The Insured Corporate Financing Plan

A life insurance solution that provides security and minimizes cash outlays.

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Introduction

Permanent life insurance is a flexible planning tool that contains both insurance and investment components.The investment component can be used to fund future insurance costs, withdrawn or borrowed back from the policy at a future date, or leveraged by assigning the policy in exchange for a collateral loan.

This type of product in combination with a collateral loan, can be structured to minimize your clients' cash outlays required to acquire the insurance protection needed while leaving more in their corporation to pursue growth opportunities. The Insured Corporate Financing Plan may be ideal for your business owner clients who have both insurance protection needs and business opportunities but only enough internal corporate funding for one or the other.

The Insured Corporate Financing Plan can help business owners get the insurance they require with minimal impact on cash flows, in addition to benefiting from the following:

- tax-deferred growth of deposits (net of charges) into the policy[1]
- creation of a valuable asset that can be leveraged to replace funds utilized to acquire insurance protection
- a tax effective benefit payment upon death (proceeds less the Adjusted Cost Basis (ACB) flow into the Capital Dividend Account (CDA)[2]
- funds available to settle outstanding debt (such payments do not reduce the CDA)
- depending on the plan, options to access living benefits including disability payouts, terminal illness advances and special death payouts on the first death of a Joint Last-to-Die policy

This combination creates a powerful financial planning tool.

To help support your understanding of the **Insured Corporate Financing Plan**, we encourage you to read this Guide and use the latest version of our Wave illustration software to help you prepare personalized proposals for your clients.

Note: The ideas presented in this guide should be reviewed for suitability to individual circumstances. The information contained in this guide is general in nature and should not be construed as legal, lending or tax advice. You and your clients are encouraged to seek the advice of other professionals such as legal, lending and tax experts to ensure that the ideas presented are appropriate for the circumstances of the individual(s) for whom this plan is being considered.

[1] Certain limits apply to the tax-exempt growth within the policy. Refer to an illustration for a projection of these amounts. [2] Based on current interpretation of the Income Tax Act (Canada).

The Opportunity

While most business owners understand the benefits of corporate-owned insurance, many don't realize that permanent life insurance products such as Universal Life (UL) or Whole Life (WL) can provide them with the protection they need as well as access to funds for business purposes.

Your clients may be business owners who require insurance:

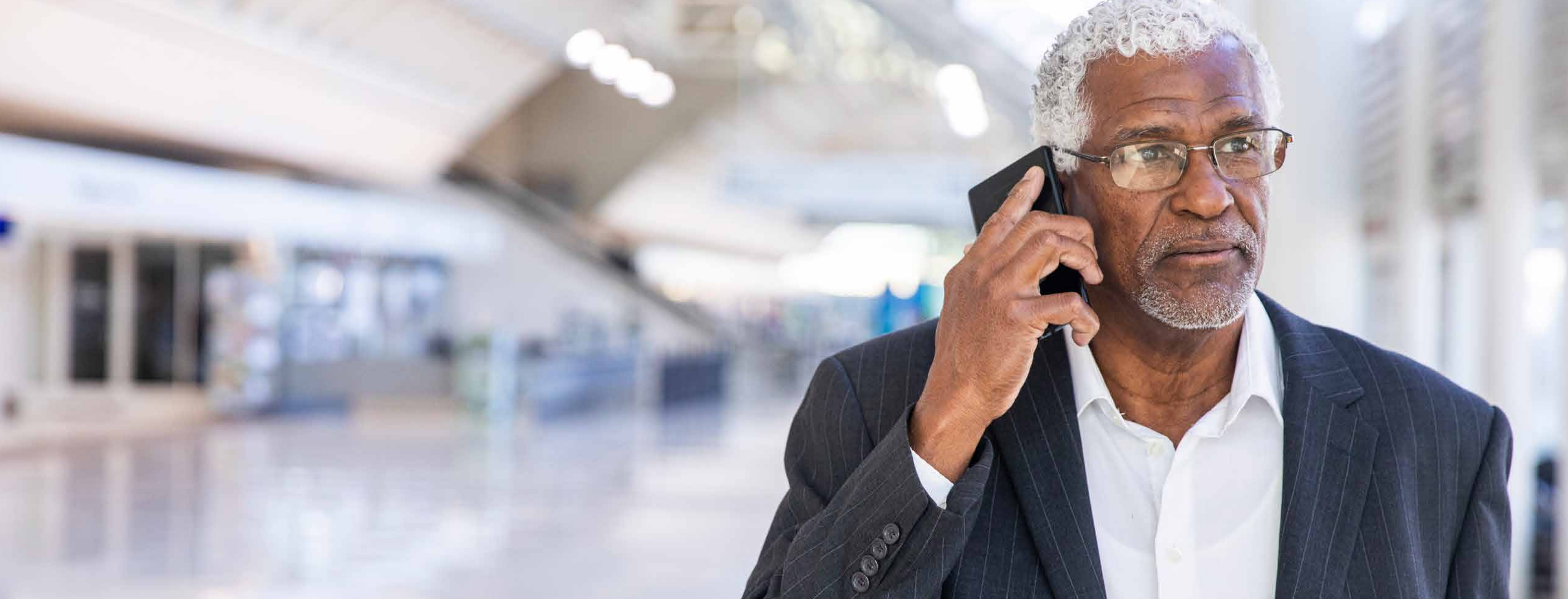
- to fund a buy-sell agreement between shareholders of the company
- to cover the loss of a key employee such as an individual with a special skill
- for estate planning to help:
  - » fund taxes that will arise on death
  - » equalize heirs that don't intend to be a part of the business, or
  - » leave a legacy to a favourite charity

