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# Life Insurance

# FINANCIAL UNDERWRITING

**For agent use only.**

Product availability, rates and features vary by state.



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# Financial Underwriting Guidelines for Life Insurance

Every application for individually underwritten life insurance includes an income factor being used to prevent or reduce speculation. This is often based on earned income, but can be adjusted on a case-by-case basis by other particulars of an individual's situation. Examples (for life insurance) could include total net worth, estate tax consequences, age and medical history. The need for financial underwriting becomes more important with larger face amounts, and for business cases. Providing financial information with the application helps to qualify the amount of risk more quickly.

In many situations, the untimely death of an individual will create a financial loss. The purpose of financial underwriting is to determine whether the amount of coverage applied for and already in force bears a reasonable relationship to this loss.

Basic financial underwriting is concerned with:

- Establishing a valid insurable interest
- Relating insurance to demonstrable needs
- Ensuring a reasonable level of persistency.

The maximum guideline formula for each life insurance application includes the total amount in force plus the applied for amount with all companies, excluding group insurance, Acci-Flex Accident and Simplified Whole Life.

If the premium amount is 5 percent or greater than the gross family income, additional questions may be asked by the underwriter.

Insurable interest exists in life insurance when the beneficiary (the person who receives the proceeds of an insurance policy) will suffer a real financial loss at the death of the insured person. Insurable interest must be present at the time of application. If legitimate insurable interest does not exist at the time of application, the contract is not valid. If the insured is the owner of the policy, they can legally name any person or organization as the beneficiary of the policy.

Alternative ownership arrangements that are valid examples of insurable interest include the following:

- Business partners own policies on each other as part of a buy-sell arrangement for the business
- A corporation owns a policy on a key employee
- A trust owns a policy on the life of a person who owns the trust for tax purposes
- The parent of a juvenile child
- A fiancé if the wedding is within 6 months; otherwise insurable interest is required

There are other acceptable arrangements which we may allow with proper justification.

**NOTE:** The state of California prohibits an employer from owning life insurance on an insured where the employer is the beneficiary.

## Financial Underwriting Guidelines (continued)

The following general purposes (not all-inclusive) for life insurance will be discussed in more detail. A common understanding of each application by sales representatives and underwriters will help ensure a smoother processing of the application and should improve time service to clients.

- Income replacement
- Insurance on those of older ages
- Juvenile insurance
  - Grandparent gifts
- Charitable giving
- Deferred compensation/split
- Buy/Sell
- Key person
- Business loan

Questions on any application may be directed to the Assurity Contact Center at (800) 276-7619, ext. 4264.

# Income Replacement

Guidelines			Routine Requirements
	Earned	Unearned	<p>Always needed: Gross annual earned income on the application.</p> <p>For cases of \$250,001 or more: Telephone inspection will be requested, except on the NonMed Term 350 product.</p> <p>Third party financials (such as CPA) will be required for applications of \$2 million or greater.</p>
• Adults to age 30	Up to 30 X earned income	X3	
• 30 through 39	Up to 25 X earned income	X3	
• 40 through 49	Up to 20 X earned income	X3	
• 50 through 59	Up to 15 X earned income	X3	
• 60 through 64	Five to 10 X earned income	X3	
• 65+	Three to five X earned income	X3	
<p>The total in force with all companies should not exceed an applicant's annual earned income times the multiple for age or current net worth, whichever is greater.</p> <p>A home maker/spouse would qualify for a face amount of \$250,000 without question. For amounts above \$250,000, we will use half of husband's income times multiple for age, or half of net worth - whichever is greater.</p> <p>Additional consideration for an amount greater than the guideline may be requested on an exception basis. Additional financial information will be requested by the underwriter and must be received prior to the medical requirements being scheduled.</p>			

Income replacement coverage establishes security against loss by providing funds to repay personal debt and continue income. In effect, the goal is to determine an amount, which maintains the previous lifestyle. This amount is referred to as the Human Life Value. This value is calculated via a multiple of income. Income in this context would include salaries, wages and bonuses.

