



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

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AN OBJECTIVE EVALUATION OF THE CURRENT PERFORMANCE OF  
THE LIFE INSURANCE PORTFOLIO FOR *(CLIENT)* ALONG WITH  
PRESENT OPTIONS

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PREPARED BY

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*(AGENT'S NAME,)* CERTIFIED AUDIT PROFESSIONAL *(AGENT'S FIRM)*

*(DATE)*

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## OVERVIEW

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Life insurance policies have traditionally been viewed as long-term assets that could be largely ignored once adequate coverage was obtained. But life insurance policies are complex financial instruments that have significantly been affected by recent changes within the industry, the marketplace and the economy.

Just as investment portfolios are actively managed and real estate is periodically appraised, life insurance needs to be managed and monitored according to a wide range of criteria, in order to optimize current opportunities and evaluate actual policy performance relative to original projections and client expectations. In the current environment, the consequence of inattention to life insurance can include lapsed policies, unnecessarily costly premiums, missed opportunities, and a breach of fiduciary responsibilities.

The convergence of critical insurance industry, medical, and economic developments has given rise to a new discipline and level of expertise within the life insurance field: The Life Insurance Audit<sup>sm</sup>. Insurance professionals who have been specially trained by Outsource Insurance Services are uniquely qualified to administer Life Insurance Audits which provide clients with a comprehensive assessment of the performance of their policies, along with an overview of options for improving current coverage.

In the majority of cases – approximately 65 percent of the time – the potential for considerable improvements is discovered and clients are presented with options to either increase death benefits at current funding levels or reduce premiums while maintaining the same coverage. The other 35 percent of clients either receive recommendations on how policies can be restructured to meet their needs and expectations, or they gain the assurance that, based on their particular circumstances, they are already benefiting from the most up-to-date underwriting standards and optimal products.

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## A COMPREHENSIVE APPRAISAL

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The insurance industry is operating on a vastly different playing field than it was five or ten years ago. This has led to significant changes in the way that life insurance products are designed, priced and medically underwritten. The accompanying Life Insurance Audit<sup>sm</sup> represents a thorough evaluation of the life insurance policy for (*client*) in light of the following medical, economic, industry, and individual factors.

- **Underwriting reclassifications due to medical advancements.** Significant medical advances have had an impact on life expectancies. In countless cases, medical histories that were deemed uninsurable or highly rated in the past could now be rated as standard. Current policies and medical profiles have been reviewed to determine whether more favorable underwriting classifications are potentially attainable.
- **Fluctuating interest rates, dividend scales and market performance.** Fluctuating interest rates have had an impact on policy crediting rates and dividend scales which are directly tied to the overall rate of return experienced within the insurance company's investment portfolio. The stock market has been up and down, causing wide fluctuations in variable policy performance.
- **Changes to product expenses and insurance charges.** Cost of Insurance (COI) charges can be changed by the insurance company, and will have a direct impact on the projected values illustrated at the time that the policies were issued.
- **Development of a secondary market.** Life settlement companies have developed the option of giving policy owners the choice to sell their policies to an investor for a fair market value which may be more than the cash surrender value.
- **Structural insurance industry changes.** Life insurance companies have undergone widespread changes in corporate structure, including mergers, acquisitions and demutualizations. In some cases, the result has been greater efficiencies that are reflected in policy pricing. In other cases, the impact has not been positive. The accompanying audit assesses the insurance company's financial stability and ability to meet its ongoing obligations.
- **Product enhancements.** Recent product enhancements reflect an increasingly competitive life insurance industry, focused on client needs. This audit is designed to ensure that (*client*) has the opportunity to benefit from any applicable policy enhancements.
- **Policy holders' planning goals and circumstances.** The Life Insurance Audit<sup>sm</sup> process has reviewed (*client's*) current life insurance needs, relative to the goals and objectives at the time that life insurance policy(ies) were originally issued.

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## INDUSTRY-LEADING EXPERTISE AND OBJECTIVITY

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*(Agent's name)* has been trained by Outsource Insurance Services Inc. to facilitate and present the following Life Insurance Audit<sup>sm</sup>. Outsource Insurance Services' certified experts are distinctly qualified to conduct comprehensive life insurance audits for clients. Outsource Insurance's dedicated Life Insurance Audit<sup>sm</sup> team provides access to unsurpassed resources, expertise and insight in the evaluation of the financial stability of life insurance companies, in-force ledgers, policy design, medical underwriting, and cost of insurance.