They also have a successful business with growth opportunities. Surplus generated each year has been reinvested into the business generating excellent returns. They have sufficient funds to purchase the insurance they require or continue to reinvest in their business. The challenge is, how do they do both? The answer for some may be to use leverage.

Target Market

Ideally, the Insured Corporate Financing Plan is suited to clients with the following profile:

- Small business owners of Canadian Controlled Private Corporations (CCPC) who require and can qualify for life insurance protection.
- Are between the ages of 45 and 65.
- Business owners who have both insurance needs and business growth opportunities but limited cash flows.
- Business owners who will qualify and are comfortable with the use of third-party loans as part of their business model.
- Businesses projected to have enough taxable earnings to utilize the tax deductions generated from the strategy; interest deductions and collateral insurance deductions.
- Typically, clients are categorized as high, or ultra high-net-worth.



The Permanent Life Insurance Solution

Implementing insurance solutions such as the Insured Corporate Financing Plan can be complex. So, it is always wise to consult with a team of experts to ensure that your proposal meets the financial objectives of your client and that all the benefits and risks of the plan are considered. Oftentimes, this team will include you (the insurance expert) as well as other legal, tax, banking and accounting professionals. Therefore, building strong working relationships with experts in each of these fields of practice is important when implementing such ideas.

You may wish to use the following as a guideline to implement the Insured Corporate Financing Plan where funds are borrowed by the corporation:

Step 1	Determine the amount of permanent business insurance your client's need and can afford.
Step 2	Work with your clients to determine the desired funding period for the policy. The quicker the better. Run the ICF illustration and review it with the client and their third-party professionals that will be engaged during the process. After agreement that the strategy goals and design are suitable for the client, proceed to the next step.
Step 3	Start discussions with lenders to ensure that the client will qualify for the loan and amount required to replace cash flow directed into the policy so that other business needs can be addressed. Ensure the proposed terms and conditions are acceptable to the client.
Step 4	Your client then applies for a whole life or universal life insurance policy from BMO Insurance and in the case of UL, selects an investment portfolio for the policy that suits their long-term objectives and risk tolerance.
Step 5	Once the policy is in-force, the loan facility can be executed, and the policy can be pledged as collateral. Additional collateral may be required in early years until the insurance policy values grow to adequately cover the loan collateral requirements. Borrowing can take place any time after the loan is in effect based on the business needs. *Note: It is very important that the insurance policy premiums do not come from the borrowed funds. The borrowed funds need to be directly linked to a business purpose, not premium financing.*

The Permanent Life Insurance Solution (cont'd)

You may wish to use the following as a guideline to implement the Insured Corporate Financing Plan where funds are borrowed by the corporation:

Step 6	When funds are drawn against the loan facility, the interest on the loan may be capitalized or funded through additional borrowings. Alternately, your client may wish to pay the interest on the loan from other available funds.
Step 7	At death, if a loan is outstanding within the corporation, it can be repaid by the company from the tax-free Death Benefit proceeds of the policy without impacting the CDA. If the loan is personally held with the corporate policy used as collateral, the shareholder's estate would repay the loan through amounts received from the corporation via tax-free dividends or using other available funds. Failure to properly structure the repayment under personal borrowing scenarios can result in serious adverse tax consequences including turning the death benefit into a taxable shareholder benefit (see Tax Considerations below).
Step 8	The remaining death benefit can be used to settle the insurance risk originally identified or used to distribute funds to shareholders tax effectively.

