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Best's
Methodology and Criteria

Rating Life-Related Premium Financing Loan Securitizations

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Outline

The following criteria procedure should be read in conjunction with *Best's Insurance-Linked Securities & Structures Methodology (BILSM)* and all other related BILSM-associated criteria procedures. The BILSM provides a comprehensive explanation of AM Best's rating process for insurance-linked securities and insurance-linked structures.

A. Market Overview

Life-related premium financings (LRPF), 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 free capital of the insured 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 typically ranges from several years 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, which typically include: 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. Generally, other assets 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 are addressed by the pledge of additional assets 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.

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 that the insurer is aware that the assignee has extended a loan to the owner, which 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) the 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 criteria procedure 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 rating assigned to the LRPF is *Best's Issue Credit Rating* (IR), which is an independent opinion of credit quality assigned to issues that gauges the ability to meet the terms of the obligations.

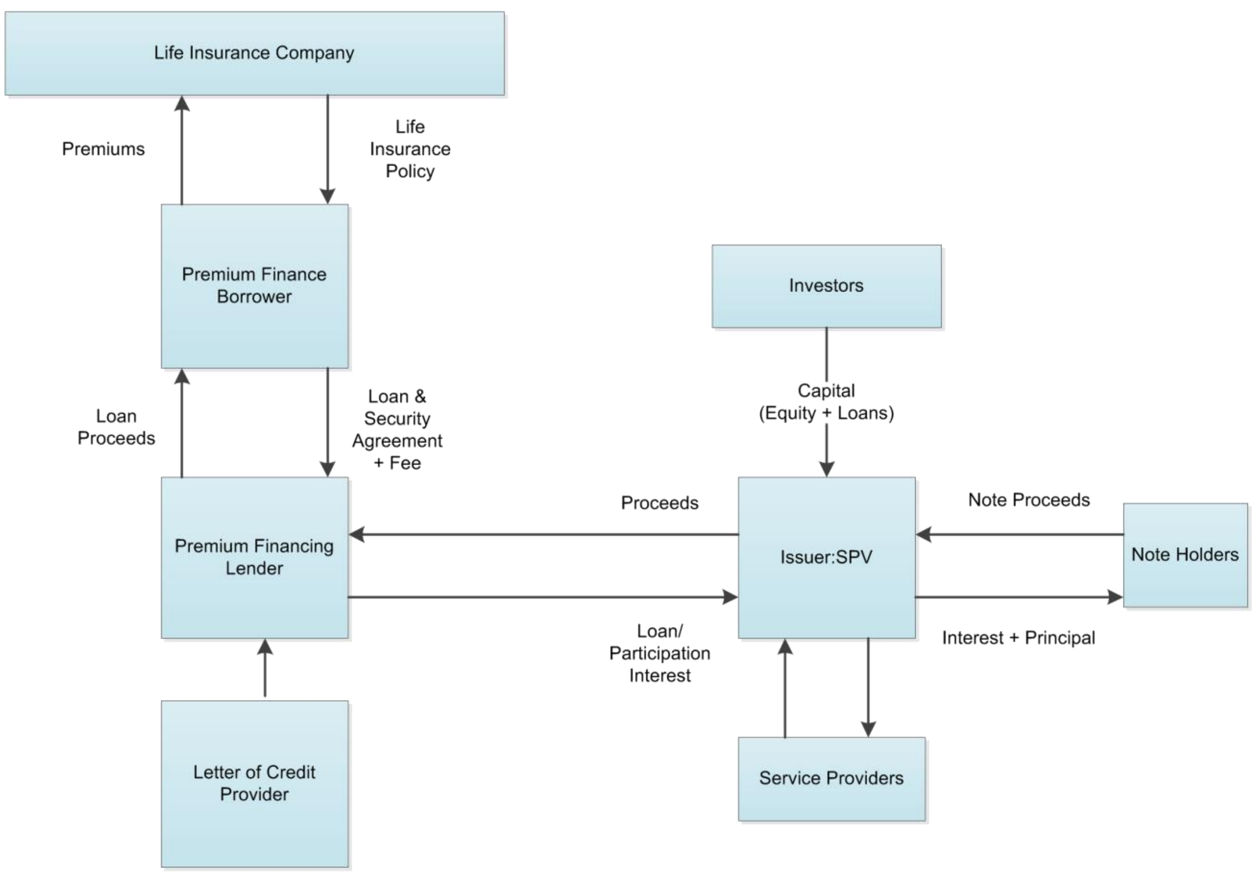
This criteria procedure refers to traditional premium financing loans as opposed to non-recourse premium financing loans popularized by the life settlement industry. In such non-recourse premium financing loans, the collateral for the loans generally consists of the death benefits associated with the 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. Often they rely on the transfer of the policies to the premium finance lender and perhaps the subsequent sale of the policies in the secondary market if the borrowers cannot or do not pay the interest, principal, 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 the 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.

Securitization 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.

Exhibit A.1: Premium Financing Loan Securitization Overview



B. Rating Considerations

As part of the rating analysis of a LRPF loan securitization, AM Best will review the following key areas:

Insurance Company Acknowledgements

- Insurer acknowledgement of the assignment of the life insurance policies as loan collateral for a premium financing transaction
- The presence or absence of the minimum policy cash surrender values and/or the minimum payment amounts in the event of claims (i.e., death claims and surrender values, etc.) are provided by the insurer.

