

# LIFE INSURANCE AUDIT<sup>SM</sup>

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EVALUATING THE LIFE INSURANCE FOR  
JOHN M. SMITH

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PREPARED BY  
THE AUDIT AGENT

MARCH, 2004

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## PURPOSE

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Life insurance is a financial instrument owned by most individuals, businesses, and estate plans. It is often one of the top assets within a financial statement yet it is seldom evaluated, appraised or assessed in a comprehensive manner – that needs to change. Statistics compiled after having performed several thousand audits demonstrate that nearly 70% of all life insurance policies can be significantly improved. Ash Brokerage's mission is to provide consumers an objective evaluation of the life insurance they own. It is with that mission in mind, Ash Brokerage works with a select group of insurance professionals across the United States. We assess the current coverage and, when appropriate, recommend alternative solutions for all that depend on life insurance to be there for their families, businesses or charities.

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## WHY ASSESS LIFE INSURANCE?

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In every industry change is constant and the life insurance industry is no exception. The insurance industry has seen changes in the way life insurance is designed, priced and medically underwritten. Having an objective third-party assess the performance of life insurance is no different than having real estate appraised or an investment plan's asset allocation reviewed. Life insurance must be treated as a critical component of an overall financial plan and given the attention it deserves. Life Insurance is intended to protect the well-being of families, charities and businesses – the Life Insurance Audit<sup>sm</sup> makes certain that it does.

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## WHAT HAS CHANGED?

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- Life Expectancies have changed. Medical advances have lengthened people's lives and insurance companies have implemented pricing and underwriting standards to reflect these improvements. Insurance companies are now offering favorable underwriting classifications for individuals with heart disease, cancer, diabetes or other medical histories. These same medical histories ten years ago may have been deemed uninsurable or highly rated. Today, many are considered standard risks.

- Interest and dividend crediting rates have changed. Economic trends have forced the insurance companies to lower their crediting rates over the last ten years. These crediting rates are directly tied to the overall rate of return experienced within the insurance company's investment portfolio. Due to today's low interest rate environment, many policies issued prior to 2000 are not performing as originally intended.
- Market conditions have changed. Fluctuations in the stock market have impacted every aspect of the financial services marketplace, including Life insurance. Many customers purchased Variable Universal Life policies in the 1990s that are at risk of failing due to these fluctuations.
- Industry structure has changed. Life insurance companies have undergone widespread changes in corporate structure, including mergers, acquisitions and demutualizations. Many times policyholders are not aware of the impact of these corporate changes. Historically, many of these changes have resulted in negative implications to policy holders.
- Planning goals may have changed. Evaluation of current goals and needs is an essential part of the life insurance audit process.

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## **WHO CONDUCTS THE AUDIT?**

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The Audit Agent has been certified to facilitate and present the Life Insurance Audit<sup>sm</sup>. Certification is granted by Ash Brokerage Corporation who performs life insurance audits on a national scale and has been assessing life insurance since 1971. Ash Brokerage Corporation understands how to comprehensively evaluate life insurance. The Ash Brokerage team has expertise in reviewing life insurance companies, in force ledgers, policy design and, most importantly, the underwriting and cost of insurance assessment process. These characteristics put Ash Brokerage Corporation in the unique position to objectively evaluate any life insurance policy.

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## WHAT IS INCLUDED IN THE AUDIT?

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- A client and policy summary.
- A review of the structure of the policy, ownership, beneficiaries, payment methods, relative to the client objectives.
- A re-evaluation of the underwriting rate class.
- An assessment of possible rate class improvements.
- An evaluation of the effect of changes in interest rates/sub-account performance, increase in cost of insurance, or any combination of these.
- An evaluation of the financial stability of the insurance company.
- An objective evaluation on whether there is a more cost effective and reliable way to provide the results the client expects. This is intended to ensure that the client's current and future objectives are being met.

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**CLIENT & POLICY SUMMARY**

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**John Smith (10-10-1929)**

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**Current Insurance Company: Pacific Life**

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**Product: Universal Life**

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**Death Benefit: \$1,000,000**

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**Current Annual Premium: \$30,000**

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**Policy Date: 6-17-1990**

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**Policy Owner: Smith Family ILIT  
James Fiduciary, Trustee  
1<sup>st</sup> National Bank**

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**Objective: Estate Liquidity**

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**Audit Objective: Evaluate Performance and Possible  
Alternatives**