ICF Overview – while the policy is in-force

01
Corporation purchases and makes premium payments into a permanent life insurance policy from BMO Insurance.

02
Policy is assigned as collateral and loan facility established (additional collateral may be required in early years).

03
Lender advances funds to corporation and proceeds are invested into business activity.

04
Corporation makes **interest payments**.

ICF Overview – at death

01
Claim filed and insurer pays off collateral.

02
Insurer pays balance of death benefit proceeds to corporation and Capital Dividend Account created.*

03
Net death benefits can be **distributed to shareholders**. If paid as a capital dividend, the amounts may be received tax-free.

Note: Personal borrowing against the corporate insurance policy may be an alternative but involves a different structure and different tax considerations.

* Capital Dividend Account (CDA) = Death Benefit less Adjusted Cost Basis. Loan repayment does not reduce the CDA amount created upon death.

The Results

By using the Insured Corporate Financing Plan from BMO Insurance, your clients will benefit from the following[3]:

Benefits

From the insurance policy	From the third-party line of credit/loan (*if utilized*)
• The corporation is protected with the valuable insurance coverage that it needs. • Deposits into the policy grow on a tax-deferred basis (*up to the maximum allowed under the Income Tax Act*). • The Death Benefit is paid to the corporation tax-free and creates a credit to the Capital Dividend Account (CDA) for the amount in excess of the Adjusted Cost Basis of the policy. The CDA balance is not eroded when death benefit proceeds are used to pay off the loan.	• The cash value of the policy is used as collateral for a loan, usually in the form of a line of credit that can replace funds used to acquire insurance. Those funds can be reinvested back into the business to take advantage of business opportunities. • Depending on the agreement with the lender, the principal and interest payments may be capitalized or serviced through additional borrowing. Therefore, no payments to service the loan may be required before death, at which time it is paid using the tax-free proceeds from the Death Benefit. • The interest expense and a portion of the premium may be deductible expenses if reinvested back into the business to earn income. However, you should consult with your team of professionals to ensure that this is feasible for your client's specific situation as well as what amount can be deducted.

Is the Insured Corporate Financing Plan right for your clients?

When considering whether to suggest the Insured Corporate Financing Plan to any of your clients, you may want to run through the following checklist to determine if the plan is appropriate for their needs:

- Are your clients, business owners that requires permanent life insurance to protect their interests?
- Will the proposed lives associated with the business qualify for life insurance?
- Do they have multiple needs (insurance and business growth) but only enough internal capital to do one or the other?
- Does the corporation have assets that could be pledged as collateral for a period of time?
- Are your clients comfortable with carrying debt now and beyond their working years?
- Does your client have excellent banking relationships and credit history?
- Will their business generate enough income for tax purpose to utilize the tax deductions from this strategy (interest and a portion of the premiums)?

If your client answers "yes" to these questions, then the Insured Corporate Financing Plan may be an ideal solution for them.

[3] Based on applicable Rules and Regulations in effect at the time of writing this Guide.

Tax Considerations

The information contained in this section is general in nature and should not be construed as legal or tax advice. The comments are provided as discussion points only for you and your client to review with their team of professionals which should include their legal and tax experts.

Structuring Third Party Lending Arrangements for the Business Owner

If the insurance policy is leveraged, structuring the loan properly is crucial to the successful implementation of the Insured Corporate Financing Plan. Either the corporation (typical scenario) or the business owner may borrow funds using the policy as collateral. However, you should note the following:

