Replacement Questionnaire (RQ)*

A Policy Replacement Evaluation Form

Replacing an existing life insurance policy with a new one generally is not in the policyholder's best interest. New sales loads and other expenses, the new company's right to challenge a death claim during the suicide and contestability periods, changes in age or health and the loss of important grandfathered rights are some of the obvious reasons that **most replacements cannot be justified.** On the other hand, there may be circumstances where a replacement is in your client's best interest. The ethical agent will provide his or her client with the impartial information needed to make an informed decision, including reasons the client should not replace the current policy and/or how to modify the existing policy to accomplish their goals. The need for additional coverage is not, by itself, a justification for replacement.

This Form is designed to assist you in evaluating some of the facts and circumstances that a policyholder should take into consideration when addressing the possibility of replacing a life insurance policy. It can be used for both internal and external replacements. **The definition of "replacement" is much broader than the cancellation of one policy and the issuance of another.** The legal meaning of the word "replacement" is determined by state law and varies substantially by state. You should be familiar with your own state's definition of the word. However, for purposes of simplifying the definition, we may think of "replacement" in general terms as an action which eliminates the original policy or diminishes its benefits or values. Examples of this are policy loans, taking reduced paid-up insurance or withdrawing dividends. Since no form can cover every possible situation, you may need additional material to enable your client to make a truly informed decision.

Please note that "illustrated" results in this Form are always non-guaranteed. Also, keep in mind that different companies use different assumptions in preparing illustrations and that illustrations alone should never be used to compare policies. However, current in-force illustrations for the existing policy and current illustrations for the proposed policy must be provided to the client, showing the effects of applicable surrender charges. In situations where the current policy will be changed, but not terminated, comparisons should include in-force ledgers of the policy before and after the change, if available. Reduced scale illustrations (or illustrations with lower yield assumptions) should be provided on both existing and proposed policies to demonstrate volatility in the performance of non-guaranteed policy elements under different circumstances. The reduced scale illustrations should be consistent with those required by the NAIC model illustration regulations, when effective.

This Form is intended for evaluation purposes. It is not a substitute for state replacement requirements. This Form is not specifically designed for direct use with clients. Further, if either the existing or proposed policy is variable life insurance, use of this Form with the client must be approved by the registered representative's broker-dealer.

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* Adapted from the Replacement Questionnaire, developed and published by the Society of Financial Service Professional in 1992. It is reproduced here with permission.

Replacement Questionnaire (RQ)

A Policy Replacement Evaluation Form

A. 1. What does the policyholder want to achieve that the existing policy cannot provide?

____

____

____

2. Has the current carrier been contacted to see if the policy can be modified to meet the policyholder's objectives?

____

B. 1. Recognizing that the replacement of an existing policy generally results in the reduction of cash surrender value as a result of new acquisition costs, what is the cash surrender value of:

a. The original policy **immediately** before replacement ________________________
b. The original policy **immediately** after the replacement ______________________
c. The proposed policy **immediately** after the replacement _____________________

These cash surrender values should be obtained directly from the insurance carrier's policy owner service department and not from an illustration, since illustrations typically reflect end of year values.

2. Illustrations should **never** be the sole criteria for evaluating a replacement. Additionally, Illustrated Cash Values and Illustrated Death Benefits are **never** reliable predictions of future results. If these non-guaranteed values and benefits are the basis for considering a replacement, the agent should attempt to know and understand the underlying assumptions in both the inforce illustration for the current policy, as well as the sales illustration for the proposed policy. In addition to reviewing illustrations, the agent should attempt to obtain an Illustration Questionnaire (IQ), which may be available directly from the companies or may be requested through the client. The agent and the client should be aware that there may be differences in the assumptions used by each company which may render a comparison based upon such illustrations invalid.

How many years from now before the proposed policy's cash surrender values and death benefits exceed those benefits in the current policy?

a. Guaranteed Cash Surrender Values ______ years and subsequent.
b. Guaranteed Death Benefits ______ years and subsequent.
c. Illustrated Cash Surrender Values ______ years and subsequent.
d. Illustrated Death Benefits ______ years and subsequent.

3. If the proposed policy is a variable life policy, what gross yield rate is being assumed? ________%

   What is your justification for that rate? ____

C. 1. Describe the differences in the plans of insurance. __________________________________

   ____

2. Describe any term riders or term elements (above the base policy). Include the ratio of the initial term amount to the total death benefit and any term rate guarantees which may or may not be included.

   Current policy: ____

   Proposed policy:

   ____

3. Other than term riders, what riders do the policies include?

   Current policy: ____

   Proposed policy: ____

4. How long is the initial death benefit **guaranteed** to be in force at the **illustrated** premium?

   Current policy: ______ years. Proposed policy: ______ years.

5. What premium is necessary to **guarantee** coverage at initial/current levels for life?

   Current policy: $__________. Proposed policy: $__________.

D. 1. Is there a potential taxable gain if the current policy is replaced?

   ❑ YES ❑ NO If yes, how is it to be managed?

   ____

2. If there is a taxable gain, **and if there is a loan,** how is the loan to be managed?

   ❑ The new policy will assume the existing loan.

   ❑ The loan will be repaid.