A home maker/spouse would qualify for a face amount of \$250,000 without question. For amounts above \$250,000, we will use half of husband's income times multiple for age, or half of net worth - whichever is greater. Income replacement and estate conservation needs may be considered concurrently. This primary focus is income, augmented by net worth when indicated.

Underwriting may evaluate applications in excess of these limits. Individuals with high net worth, potential estate taxes based on a financial advisors evaluation, and a Cover Letter from the sales representative providing specific information on why the guidelines should be exceeded will be required. Copies of the most recent tax return with all schedules, a balance sheet, and schedule of assets and liabilities should be included. Inspection reports may be obtained at any time, and are required on some larger amounts. (Prepare your clients for providing such information.) Premiums greater than 5 percent of the gross family income may require additional clarification.

# Older Age Coverages

(Retirees or post-age 70)

Guidelines	Routine Requirements
<p>Half of net worth or three to five times earned income.</p> <p>For instances where federal exemptions eliminate estate tax liability, the following formula may be used:</p> <p><i>Total line= [earned income plus retirement Social Security] x 5, plus 15% to 20% of net worth.</i></p>	<p>Always needed: Gross annual earned income on the application.</p> <p>For cases of \$250,001 or more: Telephone inspection will be requested, except on the NonMed Term 350 product.</p> <p>Third party financials (such as CPA) will be required for applications of \$2 million or greater.</p>

At the older ages, the value of the gross estate will generally be the dominant factor in determining an acceptable total line. Half of net worth or three to five times earned income is used depending on age and medical history.

Life insurance applied for by children on dependent elderly parents will not be accepted. When an elderly parent is financially dependent, even small amounts of coverage present justification problems, since the burden of the financial dependence terminates upon death. For elderly parents not dependent, there must be insurable interest to consider the application. If insurable interest is documented the parent/parents must apply as owner(s).

The three-year contemplation of death rule requires the estate of an insured-owner that transfers existing life insurance within three years of the decedent's date of death to include the insurance proceeds as part of the taxable estate.

To avoid the contemplation of death rule:

- Create a trust to own the life insurance policy before taking the application. The Trustee signs as the owner.
- If it is not possible to create the trust before taking the application, you can help the proposed insured's tax advisor by referring to PLR 9323002 for explanation. And process as listed below:
  1. Take the application COD.
  2. Create the trust before the insurance company issues the policy.
  3. Submit a Supplementary Application making the trust as owner. The original policy will be closed out and a new policy number assigned.
  4. Pay the premiums and the policy is then placed in force.
  5. Because the coverage was not in force before the trust became the owner, there was no ownership transfer.

**Note:** If you collect premiums with an application before creating the trust, notify the proposed insured's tax adviser that the three year rule may apply.

## Juvenile Insurance

Guidelines	Routine Requirements
<p>\$100,000 is the maximum amount that will be offered without financial questions.</p> <p>Can offer \$100,001 or more if one parent (or the person who is financially and/or legally responsible for the child) has two times the amount of insurance in force on themselves.</p> <p>All siblings should apply for equal amounts or already have equal amounts in force.</p>	<p>If up to age 16 or younger, complete the Juvenile Insurance Application to Assurity Life.</p> <p>If over age 16, complete the application for life insurance.</p>

If the parents are insurable, they should be adequately insured before applying for life insurance on a dependent child.

Do not complete an application on a juvenile not yet 15 days of age. (This does not apply to a Children's Rider.) Mortality is highest during this initial period of life. If completed before 15 days, we immediately return the application and any premium to the Applicant, even if the 15 days elapsed. A new application with up-to-date responses will be required.

Infants born prematurely (two weeks or more before due date) are not considered for insurance until six months of age because of the extra mortality involved. Depending on birth weight or congenital defects, consideration for insurance could be postponed until one year of age or longer. If in doubt, submit the application as COD.