If the corporation does the borrowing	If the shareholder/business owner does the borrowing using the corporate policy as collateral
• The policy is assigned as collateral to the third-party lender and may need to be supplemented with additional collateral for a number of years. The loans are advanced to the corporation. • The corporation would use the borrowed funds for business purposes as there needs to be a direct link between these borrowed funds and the business use. • Upon death of the insured, the life insurance benefit is used to pay-off the principal and interest outstanding on the loan. Any residual amount is paid to the corporation as the beneficiary tax-free. • The amount of the Death Benefit in excess of the policy's Adjusted Cost Basis (ACB) creates a Capital Dividend Account (CDA) credit. This credit is not impacted when funds are used to repay the loan. • The company can elect to pay an amount up to the CDA balance to shareholders of record which may be received tax free.	• The shareholder uses the corporate policy as collateral and receives the proceeds of the loans personally. • While the shareholder is alive, they may be deemed to incur a shareholder benefit if the borrowing is done personally. To minimize this concern, they may consider paying a guarantee fee to the corporation. • Upon their death, the Death Benefit would need to first be paid to the corporation creating a CDA balance (the lender would need to agree and likely ask for substitute collateral). An amount equal to the outstanding loan could be distributed to the shareholder's estate via a tax-free dividend. The shareholder's estate would pay-off the outstanding loan using the dividend payment. Any residual death benefit proceeds could also be distributed to the shareholders of record and may be tax-free. • The process to pay-off the loan using this option is more complex. Clients should consult with a team of professionals to determine if a taxable benefit would be assessed, to ensure that the loan is paid off correctly and to minimize any unforeseen tax consequences.

Tax Considerations (cont'd)

Unused CDA Balance

In many cases, significant unused CDA remains as it was not eroded when insurance death benefits were used to repay the loan. If the company has other liquid assets available, those can be distributed tax-free to Canadian shareholders as a Capital Dividend using this unused CDA balance. This is an additional benefit that would increase the net estate values and the Internal Rate of Return (IRR) for this strategy. Some companies include this balance in their reports assuming excess funds are always available. That may not be the case which means the net estate values and IRR are overstated. Be sure you understand how the unused CDA is reflected in reports and make sure the client is aware of what is being displayed so they can judge the ultimate benefit that they may potentially receive.

Interest Expense Deduction

If the funds are borrowed by the corporation and used to earn income from the business or to replace capital (fund a dividend) and as a condition of the loan, life insurance is required to secure the loan, the interest on the loan should be tax deductible. In addition, if interest is deductible, a portion of the premiums may also be deductible (this Collateral Insurance Deduction equals the lesser of the premium paid or the Net Cost of Pure Insurance (NCPI) prorated by the amount of the outstanding loan over the policy's face amount).

If the funds are borrowed personally using the corporate policy as collateral and the proceeds of the loan are invested to earn income, the interest may be deductible from the borrower's taxable income.

The ability to deduct interest expense on a loan has been recently scrutinized by the Canada Revenue Agency (CRA). Your client's legal, tax and accounting advisors should determine whether this is feasible for their individual circumstance. The Collateral Insurance Deduction is not available for third party leveraging situations such as personal borrowing (deduction limited to policyowners only). Interest deductibility is not available if the funds are used for personal lifestyle purposes.

Taxation of Bank Loans

General Anti-Avoidance Rules (GAAR) prohibit financial transactions that are generated solely for the purpose of creating tax benefits. Using the Insured Corporate Financing Plan serves a business purpose and based on the current interpretation of the Canadian Income Tax Act, the bank loan should be received tax-free by the recipient. However, CRA could attempt to apply GAAR rules to the loan and consider the amount to be a policy loan. Although such an interpretation is contrary to the definition of a policy loan, if CRA took this position the result would mean that a portion (or all) of the loan amount would be taxed as income. Your clients should be aware that this risk exists, but also that the Agency accepts the fact that taxpayers should be allowed to structure their affairs in an efficient manner.

The Value of a Permanent Life Insurance Policy in a Corporation

The Cash Value of a life insurance policy is considered to be a passive asset within the corporation. Your clients should therefore be aware of the following:

- Any direct access to the values in the insurance policy prior to death result in a disposition. A taxable gain may arise that would be subject to full taxation at marginal tax rates. Such income would also be passive income that could limit the small business tax limit available to the corporation.
- Also, if a significant amount of a corporation's total assets are passive (often looked at as 10% or more), the shareholders may not qualify for the capital gains exemption if they dispose of their shares.

It is generally recommended to hold the insurance policy outside of an active operating company if enough taxable income will be available in such other corporation to offset tax deductions created by this plan.