   ❑ The policy owner will recognize taxable income.

E. Is an IRC Sec. 1035 exchange planned to preserve basis? ❑ YES ❑ NO

F. If a replacement is under consideration because a more favorable rate classification is available, has a reduction or removal of the rating on the existing policy been requested? If so, what was the result. If not, explain why such a request has not been made.

   ____

G. Does the proposed policy qualify as life insurance under IRC Section 7702?
❑ YES ❑ NO

H. What is the issue date of the current policy? ________________________

The following "grandfathered" features will be lost if the policy is replaced.
(See Appendix for explanation of items 3-9.)

1. The current policy is incontestable by the insurance company. ❑ YES ❑ NO
2. The period has expired during which the insurance company can deny policy benefits in the event of the insured's suicide. ❑ YES ❑ NO

The current *life insurance policy* was issued on or before:	YES	NO	The current *annuity policy* was issued before:	YES	NO	The current *second to die policy* was issued before:	YES	NO
3. 8/06/63	❑	❑	6. 10/21/79	❑	❑	9. 9/14/89	❑	❑
4. 6/20/86	❑	❑	7. 8/14/82	❑	❑			
5. 6/20/88	❑	❑	8. 2/28/86	❑	❑			

I. If the current policy is term, is a conversion to permanent insurance available?
❑ YES ❑ NO

If so, other than the suicide and incontestable provisions would a conversion to permanent insurance be more advantageous?

❑ YES ❑ NO Explanation: ____

____

J. Financial Strength Ratings. Much has been made of ratings in the last few years; financial strength is important, but it is not the sole determining factor in selecting a life insurance company. A drop in ratings alone generally is not a sufficient reason to replace a policy. It is also important to know that there can be differences of opinion among rating agencies and that small differences in ratings generally are not significant. Furthermore, financial strength ratings are not necessarily indicative of policy performance. If reviewed with the client, a detailed explanation of the ratings must be provided in accordance with state regulations.

	Current Company Rating (Rank)*	Proposed Company Rating (Rank)	Date & Source of Answer
A. M. Best (15 ranks)	______	______	______
Fitch (18 ranks)	______	______	______
Moody's (19 ranks)	______	______	______
S&P (18 ranks)	______	______	______

* For example, an AA rating from S & P is the third highest **rank** out of 18 possible ratings.

COMDEX Rating (composite): ______________

"COMDEX" – a fee-based service accessed by many agents and brokers - creates a composite index from the various financial strength ratings an insurance company has currently received. COMDEX is not itself a rating or financial strength judgment, merely an aggregator of rating data that provides a clearer, relative picture of financial strength.

The COMDEX " ... gives the company's standing, on a scale of 1 to 100, in relation to other companies that have been rated by the services. It is an objective value based solely on the mathematical distribution of all of the companies that have been rated."

K. Policy loans:	Current Policy	Proposed Policy
1. Gross rate	______	______
2. Fixed or Variable?	______	______
3. Permanent policies: Direct Recognition?	______	______
4. Universal life, etc. a. Current spread?	______	______
b. Is spread guaranteed?	❑ YES ❑ NO	❑ YES ❑ NO

L. Additional remarks:

____

____

____

____

Appendix
Grandfathered Features Explanation
(See question H.)

3. The current policy was purchased on or before 8/6/63, so IRC Section 264(a)(3) which limits deductions for interest indebtedness does not apply. If the current policy has met the "four out of seven" test of IRC Section 264(c)(1), interest on indebtedness is deductible to the extent otherwise allowed by law. Personal interest deductions are generally denied for tax years beginning after 1990, irrespective of when the policy was purchased. IRC Sec. 163(h)(1).

4. The current policy was purchased on or before June 20, 1986. Certain policies purchased for business purposes after this date have a $50,000 ceiling on the aggregate amount of indebtedness for which an interest deduction is allowed. IRC Sec. 264(a)(4).

5. Policy was issued on or before 6/20/88 and is not subject to Modified Endowment Contract rules. IRC Sec. 7702A. Substantial increases in the death benefits of grandfathered contracts after 10/20/88 may cause the imposition of the MEC rules. H.R. Conf. Rep. No. 1104, 100th Cong., 2d Sess. (TAMRA '88) reprinted in 1988-3 CB 595 - 596.

6. Variable annuity contracts purchased before 10/21/79 are eligible for a step-up in basis if the owner dies before the annuity starting date. IRC Sec. 72; Rev. Rul. 79-335, 1979-2 CB 292.

7. An annuity issued prior to 8/14/82 is subject to more favorable (basis out first) cost recovery rules for withdrawals. IRC Sec. 72(e). Such policies are not subject to the 10% penalty on withdrawals made prior to age 59 1/2. IRC Sec. 72(q)(2).

8. To the extent contributions are made after 2/28/86 to a deferred annuity held by a non-natural person (such as a business entity), the contract will not be entitled to tax treatment as an annuity. IRC Sec. 72(u).

9. A survivorship life policy issued prior to 9/14/89 is not subject to the 7-pay MEC test if there is a reduction in benefits. IRC Sec. 7702A(c)(6).

This Appendix is provided for educational purposes only.
You should seek competent legal counsel before
applying this to any specific situation.