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## POLICY OWNERSHIP, FUNDING AND BENEFICIARY REVIEW

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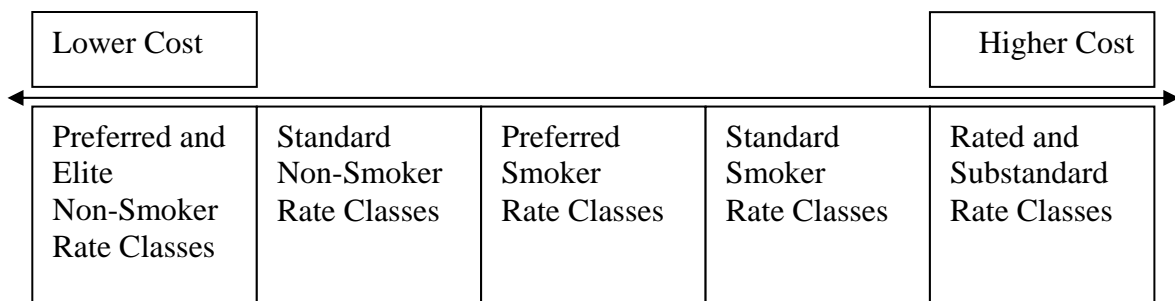
- This policy is currently owned by the Smith Family Trust, 1990. James Fiduciary of 1<sup>st</sup> National Bank serves as the trustee.
- The Smith Family Trust is the listed beneficiary.
- John Smith gifts \$30,000 annually to the Smith Family Trust in order to fund the policy.
- Mr. Smith's legal and tax counsel should assist in reviewing these arrangements.

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## UNDERWRITING RATE CLASS REVIEW

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- The 1990 Pacific Life policy indicates that John Smith was issued in a non-smoker mortality classification.
- An extensive evaluation of the medical underwriting elements was conducted. Based on the medical information provided, a few select insurance companies are likely to offer John Smith a preferred non-smoker rate class.
- Medical testing will be required to validate rate classification.
- It is important to note that a reduction in policy cost is to be expected if John Smith were to obtain a preferred non-smoker rate class. See the figure below for a general idea of the relationship between an underwriting rate class and policy costs.



## POLICY PERFORMANCE ASSESSMENT

This portion of the audit focuses on the current and future performance of the existing policy. Interest rates, cost of insurance, premium level, projected and guaranteed assumptions are assessed.

### Pacific Life In-Force Ledger

- ① The current net death benefit is \$1,000,000.
- ② The annual premium is \$30,000.
- ③ The year end projected surrender value is \$284,823.
- ④ At the current funding level, current cost of insurance charges and current interest crediting rate, this policy is projected to remain in-force to age 92.
- ⑤ At the current funding level, maximum cost of insurance charges and minimum interest crediting rate, this policy is projected to remain in-force to age 82.

Non-Guaranteed Assumptions				
Policy Year	Premium Outlay Annualized	Net Policy Value	Net Surrender Value	Net Death Benefit
13	0.00	284,823	284,823	1,000,000
14	② 30,000.00	305,466	305,466	① 1,000,000
15	30,000.00	325,105	③ 325,105	1,000,000
16	30,000.00	343,500	343,500	1,000,000
17	30,000.00	360,233	360,233	1,000,000
18	30,000.00	375,232	375,232	1,000,000
19	30,000.00	388,158	388,158	1,000,000
20	30,000.00	398,697	398,697	1,000,000
21	30,000.00	406,301	406,301	1,000,000
22	30,000.00	④ 410,139	410,139	1,000,000
25	30,000.00	386,022	386,022	1,000,000
AGE 92	30,000.00	86,758	86,758	1,000,000

Guaranteed Assumptions				
Policy Year	Premium Outlay Annualized	Net Policy Value	Net Surrender Value	Net Death Benefit
13	0.00	265,739	265,739	1,000,000
14	30,000.00	263,707	263,707	1,000,000
15	30,000.00	256,599	256,599	1,000,000
16	30,000.00	243,495	243,495	1,000,000
17	30,000.00	⑤ 223,193	223,193	1,000,000
18	30,000.00	193,979	193,979	1,000,000
19	30,000.00	153,435	153,435	1,000,000
20	30,000.00	98,193	98,193	1,000,000
21	30,000.00	23,566	23,566	1,000,000
22	0.00	***	***	0
25	0.00	***	***	0
AGE 92	0.00	***	***	0

Policy values were obtained from insurance company papers and were treated as current.

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## FINANCIAL STABILITY – PACIFIC LIFE

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**A.M. Best Company  
Rating****A++ (1)**

Superior. Assigned to companies which have, on balance, superior financial strength, operating performance and market profile when compared to the standards established by the A.M. Best Company. These companies have a very strong ability to meet their ongoing obligations to policyholders.