For a more complete understanding of these issues it is highly recommended that you and your clients seek out the advice of a tax professional.

Other Considerations

Other Insurance Considerations

When proposing the Insured Corporate Financing Plan, you and your clients should consider the following:

Longevity risk
Be conservative with the projected values on the illustration you present to your clients. If your client outlives the projection, additional collateral security may be required to maintain the loan, to continue to capitalize the loan or draw additional amounts to fund the interest costs. Alternatively, the client could be forced to repay a portion of the loan from other funds to get it back within the lending criteria. If other funds are not available, the policy may have to be surrendered for its cash value. This latter option would mean a taxable disposition and tax would need to be paid by the policy owner.

Rates earned on the life insurance cash and loan not connected
The growth of the cash value is independent of the accumulated balance of the loan and the interest rate charged on the loan is negotiated between your client and their lender. The lending institution advancing the loans will monitor the policy's cash value to ensure that it is enough to pay-off the outstanding loan balance, but you should also check to make sure that your client's objectives are still on track. In-force illustrations may be a good tool to monitor this progress.

Lending Considerations*

Insurance policy values are only one consideration in the loan underwriting process. Advisors successful in this market also familiarize themselves with the lending process to help guide and determine if their client is suitable for this strategy.

A full credit application and disclosures will be required by the lender at time of issue, and throughout the loan period. Lenders often ask for corporate financial statements, personal net worth statements and tax returns along with the insurance policy illustration.

General credit worthiness and a balanced approach to financial management are key considerations for the lender. This type of lending, often referred to as asset based lending, is specialized and not available through a bank's retail branch network. Typically, highly qualified lenders have been trained on this type of lending in private banking units.

Eligibility
Eligible borrowers for this strategy include Canadian corporate entities, partnerships, and resident Canadian taxpayers. Lending programs tend to have limits including minimum borrowing amounts and annual loan draw expectations. These loans tend to be for larger amounts and are more complex in nature. Eligible insurance policies for leveraging include universal life and whole life.

* Specific lending practices will differ between providers. The lending requirements and practices of the financial institution may change over time. There are no guarantees the loan terms from the initial arrangement may be the same at the time of renewal/requalification. The commentary in this section is high level and general in nature. Your client should engage their lending professional to get precise details of loans available, terms, and conditions. These guidelines are only to help determine if this concept may be available to your client based on their specific circumstances.

Other Considerations (cont'd)

Loan Type and Interest Options
The types of loans offered may include lines of credit, demand loans, or mortgages. Interest rates typically include floating rate or fixed rate options. Requests to capitalize interest are considered on a case-by-case basis, but lenders prefer the client pay the required interest and if needed, use additional borrowings to fund the costs.

Collateral
With respect to the insurance collateral values, anywhere from 50% to 100% of the policy cash surrender value may be considered depending on type of policy and underlying investment risk.

Insurance policy values build quickly over the premium funding period but may take several years to be enough to cover loan requests made shortly after the policy is issued. Lenders will accept other forms of additional collateral during this period of shortfall. The collateral value of these other assets being pledged differs by type of asset. The list below indicates a typical range of value assigned to various types of assets being pledged in addition to the insurance policy:

- up to 80% on principal residences or cottages
- up to 95% on government or high-quality corporate bonds
- between 50% and 75% on equities
- up to 60% on commercial properties

Credit Philosophy
Beyond the financial analytics used by lenders to determine loan eligibility, borrower traits are also very important. For corporations, lenders may look at the 4 M's:

- **money** – financial analysis (ratios; Current, Quick, DuPont), audited statements by a CPA
- **management** – ownership of the business, succession plans, strengths and weaknesses
- **markets** – industry size, competition/rivalry, power of suppliers/consumers
- **material** – collateral types, business inventory/assets, profitability, turnover ratios

For individuals, lenders may look at the 5 C's:

- **character** – credit history, their personal profile, first impressions
- **capacity** – total debt service ratio (TDSR), income to support debt obligations, ability to pay
- **capital** – what's at stake for your client if their business fails
- **collateral** – what's securing the loan in addition to the insurance policy
- **conditions** – impact of industry or market on your client's business

Lending Analytics
A number of analytics are applied by lenders to determine loan eligibility. Three of the more common tools used are:

1. **Credit Bureau Score** – typically a score of 600 or more is required along with no history of bankruptcy, less than four major derogatory trades listed, and no major derogatory trades listed with respect to a recent mortgage.
2. **Total Debt Service** – this ratio is defined as total monthly debt servicing requirements divided by gross monthly income. This ratio should be approximately 40% or less.
3. **Loan to Tangible Net Worth** – This ratio is defined as the loan balance dividend by total financial investments. A ratio of less than 50% is targeted.