Applications for insurance in equal amounts, which can include the same face amounts and/or the same premiums, need to be submitted at the same time for all siblings under age 16; Unless an equal amount of life insurance is already in force with us or another company. This helps to avoid anti-selection.

The parent(s) or person(s) financially and legally responsible for a juvenile must carry at least two times the amount of insurance on the child. This is to help avoid speculation and anti-selection. We consider well-documented exceptions.

Parents are generally the only persons eligible to purchase life insurance on their child. Other persons can apply, however, the parent with whom the child permanently resides must sign the application and the medical authorization on the "signature of parent or guardian" line. This signature shows acceptance of the insurance and certifies the child's current health status.

If an Applicant does not have an insurable interest in the child's life, he/she cannot be Policyowner or Beneficiary, however, we would allow he/she to be the premium payor. (Aunts and uncles do not ordinarily have an insurable interest in the life of a niece or nephew. Grandparents do have an insurable interest.)

# Grandparent Gifts

A Grandparent can be an applicant, policyowner and premium payor for an application on a juvenile provided a parent is the beneficiary and signs the application and medical authorization. This can leave the grandparent's estate with a gift tax problem.

- A gift is made when a grandparent pays a premium on a policy owned by someone else. As long as the premium is no more than \$12,000, it comes within the annual gift tax exclusion. If both grandparents join in the gift, \$24,000 can be given annually to any one person without a gift tax. For most cases, a \$12,000 exclusion is adequate, since the amount of coverage that can be written on a child is limited.
- Through gifting, the grandparents reduce their taxable estates and remove future growth on those assets from estate tax. They also reduce probate costs by removing assets from the probate estate. They can also create a life insurance trust and accomplish the same objectives.
- If the grandparent retains ownership, a subsequent policyowner should be named to lessen probate costs.
- If a grandparent is concerned about reducing the size of the estate, ownership should be placed with some other party, like their own child (the father or mother of the grandchild).
- The policy should pass by contract rather than by will or intestate succession.
- Another possibility is to pass ownership to the child.

**NOTE:** We discourage ownership of a contract by a child who is under the age of majority. While some states permit contracts with minors, we reserve the right to refuse ownership by juveniles.



## Charitable Giving

Guidelines	Routine Requirements
Annual contribution x 10 equals charitable amount of life coverage. (Does not include charitable remainder trusts.)	Always needed: Gross annual earned income on the application.  Cover letter and copy of contribution record for past two years.  For cases of \$250,001 or more: Telephone inspection will be requested, except on the NonMed Term 350 product.  Third party financials (such as CPA) will be required for applications of \$2 million or greater.

The use of life insurance in charitable giving is most often simply an attempt to provide an uninterrupted continuation of an existing pattern of giving. The pattern of giving will typically be defined monetarily, but donations of time and services will be evaluated also.

### Favorable Factors

The proposed insured has an established pattern of giving; a long-standing volunteer relationship, or has personally benefited from the organization's services.

Personal life coverage is already in force for income replacement and/or estate needs, and the intended charitable amount is in line with the proposed insured's income and net worth.

The proposed insured pays the premium and is the owner (unless state regulations require otherwise).

### Unfavorable Factors

There is no pattern of giving or long-standing relationship.

Personal in-force coverage is minimal.

The charitable organization is paying all premiums, initiating applications selectively, and/or is insisting on ownership (even though not required by state regulation).

The amount allowed is an approximation of an amount equal to or less than the anticipated remaining lifetime contributions. The multiple is 10 times the average annual contribution unless more specific justification is available, i.e., charitable remainder trusts.