**Standard & Poor's Financial Strength Rating****AA (3)**

An insurer rated 'AA' has VERY STRONG financial security characteristics, differing only slightly from those rated higher.

**Moody's Financial Strength Rating****Aa3 (4)**

Insurance companies rated Aa offer excellent financial security. The Aaa and Aa group constitute high grade companies, with the Aa companies rated lower because long-term risk appears somewhat larger.

**Fitch Ratings' Insurer Financial Strength Rating****AA+ (2)**

Insurers are viewed as possessing VERY STRONG capacity to meet policyholder and contract obligations. Risk factors are modest, and the impact of any adverse business and economic factors is expected to be very small.

**Comdex - VitalSigns Composite Index****95**

The Comdex gives the average percentile ranking of this company in relation to all other companies that have been rated by the rating services. The Comdex is the percentage of companies that are rated lower than this company.

Ratings received from Vital Signs Financial and Ratings Reports.

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## SUMMARY OF ALTERNATIVES

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All known rate class factors are considered and applied to many of the current products offered by over seventy-five life insurance companies. The top 5 products are listed for companies that possess financial ratings similar to Pacific Life.

### Objectives: (1) Reduce Cost (2) Extend Guarantees

Rank	Company Name	Rate Class	Death Benefit	Premium	Carrier Ratings		Coverage Beyond Age 100	Lifetime Guaranteed
					A.M. Best	S & P		
1)	Travelers	Preferred Non-Smoker	\$1,000,000	\$10,390	A++	AA	Yes	Yes
2)	Manulife	Preferred Non-Smoker	\$1,000,000	\$11,041	A++	AA+	Yes	Yes
3)	ING-Reliastar	Preferred Non-Smoker	\$1,000,000	\$11,648	A+	AA	Yes	Yes
4)	Sun Life of Canada	Preferred Non-Smoker	\$1,000,000	\$12,086	A++	AA+	Yes	Yes
5)	John Hancock	Preferred Non-Smoker	\$1,000,000	\$13,210	A++	AA	Yes	Yes

### Objectives: (1) Increase Coverage (2) Extend Guarantees

Rank	Company Name	Rate Class	Death Benefit	Premium	Carrier Ratings		Coverage Beyond Age 100	Lifetime Guaranteed
					A.M. Best	S & P		
1)	Travelers	Preferred Non-Smoker	\$1,538,746	\$30,000	A++	AA	Yes	Yes
2)	John Hancock	Preferred Non-Smoker	\$1,514,578	\$30,000	A++	AA	Yes	Yes
3)	ING-Reliastar	Preferred Non-Smoker	\$1,513,873	\$30,000	A+	AA	Yes	Yes
4)	Manulife	Preferred Non-Smoker	\$1,510,938	\$30,000	A++	AA+	Yes	Yes
5)	Sun Life of Canada	Preferred Non-Smoker	\$1,496,124	\$30,000	A++	AA+	Yes	Yes

This report should only be used in conjunction with the complete illustrations, reports, and professional interpretation of a properly licensed representative. This is not tax or legal advice.

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## SUMMARY COMPARISON

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### Objective: Cost Reduction - Increased Guarantees

	<u>Pacific Life</u>	<u>Travelers</u>
Annual Premium:	\$30,000	\$10,390
Death Benefit:	\$1,000,000	\$1,000,000
Years Guaranteed:	8	Lifetime
Underwriting Rate Class:	Non-smoker	Preferred Non-smoker
Company Ratings:		
AM Best	A++	A++
S & P	AA	AA
Moody's	Aa3	Aa1
Fitch	AA+	AA+
Comdex	95	97

Comments: Assumes all additional underwriting requirements are within Travelers' preferred non-smoker rate class. Assumes a 1035 exchange of \$284,823.

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## CONCLUSIONS

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Evaluation of the current policy suggests:

- Mortality class could be improved from non-smoker
- Policy is projected to lapse at age 93 at current funding levels
- Policy will lapse at age 83 at current funding levels and guaranteed assumptions

Review of alternatives suggests:

- Preferred non-smoker mortality class is attainable.
  - Medical testing is required to validate rate classification
- Policies are available that will enhance performance
  - Premiums can be reduced while maintaining a lifetime guaranteed death benefit
  - Death benefit can be increased while maintaining current funding level

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## WHAT TO DO NEXT

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- Consult with the Audit Agent regarding the results of this audit and address the following:
  - Review and update financial planning objectives
  - Determine if the existing policy should be maintained
- If an alternate solution is appropriate:
  - Work with the Audit Agent to complete necessary paperwork
  - Schedule medical examination and assist in gathering medical records

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