Program pricing
Pricing often varies depending on loan size and typically includes an interest rate, application fee, and review fees.

Whole Life Case Study

Marsha (45): Real Estate Property Manager & Developer

Marsha owns a successful Real Estate Property Management and Development company. The business has significant growth opportunities which will provide excellent returns for many years. She tends to reinvest profits into these opportunities each year. Business income from properties leased out is steady and reliable. Marsha is comfortable with debt as each new project is leveraged.

Marsha realizes that she needs life insurance for estate planning purposes. She can set aside $3,000,000 (spread out over 10 years) but that would prevent her from pursuing other business opportunities. As such, she needs a solution that provides liquidity while preserving capital. She prefers an insurance plan that requires minimal management and strong guarantees.

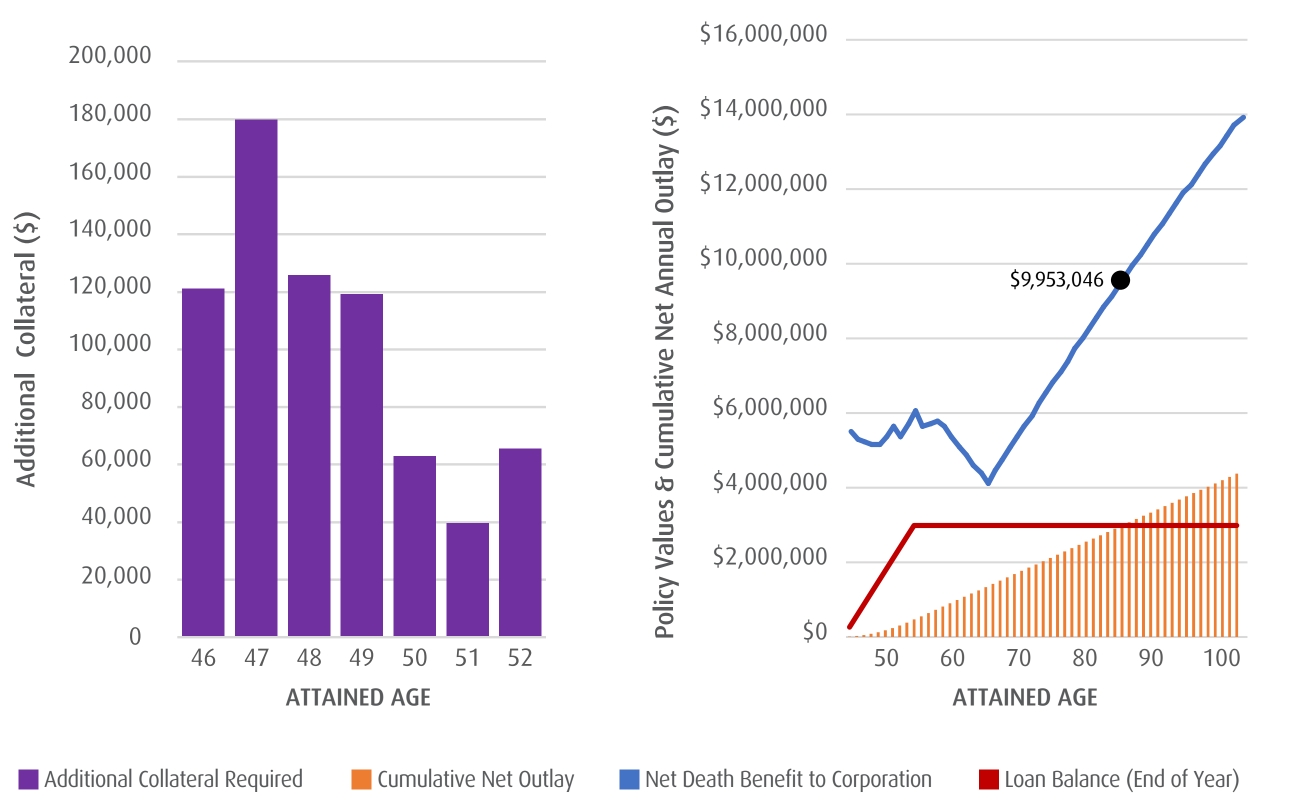
Solution: The Insured Corporate Financing Plan	
Insured	Female 45 Non-Smoker
Coverage Type	Single
Objective	Minimal collateral requirement with competitive estate values by life expectancy.
Assumptions	• BMO Insurance Whole Life Wealth Accelerator • Annual Premium: $300,000 x 10 years • Illustration rate: 4.50% • Loan rate: 5.50%