Cash Flows

- Assessment of the transaction to determine whether the cash flows are sufficient to service the notes and pay applicable operating expenses of the SPV
- Assessment of the ability of the SPV to service the notes based on cash flow outputs following the application of deterministic stress testing on key factors
- Review of investment guidelines that apply to the investment of excess cash

Operational Risk

- Determination of the risks associated with loan originations that may be subject to challenges from insurers and/or borrowers
- Assessment of the adequacy of the servicing function through a review of the servicer and back-up servicer arrangement (if any) and identification of the potential for the disruption of the transaction
- Determination of the experience level of the staff and whether the entities have the appropriate infrastructure, systems and experience to provide the required administrative support. The servicing activities reviewed to make this determination 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
- Determination as to whether the servicer maintains an Issuer Credit Rating (ICR) or if 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 in the analysis
- Determination of whether there is adequate separation of duties based on a review of the various service providers (e.g., servicer, owner trustee, indenture trustee, etc.) and their roles in the securitization structure

Structure

- Determination as to whether the securitization structure provides for: ample liquidity (amount and source) during times of market dislocation (i.e., broad market disruption periods)
- The absence or presence of credit enhancements and/or waterfall trigger mechanism to divert additional cash flow to the servicing of the notes to provide additional protection to the noteholders
- Remedies available in the event of foreclosure or loan acceleration events; and the liquidation priority of the supporting assets

Documentation

- 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
- Transaction specific documents including loan and security agreement, indentures, liquidity facility agreements, servicing agreements, and participation purchase and sale agreements. Documents reviewed for the potential following mechanisms: the lender has the ability to terminate the loans early; default and foreclosure triggers are present; rights can be transferred from the lender to the SPV; and minimum collateral requirements are stated

C. The Assignment of a Rating

To determine the rating of the securities, AM Best analysts take the following steps:

1. Obtain the current ICR, rating outlook and modifier for each of the insurance carriers and other entities providing collateral support; if no AM Best rating is available on the entities in question, then adopt the ratings, if any, assigned by designated Nationally Recognized Statistical Rating Organizations (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

[1] Please note that for analytical purposes if an entity does not have a rating from a designated NRSRO, the assumed rating for that entity would be "bb+". 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 be "b".

4. Adjust the rating determined in Step 3, if warranted, to reflect the other considerations mentioned earlier in the criteria procedure to arrive at the assigned rating for the securities backed by premium financing loans

Surveillance Procedures

AM Best follows surveillance procedures to determine whether performance measurement metrics have been established. Typical monitoring activities that AM Best expects to review on a timely basis include: applicable servicer reports; routine insurance company surrender value acknowledgements; and changes in the credit quality of the insurers, the LOC providers and/or the servicer.

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METHODOLOGY AND CRITERIA

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Best's Financial Strength Rating (FSR): an independent opinion of an insurer's financial strength and ability to meet its ongoing insurance policy and contract obligations. An FSR is not assigned to specific insurance policies or contracts.

Best's Issuer Credit Rating (ICR): an independent opinion of an entity's ability to meet its ongoing financial obligations and can be issued on either a long- or short-term basis.

Best's Issue Credit Rating (IR): an independent opinion of credit quality assigned to issues that gauges the ability to meet the terms of the obligation and can be issued on a long- or short-term basis (obligations with original maturities generally less than one year).

Best's National Scale Rating (NSR): a relative measure of creditworthiness in a specific local jurisdiction that is issued on a long-term basis and derived exclusively by mapping the NSR from a corresponding global ICR using a transition chart.

Rating Disclosure: Use and Limitations

A Best's Credit Rating (BCR) is a forward-looking independent and objective opinion regarding an insurer's, issuer's or financial obligation's relative creditworthiness. The opinion represents a comprehensive analysis consisting of a quantitative and qualitative evaluation of balance sheet strength, operating performance, business profile, and enterprise risk management or, where appropriate, the specific nature and details of a security. Because a BCR is a forward-looking opinion as of the date it is released, it cannot be considered as a fact or guarantee of future credit quality and therefore cannot be described as accurate or inaccurate. A BCR is a relative measure of risk that implies credit quality and is assigned using a scale with a defined population of categories and notches. Entities or obligations assigned the same BCR symbol developed using the same scale, should not be viewed as completely identical in terms of credit quality. Alternatively, they are alike in category (or notches within a category), but given there is a prescribed progression of categories (and notches) used in assigning the ratings of a much larger population of entities or obligations, the categories (notches) cannot mirror the precise subtleties of risk that are inherent within similarly rated entities or obligations. While a BCR reflects the opinion of A.M. Best Rating Services, Inc. (AM Best) of relative creditworthiness, it is not an indicator or predictor of defined impairment or default probability with respect to any specific insurer, issuer or financial obligation. A BCR is not investment advice, nor should it be construed as a consulting or advisory service, as such; it is not intended to be utilized as a recommendation to purchase, hold or terminate any insurance policy, contract, security or any other financial obligation, nor does it address the suitability of any particular policy or contract for a specific purpose or purchaser. Users of a BCR should not rely on it in making any investment decision; however, if used, the BCR must be considered as only one factor. Users must make their own evaluation of each investment decision. A BCR opinion is provided on an "as is" basis without any expressed or implied warranty. In addition, a BCR may be changed, suspended or withdrawn at any time for any reason at the sole discretion of AM Best.

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