## Deferred Compensation/Split Dollar

Guidelines	Routine Requirements
The amount must be justified for the deferred compensation and/or the reverse split dollar program	<p>Always needed: Gross annual earned income on the application.</p> <p>If age 70 and total amount applied for is between \$300,000 and \$1,999,999, a Financial Questionnaire will be requested.</p> <p>For cases \$250,001 or more: Business beneficiary inspection report will be requested.</p> <p>Third-party financials (such as CPA) will be required for all applications of \$2 million or greater.</p>

These arrangements are used when someone with the need for life insurance and someone else with the ability to pay premiums agree to purchase insurance and share in the proceeds. Each plan is custom-tailored and is not limited to any particular business relationship. An employer/employee relationship is the most common with the employer paying the premium.

It is always important to integrate possible purposes to avoid situations where the same loss is covered more than once, i.e., personal income replacement versus deferred compensation coverage, charitable remainder trust versus overall estate protection.

## Business Related Insurance

Life Insurance is often used in well-defined business contexts to alleviate the financial strain caused by the unexpected death of an owner or key employee. The purpose is not to enhance the financial position of the organization but to maintain the same financial position that existed prior to the loss. Accidental death benefit is rarely appropriate in business coverages.

## Business Loan Insurance

Guidelines	Routine Requirements
<p>Collateralized and Non-collateralized - Not to exceed 75 percent of loan amount.</p> <p>Mortgage – Up to 100 percent of mortgage balance.</p>	<p>Always needed: Gross annual earned income on the application.</p> <p>Copy of loan agreement.</p> <p>Business Financial Questionnaire.</p> <p>For cases \$250,001 or more: Business beneficiary inspection report will be requested.</p>

This is debt coverage in a business environment. It is the company's ability to repay the loan and the emerging equity in the purchased asset that allows assumption of the risk at the time the loan is extended. It is important to document any existing amount of business coverage, since this coverage may also be available for collateral assignment.

## Business Loan Insurance (continued)

Mortgage insurance is usually acceptable for amounts up to 100 percent of the mortgage balance.

Collateralized and non-collateralized loans may be considered with the insured maximum range of 75 percent of the loan amount with a five year minimum repayment period.

The underwriter would evaluate the loan amount, the duration of the loan, the source of the loan and the interest rate on the loan. Loans originating from non-mainstream lenders should be avoided.

## Buy-Sell Coverage

Buy/sell partnership, stock purchase, stock redemption, entity purchase, cross-purchase

Guidelines	Routine Requirements
<p>Percentage of ownership times corporate value and/or five to 10 times average net earnings for past two years.</p> <p>To determine market value, we will use capitalization of net income.</p> <p>Capitalization is from two to 10 times, depending on the proven record of the business.</p>	<p>Always needed: Gross annual earned income on the application.</p> <p>For cases \$250,001 or more: Business beneficiary inspection report will be requested.</p> <p>Third-party financials (such as CPA) will be required for all applications \$2 million or greater. These papers should include a current balance sheet and income statement.</p> <p>Underwriter may also request a copy of the Buy/Sell agreement. Some cases may require business and/or personal tax returns.</p> <p><b>Note:</b> Any other type of financial information can be requested at the underwriter's discretion.</p>

Buy/Sell partnership, stock purchase, stock redemption, entity purchase and cross-purchase all describe coverages sought to preserve existing assets from forced liquidation upon the unexpected or untimely death of a business owner or other business associate.

Buy/Sell agreements fall into two categories: cross purchase, and entity. Cross purchase allows individual owners to purchase insurance coverage on other owners. An entity agreement allows the business to purchase and own all coverages.

A Buy/Sell agreement details the specifics of the agreement between the business associates involved. Two major considerations for a Buy/Sell agreement are the identification of major principles in the business, and their respective ownership positions; and a determination of the market value of the business. Partners or owners are considered for insurance in proportion to their percentage of ownership in the business. In some sales, it may be advisable to provide underwriting with a copy of the Buy-Sell agreement.