Whole Life Case Study (cont'd)

The projected results for Marsha are displayed in the table and graph below:

Age	Cumulative Net Outlay*	ICF Net Estate Value	Alternative Investment Net Estate Value**	Insurance Advantage	IRR[4]	ERR[4]
55	$443,472	$6,046,615	$255,822	$5,790,793	59.9%	119.4%
80	$2,498,959	$8,546,886	$1,847,595	$6,699,291	6.9%	13.7%
85	**$2,910,057**	**$9,953,046**	**$2,271,491**	**$7,681,555**	**5.9%**	**11.8%**
90	$3,321,154	$11,323,481	$2,739,350	$8,584,131	5.2%	10.3%

Additional Collateral VS. Policy Values, Cumulative Net Outlay, Loan Balance



* Premiums and interest less tax deductions ** Assuming 100% Fixed Income at 4.00%

[4] IRR: Internal rate of return earned on total death benefit. ERR: Equivalent rate of return required on taxable portfolio.

Whole Life Case Study (cont'd)

The Result:

- Over a period of ten years, Marsha's net cash outlays amounted to only $443,472.
- Marsha was able to pursue both her business opportunities and her insurance needs.
- If Marsha were to pass away at age 85, there would still be $9,953,046 left to her estate (even after the outstanding balance of the loan is paid-off). This results in an IRR of 5.9% or ERR of 11.8%.
- With the alternative investment, Marsha's estate would only realize $2,271,491 after her death. That is $7,681,555 less than the Insured Corporate Financing Plan is projected to provide.
- In addition, Marsha's corporation has an unused CDA balance of $2,125,893 which can be used to flow future profits out to shareholders on a tax-free basis.

Alternative Solution: Financing Interest Cost

If Marsha wanted to reduce the out of pocket cash flow required for the strategy, she may be able to finance the interest costs instead of paying them each year. That reduces the cumulative net outlay but also reduces the net death benefit to the corporation.

The table below displays the impact of financing in this situation and the trade-off between cash outlays and net death benefits:

Age	Cumulative Net Outlay		ICF Net Estate Value	
	Without Financing	With Financing	Without Financing	With Financing
55	$443,472	$361,252	$6,046,515	$6,046,515
80	$2,498,959	$563,064	$8,546,886	$6,660,369
85	**$2,910,057**	**$563,064**	**$9,953,046**	**$7,493,538**
90	$3,321,154	$563,064	$11,323,481	$8,223,793

Note: This example is based on a BMO Insurance Whole Life Wealth Accelerator 20-Pay with maximum Additional Payment Option and are merely a projection of future results, using a set of assumptions that will change over time. Actual results displayed are not guaranteed and will vary. Source: The Wave 45.0.

Frequently Asked Questions

The information contained in this section is general in nature and should not be construed as legal, tax, or lending advice. The comments are provided as discussion points only for your client to review with their professionals advisors including legal and tax experts, as well as lending professionals.

Q 1

When presenting the Insured Corporate Financing Plan, what are some of the risks that should be discussed with your client?

i. Interest rate spread
The spread between the interest credited within the policy versus the interest rate charged on the bank loan is key and should be set conservatively given the long-term nature of the plan. Although the absolute rates of interest on the two products are certain to differ from those illustrated, if the spread doesn't change much, the solution shouldn't be drastically impacted by such changes. Ideally, multiple illustrations should be run to demonstrate to your client the impact of such fluctuations in rates.

ii. Funding risk
If the client doesn't fund the policy as illustrated, the policy may not provide the collateral value to maintain this strategy. In addition, if the policy is not flexible with respect to premium funding, the policy may lapse, and the structure would collapse.

