typically kept at a minimum. Therefore, premium financing lenders in the life settlement industry normally require life expectancy reports and quite often rely on transfer of the policies to the premium finance lender and perhaps the subsequent sale of the policies in the secondary market if the borrowers can not or will not pay the interest, principle, and fees associated with the loans when due. In the more traditional premium financing loan programs, the lenders put more reliance (for collateral purposes) on cash surrender value of the policies, letters of credit, and liquid assets as described in greater detail in this document. The lender generally does not consider mortality or longevity risk in the decision as to whether to make the loans.

Methodology

ANALYTICAL COMMUNICATIONS

Carole Ann King, Managing Senior Business Analyst
Brendan Noonan, Managing Senior Business Analyst
Carol Demyanovich, Senior Business Analyst
Joe Niedzielski, Senior Business Analyst
Laura McArdle, Business Analyst
Christopher Sharkey, Business Analyst
Thomas Dawson IV, Associate Editor

PRODUCTION SERVICES

Joanna Herren, Senior Designer

Transaction Structure

In a securitization of premium financing loans, a special-purpose vehicle (SPV) is established and capitalized with funds from investors. The SPV subsequently borrows funds from note holders to purchase a pool of life insurance premium financing loans or a 100% undivided participation interest in a pool of life insurance premium financing loans from a lender. As described earlier, the lender is assigned the assets related to the insurance policies (i.e., death benefits and cash surrender values), letters of credit and cash. This assignment effectively is transferred to the note holders via the securitization.

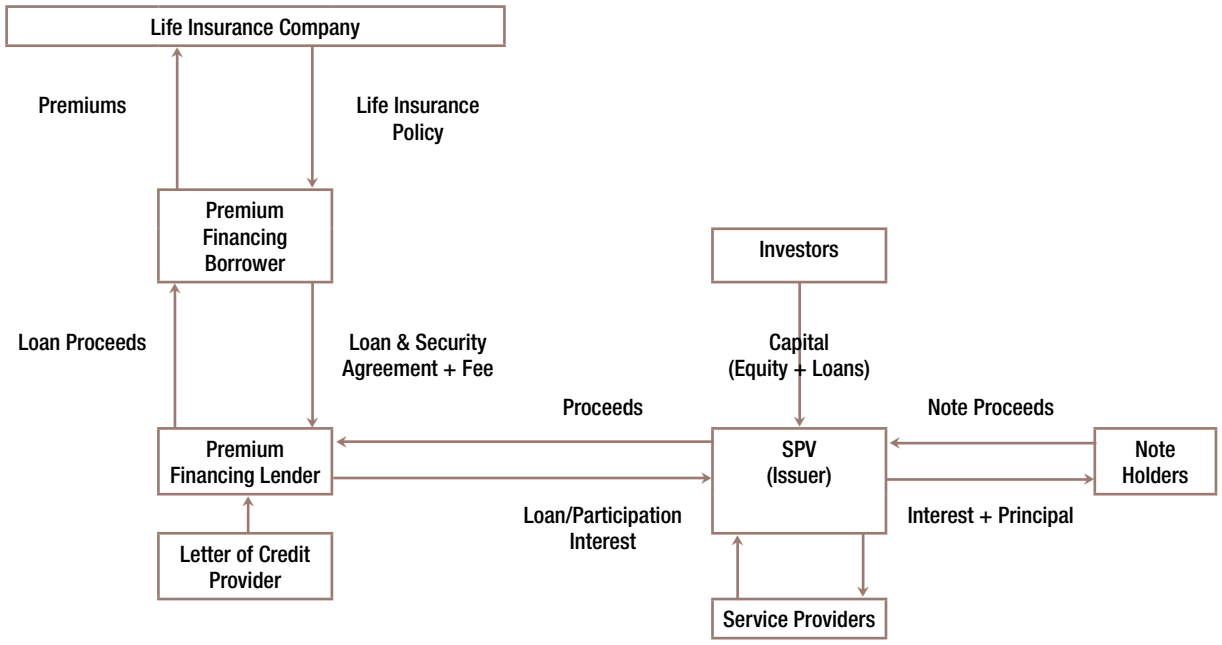
To fund ongoing obligations (e.g., operating expenses, reserve requirements, etc.) the SPV may receive additional capital injections from the investors. The additional capital may take the form of cash transfers and/or loans to the SPV. If the equity investors make loans to the SPV, such loans may or may not be subordinate to the claims of the note holders.

Rating Assigned

The rating assigned is Best's Debt Rating, which is an opinion as to an issuer's ability to meet its ongoing financial obligations to security holders when due.

To determine the rating of the securities,

Exhibit 1
Premium Financing Loan Securitization Transaction



A.M. Best analysts take the following steps:

1) Obtain the current Best's Issuer Credit Rating (ICR), rating outlook and modifier for each of the insurance carriers and other entities providing collateral support; if no A.M. Best rating is available on the entities in question, then adopt the ratings by designated Nationally Recognized Statistical Rating Organizations (or NRSROs) for the analysis.[1]

2) Adjust these ratings downward by one notch for any insurance carrier or entity with a rating that is under review with a negative modifier.

3) Determine the minimum rating of all the insurance carriers and other entities after the adjustments in Step 2 to arrive at the maximum rating for the securities backed by life insurance premium loans.