## Key-Person Insurance

Guidelines	Requirements
<p>Multiples of earned income of the proposed insured from the business.</p> <ul style="list-style-type: none"> <li>To age 50, an income factor of 10 times income is suggested.</li> <li>Above age 50, an income factor of five times income is suggested.</li> <li>An established time with the company, unless it can be documented that the proposed individual brings "so much to the table" that profitable business continuation would be dependent on this individual.</li> <li>One or two employees requested key-person coverage on their employer/owner (who wants the employees to run the business after the owner's death) involve speculation, and should not be submitted. If a purchase agreement between the parties exists (see Buy-Sell), consideration may be given.</li> </ul>	<p>Always needed: Gross annual earned income on the application.</p> <p>Business Financial Questionnaire is required.</p> <p>Inspection report will be requested for all applications \$1 million or greater.</p> <p>For cases \$250,001 or more: Business beneficiary inspection report will be requested.</p> <p>Note: any other type of financial info can be requested at Underwriter's discretion.</p>

Business situations exist where the individual(s) in a business have a worth to that organization that helps ensure continued profitability. The purpose of key-person coverage is to insure against the loss of the individual's expertise, skills, revenue-producing abilities, and the integrity and reputation they may bring to the business. In the event of the death of this person, future earnings of the business may be at risk. Also impacted are investments, credit, and the "good-will" of the business. The cost for the business to replace an individual can require an extensive and time-consuming search, often with the expenditure a great deal of resources.

In the case of a new company, occasionally an estimate can be made of the value of the key person's relative contribution in organizing the business, securing financing and planning future operations. In many instances, however, the underwriter must depend on considerations of the individual's background and experience, as well as the economic track record. Since a significant percentage of new businesses fail in the first few years of operation, key person underwriting should be more conservative for new enterprises.

Factors evaluated for key-person coverage include:

- Analysis of an individual's and the company's track records
- The ability of the key-person to secure needed financing for the business
- Special skills or talents in the individual's occupation
- Examination of the financial position of the business
- The age of the proposed insured, and the number of years of employment remaining. Key-person insurance becomes speculative over the age of 60 since most organizations will have a successor plan in place by this time.

# Sources of Financial Information

Detailed information regarding the need and purpose of coverage may be requested by the underwriter along with any of the following requirements.

- Income is always needed on the application
- The agent's cover letter
- Inspection reports and business beneficiary inspection reports
- Personal and/or Business Financial Questionnaire
- Personal financial statements detailing a breakdown of personal assets, liabilities, and worth plus income information
- If the premium is greater than 5 percent of the gross family income, we may request an inspection report with additional clarification questionnaire
- Business financial statements including balance sheet, income statement and accompanying notes.
- Copy of most recent W-2
- Agreements or contracts including buy-sell agreements, estate analysis calculations, trust agreements, loan instruments or similar documentation
- Individual, Corporate or Subchapter S corporate returns with their various schedules:
  - Sole proprietorship income—Detailed under Schedule C
  - Partnership—Partner's income detailed under Schedule K
  - Corporate—Schedule E details owner's compensation and ownership
  - Subchapter S corp.—Ownership and income Schedule K-1

## About Assurity

Assurity Life Insurance Company's origins are rooted in a century-long legacy of providing long-term security to policyholders that has earned generations of customers' confidence and trust.

Assurity Life serves customers across the nation, offering disability income, critical illness, accident, long-term care and life insurance, annuities and specialty insurance plans through our representatives, worksite distribution and direct mail.

With assets exceeding \$2 billion, Assurity Life has built a reputation for "best in class" service and sound, conservative business practices with a disciplined approach to financial management. Headquartered in Lincoln, Neb., Assurity Life has earned a high rating from A.M. Best Company, one of the insurance industry's leading independent analysts. For more information about this rating, please visit [www.ambest.com](http://www.ambest.com) or [www.assurity.com](http://www.assurity.com).

We're proud of our history of integrity, financial accountability...and helping people through difficult times.

## Revisions to this Guide

Date	Page	Update
3/26/2010	3	Added the last bullet to the "Alternative ownership arrangements" section