iii. Outliving projection
The possibility (and consequences) of the insured outliving the projected values (i.e. the year the projected loan to CSV ratio exceeds the lender's lending limit in the illustration) could mean that additional security will need to be pledged for the loan or repayments may be required to get back within lending limits This typically happens in later years when a client's ability to come up with additional values or funds is limited. You should always project hitting the maximum loan to cash value ratio several years beyond expected mortality to reduce this risk.

iv. Interest deductibility
The interest expense on borrowed funds may not be deductible or may get so large that insufficient taxable income is available to take advantage of the deduction. Even if income is sufficient to absorb the tax deductions you and your clients should evaluate whether those deductions will still be at the assumed marginal tax rate.

v. Loan availability
The loan arrangement is not finalized until after the insurance policy is funded and in-force. Discussions on terms, conditions, and eligibility for the loan, should be discussed with a lender before committing funds to this plan. Clients need to ensure the loan will be available when they plan to leverage the policy or funds that may be required for other business purposes may no longer be available. In addition, most lenders have minimum loan amounts that must be met before considering a lending program that involves the collateralization of a life insurance policy. So, be sure that the projected annual loan amounts meet the lenders minimum requirements.

It is worth noting that the loan may need to be renewed after a period of time (e.g.: 5, 7, 10 years). In this situation, a full credit application process will start again and will be subject to any new banking conditions and requirements. The previous terms and rates may not be available upon renewal.

Frequently Asked Questions (cont'd)

vi. Tax risks

Clients need to ensure that interest and collateral insurance amounts are deductible in their situation. Future tax rules may change which could impact results projected for this strategy.

vii. Loan default risk

If the client defaults on the loan terms and the bank forces repayment, the insurance policy may need to be surrendered and any tax consequence that arise from that disposition will remain with the client (even though the funds go to the lender).

Q 2

Why would my client use a collateral loan instead of a policy loan?

Policy loans may trigger taxes and are limited to a percentage of the cash surrender value available at the time of borrowing. Collateral loans do not result in taxes when funds are advanced and larger amounts can be borrowed as long as additional collateral is pledged. Having additional collateral does not help with policy loans.

Q 3

How much will the lender advance against the policy values?

Advances are generally limited to a portion of the cash value available. Depending on the type of policy and underlying investment risk, the advances can range from 50% to 100% of the cash value. Lenders tend to accept a maximum loan to cash value ratio of 90% to 100% on whole life policies. For universal life policies, the typical range is 50% to 90% depending on the underlying investment options selected by the client on their UL policy. Fixed income accounts like Guaranteed Interest Accounts, BMO Insurance's Guaranteed Market Indexed Account (GMIA) or Enhanced Market Index Account (EMIA) tend to be at the higher end of the range whereas equity linked investment accounts would be at the lower end of the range. *Note: the lender will determine the loan to cash value ratio for each specific case and is not bound by the examples suggested in this response.*

Q 4

How does the lender determine the credit limit for the loan?

The credit limit on the loan typically reflects the clients requested advances over the next three to five years. If the client needed $300,000 per year for five years, the credit limit may be set at $1,500,000. The $1,500,000 lending limit is what would typically be compared to the lender's minimum requirements to determine if they would participate in the arrangement. Lenders may also have minimum annual draw amounts. For example, they may want the borrower to draw at least $300,000 annually against the loan facility for several years instead of drawing larger amounts in later years to meet the facility minimum.

Q 5

Is it safe to assume that the lender will allow the client to capitalize the loan interest?

Many lenders are moving away from capitalization of interest on their credit facilities as it may impact their ability to recognize income on the loans. Instead, they prefer that clients either pay the interest each year or borrow additional amounts to cover interest costs each year. Clients seeking capitalization should discuss this option during the negotiations of their loan terms to see if it would be available in their situation.

Q 6

What happens if the client's income fluctuates from year-to-year and decreases in retirement?

This strategy assumes there is enough taxable income each year to absorb the tax deductions projected and that the tax rate is as assumed. If income is not sufficient to absorb these deductions the required cash flows to maintain the program will increase. If the clients marginal tax rate decreases from that assumed in the illustration, the tax deductions won't generate the amount of savings projected. This would again increase the cash flow required to maintain the plan.

Let’s connect

To find out more about BMO Insurance products, please call your MGA, contact the BMO Insurance regional sales office in your area or call 1-877-742-5244.

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