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## THE LIFE INSURANCE AUDIT PROCESS

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Incorporating a range of resources and expertise, the Life Insurance Audit<sup>sm</sup> includes an evaluation of the following key issues:

- A client and policy summary.
- A review of the structure of the policy, ownership, beneficiaries, and payment methods, relative to 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.
- A fair market value assessment of the policy, if applicable.
- An evaluation of the financial stability of the insurance company.
- An objective and comprehensive evaluation of potentially more cost effective or beneficial alternatives.

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**CLIENT AND POLICY SUMMARY**

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**John Smith (10-10-1931)**

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Current Insurance Company: **Sample Company**

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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: **6-17-1992**

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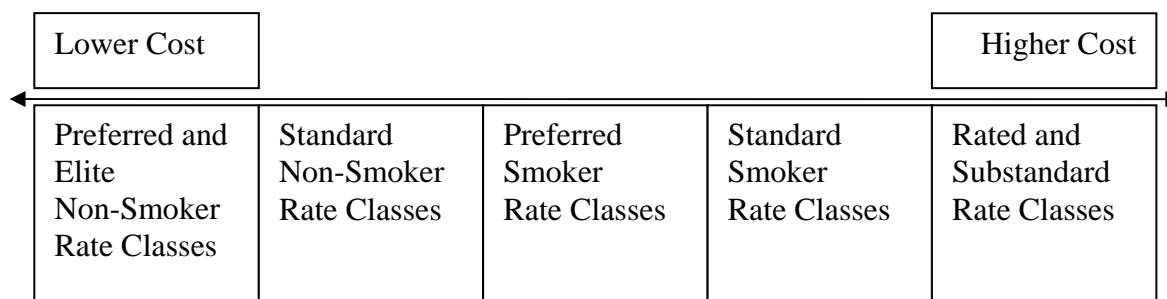
- This policy is currently owned by the Smith Family Trust, 1990. James Fiduciary of 1<sup>st</sup> National Bank serves as the trustee.
- The Smith Family Trust is the listed beneficiary.
- John Smith gifts \$30,000 annually to the Smith Family Trust in order to fund the policy.
- It is recommended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

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## UNDERWRITING RATE CLASS REVIEW

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- The 1992 Sample policy indicates that John Smith was issued as 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.
- A reduction in policy cost is expected if John Smith obtained a preferred non-smoker rate class. The figure below illustrates the relationship between an underwriting rate class and policy costs.



## POLICY PERFORMANCE ASSESSMENT

Below is an assessment of the current and projected future performance of the existing policy based upon interest rates, cost of insurance, premium levels, and projected and guaranteed assumptions.

### Sample Policy 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	30,000.00	305,466	305,466	1,000,000
15	30,000.00	325,105	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	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	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

Additional Analysis: Based on the current cost of insurance charges and the current interest crediting rate, the annual premium must be increased to \$32,500 in order to maintain coverage for life.

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## FAIR MARKET VALUE ASSESSMENT

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This portion of the audit compares the existing policy's value if it were to be surrendered or sold via a life insurance settlement.

### Cash Surrender Option

If this policy were to be surrendered to the existing life insurance company for cash or for a transfer to a new policy through a 1035 exchange, its value would be:

Policy Value	\$284,823
Less Surrender Charges	<u>0</u>
Net Cash Surrender Value	\$284,823

### Life Insurance Settlement Option

The fair market value for many policies is the cash surrender value. However, insureds, who are over the age of 65 and have experienced any change in health status since the policy was originally issued, may find the life insurance settlement option to be more to their advantage. The following table provides a range of fair market value estimates for this policy:\*

Change in Health Since Policy Issue	Estimated Sale Value	
	Low End	High End
Improved	\$284,823	\$284,823
None	\$284,823	\$284,823
Declined	\$284,823	\$512,000

Since (*client name's*) health has not declined, it does not appear likely that the life settlement value will exceed the net cash surrender value.

\* The fair market assessment is an estimate based on historical life settlement data, and is not a guarantee or an offer to purchase. Those interested in pursuing the life insurance settlement option should discuss the full implications of the transaction with their financial advisor.

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## FINANCIAL STABILITY – *(Sample Company)*

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<b>A.M. Best Company Rating</b>	<b>A++ (1)</b>
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Superior. Assigned to companies that have, in our opinion, a superior ability to meet their ongoing obligations to policyholders.

<b>Standard &amp; Poor's Financial Strength Rating</b>	<b>AA (3)</b>
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An insurer rated 'AA' has VERY STRONG financial security characteristics, differing only slightly from those rated higher.