4) Adjust the rating determined in Step 3, if warranted, to reflect some of the other considerations listed below to arrive at the assigned rating for the securities backed by premium financing loans:

- **Insurance Company Acknowledgements:**
  - o The extent to which the insurers have acknowledged the assignment of the life insurance polices as loan collateral for a premium financing transaction.
  - o The extent to which the insurers provide minimum policy cash surrender values and/or minimum payment amounts in the event claims (i.e., death claims and surrender values, etc.) are submitted.
- **Spreadsheet Review:**
  - o Review of the transaction spreadsheet to assess whether cash flows are sufficient to service the notes and to pay applicable operating expenses of the SPV.
  - o Application of deterministic stress testing of key factors to assess the ability of the SPV to service the notes.
  - o Review of permitted investment guidelines that apply to the investment of excess cash.
- **Operational Risk Evaluation:**
  - o Risks associated with loan originations that could raise the prospects of challenges by insurers and/or borrowers.
  - o A review of the servicer and back-up servicer arrangement (if any) is important to assess the adequacy of the servicing function and identify the potential for the disruption of the transaction. Factors considered include: experience level of the staff and whether the entities have the infrastructure, systems and experience to provide the

[1] Please note that if there is no rating by any designated NRSRO on an entity, the assumed rating for that entity would be "c". In addition, if an entity is designated as a Financially Impaired Company or a company in default, and that entity is still fulfilling its financial obligations to its counterparties, the assumed rating for that entity would also be "c".

required administrative support. Servicing activities include: verification services, premium payment and loan funding services, foreclosure, acceleration and/or default loan processing services and periodic (i.e., monthly, weekly, etc.) portfolio reporting requirements.

- o Determine if an ICR of the servicer or a servicer evaluation is available. To the extent the servicer has no public or private rating, other factors such as length of servicing history, staffing, senior management experience and other factors will be considered.
- o Review the various service providers (e.g., servicer, owner trustee, indenture trustee, etc.) and their roles to determine whether there is adequate separation of duties.

- **Structural Review:**
- o Review the structure of the transaction to determine whether it provides for: ample liquidity (amount and source) during times of market dislocation (i.e., broad market disruption periods); provisions for additional protection through credit enhancements and/or waterfall trigger mechanism to divert additional cash flow to the servicing of the notes; remedies available in the event of foreclosure or loan acceleration events; and the liquidation priority of the supporting assets.

- **Document Review:**
- o Review of the legal and/or enforceability opinions, including non-consolidation opinions, true sale opinions, loan and security enforceability opinions and other legal opinions regarding insurance and other matters related to premium financing lending.
- o Review of transaction documents, including loan and security agreement, indentures, subscription, liquidity facility agreements, servicing agreements, and participation purchase and sale agreements. Important considerations include: the lender's ability to early terminate the loans; default and foreclosure triggers; transfer of rights from the lender to the SPV; minimum collateral requirements and other factors.

Exhibit 2

Short-Term Rating Matrix

Issuer Credit Rating	Short-Term Rating
aaa	AMB-1+
aa+	AMB-1+
aa	AMB-1+
aa-	AMB-1+
a+	AMB-1+ or AMB-1
a	AMB-1 or AMB-2
a-	AMB-1 or AMB-2
bbb+	AMB-2
bbb	AMB-2 or AMB-3
bbb-	AMB-3
bb+	AMB-4
bb	AMB-4
bb-	AMB-4
b+	AMB-4
b	AMB-4
b-	AMB-4
ccc+	AMB-4
ccc	AMB-4
ccc-	AMB-4
cc	AMB-4
c	AMB-4

- **Surveillance Procedures:**
- o Review surveillance procedures to determine whether performance measurement metrics have been established. Specific monitoring activities include: the timely review of applicable servicer reports; routine review of insurance company surrender value acknowledgements; and the continuous monitoring of the credit quality of the insurers, the LOC providers and the servicer.

If the maturity of the securities is less than about a year, the rating assigned would be a short-term debt rating. Exhibit 2 shows the translation of issuer credit ratings to A.M. Best's short-term ratings. For the purposes of this methodology, any overlap in ratings will result in the assignment of the lower short-term rating if the rating outlook is negative. For example, if the ICR of the securities is determined to be "a" with a negative outlook, according to the procedures described earlier, the corresponding short-term rating would be AMB-2, not AMB-1.

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CHAIRMAN & PRESIDENT **Arthur Snyder III**

EXECUTIVE VICE PRESIDENT **Larry G. Mayewski**

EXECUTIVE VICE PRESIDENT **Paul C. Tinnirello**

SENIOR VICE PRESIDENTS **Manfred Nowacki, Matthew Mosher, Rita L. Tedesco**

A.M. BEST COMPANY
WORLD HEADQUARTERS
Ambest Road, Oldwick, N.J. 08858
Phone: +1 (908) 439-2200

NEWS BUREAU
830 National Press Building
529 14th Street N.W., Washington, D.C. 20045
Phone: +1 (202) 347-3090

A.M. BEST EUROPE LTD.
12 Arthur Street, 6th Floor, London, UK EC4R9AB
Phone: +44 (0)20 7626-6264

A.M. BEST ASIA-PACIFIC LTD.
Unit 4004 Central Plaza, 18 Harbour Road, Wanchai, Hong Kong
Phone: +852 2827-3400

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For press inquiries or to contact the authors, please contact James Peavy at (908) 439-2200, ext. 5644.

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