<b>Moody's Financial Strength Rating</b>	<b>Aa3 (4)</b>
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Insurance companies rated Aa offer excellent financial security. Together with the Aaa group, they constitute what are generally known as high-grade companies. They are rated lower than Aaa companies because long-term risks appear somewhat larger.

<b>Fitch Ratings' Insurer Financial Strength Rating</b>	<b>AA (3)</b>
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Very strong. 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.

<b>Comdex - VitalSigns Composite Index</b>	<b>93</b>
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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.

## SUMMARY OF OPTIONS

All known rate class factors have been considered and applied to policies offered by over 50 life insurance companies. Often, the acquisition of a newer policy can lead to substantial cost improvements or improvements to the guaranteed or projected length of coverage. Four of the best alternatives are listed below.

### Objective: Increase and Extend Coverage

Rank	Company Name	Rate Classes	Benefit Amount	Premium	Carrier Ratings		Guaranteed To:	Projected To:
					A.M. Best	S & P		
1)	American General	Preferred Non-Smoker	<b>\$1,725,700</b>	\$30,000	A++	AA+	<b>Lifetime</b>	<b>Lifetime</b>
2)	ING	Preferred Non-Smoker	\$1,612,801	\$30,000	A+	AA	Lifetime	Lifetime
3)	Lincoln Benefit	Preferred Non-Smoker	\$1,602,976	\$30,000	A+	AA	Lifetime	Lifetime
4)	Jefferson Pilot	Preferred Non-Smoker	\$1,513,243	\$30,000	A+	AA	Lifetime	Lifetime

The alternatives assume a 1035 exchange of \$284,823.

Current Policy								
Sample Company	Standard Nonsmoker	\$1,000,000	\$30,000	A++	AA	Age 82	Age 92	

### Objective: Reduce Cost

Rank	Company Name	Rate Classes	Benefit Amount	Premium	Carrier Ratings		Guaranteed To:	Projected To:
					A.M. Best	S & P		
1)	American General	Preferred Non-Smoker	\$1,000,000	<b>\$7,677</b>	A++	AA+	<b>Lifetime</b>	<b>Lifetime</b>
2)	Lincoln Benefit	Preferred Non-Smoker	\$1,000,000	\$9,221	A+	AA	Lifetime	Lifetime
3)	ING	Preferred Non-Smoker	\$1,000,000	\$9,466	A+	AA	Lifetime	Lifetime
4)	Jefferson Pilot	Preferred Non-Smoker	\$1,000,000	\$11,844	A+	AA	Lifetime	Lifetime

The alternatives assume a 1035 exchange of \$284,823.

Current Policy								
Sample Company	Standard Nonsmoker	\$1,000,000	\$30,000	A++	AA	Age 82	Age 92	

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><i>(Sample Company)</i></u>	<u><b>American General</b></u>
Annual Premium:	\$30,000	\$7,677
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	93	98

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

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## CONCLUSION

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Evaluation of the current policy suggests:

- Mortality class could be improved from non-smoker to preferred 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
- The fair market value of the policy is \$284,823.
- *(Sample Company)* has a Comdex rating of 93, which indicates that approximately 93% of all rated life insurance companies are rated at or below *(Sample Company)*.

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## OPTIONS

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1. **Make no changes to current life insurance policy.** Continue to pay current premium of **\$30,000 per year** for the policy. Based on current assumptions, policy will lapse with no value or death benefit at age 93.
2. **Make adjustments to current life insurance policy.** In order for the policy to carry to maturity under its current assumptions, the premium payment will need to increase to **\$32,500 per year**. This amount is not guaranteed to remain at this level and may increase or decrease based upon actual performance.
3. **Acquire a new policy.** The new policy will have an annual premium of **\$7,677** - an annual reduction of **\$22,323** from the current premium, and a reduction of the premium required to extend the current policy to maturity by **\$24,823 per year**. In addition, the death benefit amount and premium payments would be guaranteed for the life, providing the premiums are paid as scheduled and no withdrawals and/or loans are taken from the policy).  
*Medical testing and complete underwriting will be required to verify insurability.*

**I acknowledge that I have been presented with this entire document (12 pages)  
and have reviewed and understand my options.**

**At this time I wish to implement the following option** (please check the appropriate box):

**Option 1**                       **Option 2**                       **Option 3**

**Insured/Owner Signature** \_\_\_\_\_

**Insured/Owner Printed:** \_\_\_\_\_

**Date:** \_\_\_\_\_

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