

# Athene's Position And Guidelines On Replacements

This guide is intended to help you comply with replacement regulations in general, and to assist you in making appropriate replacement recommendations. In developing this guide, we have established procedures and guidelines that do more than just meet the requirements of any one state. Because each state has its own regulations and requirements, and they change from time to time, **you are expected to know and follow Athene guidelines and policies, as well as replacement regulations in all states where you do business.**

## ATHENE'S POSITION ON REPLACEMENTS

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Athene does not encourage or condone the systematic or deliberate replacement of existing life insurance and/or annuity policies and contracts (sometimes referred to as "churning and/or twisting") as a marketing practice or method of doing business. This includes not only replacement of other companies' policies and contracts, but the replacement of Athene policies and contracts as well. At the same time, we acknowledge that not all replacements are improper, and that many are appropriate.

## WHEN IS A SALE ALSO A REPLACEMENT?

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Regulations concerning replacement apply not only when existing coverage or contracts are canceled or terminated. Many other situations are also covered in replacement regulations and laws. Many states have adopted the NAIC Life Insurance and Annuities Replacement Model Regulation or similar laws. Be sure you understand what is considered a replacement in the states in which you do business.

The replacement of life insurance and/or annuities occurs when:

1. A client applies for any type of annuity with Athene, or applies for a face amount increase on an existing Athene policy; AND
2. The client owns an existing policy or contract, including:
  - Any life insurance policy or annuity issued by Athene, even if still within the free look period.
  - Any life insurance policy or annuity issued by another company, even if still within the free look period. This includes any life insurance under a binding or conditional receipt of another company, AND
3. The agent knows, or with reasonable amount of inquiry should know, that an existing policy or contract has been or will likely be:
  - Canceled.
  - Changed, causing reduced or eliminated benefits.
  - Changed so that reduced insurance is provided.
  - Changed so that the term of coverage is reduced.
  - Exchanged.
  - Lapsed.
  - Loaned against (even automatic premium loan).
  - Made reduced paid-up.
  - Made to go extended term.
  - Partially surrendered.
  - Reduced in face amount.
  - Reduced in value through nonforfeiture benefits.

- Reduced in value through policy values.
- Reissued with reduced cash value.
- Surrendered.
- Terminated in any manner.
- Used as collateral for a third party loan.
- Used to pay premiums on new coverage.

These rules apply even if the existing life insurance policy is being replaced by an annuity, and vice-versa.

It is critical that you understand that the broad definition under the NAIC Model (and therefore the requirements for compliance) extends to situations involving the purchase of a new annuity product using values from an existing life insurance policy or annuity contract. Under the NAIC Life Insurance and Annuities Replacement Model Regulation, a so-called “financed purchase” is included in the definition of a replacement transaction. A financed purchase is described as “the purchase of a new policy involving the actual or intended use of funds obtained by the withdrawal or surrender of, or by borrowing from, values of an existing policy to pay all or part of any premium or payment due on the new policy. Further, the Model regulation provides that:

“For purposes of a regulatory review of an individual transaction only, if a withdrawal, surrender, or borrowing involving the policy values of an existing policy is used to pay premiums on a new policy owned by the same policyholder and issued by the same company, within 4 months before or 13 months after the effective date of the new policy, it will be deemed prima facie evidence of the policyholder’s intent to purchase the new policy with existing policy values.”

## APPROPRIATENESS OF REPLACEMENTS

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In order to determine if a replacement is appropriate for the client, you and your client together must look at all aspects of the new policy or contract compared to the old policy or contract as well as the financial needs and objectives of the client. Athene requires the use of a Product Comparison Worksheet for each proposed replacement, which allows your client to compare the existing and proposed policy or contract side by side, and allows you to document your rationale for recommending the replacement.

## FACTORS TO CONSIDER BEFORE RECOMMENDING A REPLACEMENT

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Before recommending a replacement, be sure to obtain up to date information regarding the existing life insurance policy or annuity contract, and compare and contrast the existing coverage with the proposed product. The agent should take a number of factors into consideration including the following:

### **Annuity to Annuity Replacements**

- Surrender charges incurred if current policy is replaced
- Market Value Adjustment on surrendered policy
- Surrender charges of proposed policy (duration and amount)
- Guaranteed and non-guaranteed values
- Death benefit provisions
- “Free” withdrawal amounts and limitations
- Financial status of customer
- Retirement income needs of customer
- Liquidity needs of the customer
- Flexibility of income/annuitization provisions
- Available riders and their associated costs/benefits
- Use of 1035 exchange process to prevent taxable gain, carry over cost basis

## Life Insurance to Annuity Replacements

- Health of insured (especially if short life expectancy)
- Purpose for the proposed annuity (income needs vs. legacy for heirs)
- Beneficiaries will receive substantially less upon death of insured
- Loss of tax-free death benefit
- Loss of non-taxable (FIFO) withdrawals
- Clear disclosure of annuity surrender charges/other liquidity limitations
- Use of 1035 exchange process to prevent taxable gain, carry over cost basis

## ALTERNATIVES TO REPLACEMENTS

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You should always consider whether alternative solutions to your client's needs will work instead of replacing existing coverage. In any case, you should present other options to your client to weigh against replacement. These options may include, but are not limited to:

- Updating an existing policy to provide better cash value growth.
- Leaving existing coverage in place, and purchasing a new policy to meet additional needs.
- Finding out if the client qualifies for an improved rating classification on the existing policy. This may provide lower premiums and increased cash values.
- Exploring whether there are allowable adjustments to values, premiums, etc., on flexible type policies.
- Reviewing and /or choosing other dividend options, if applicable.
- Using dividends for paid-up additions or to pay off existing loans.
- Partially surrendering a policy to pay off an existing loan.
- If allowed, changing a current policy to the paid-up option and using premium saved to purchase a new policy.

Some of these options may still constitute replacement transactions, but they may represent more suitable recommendations for the customer.

## REGULATION OF AND REQUIREMENTS FOR REPLACEMENT TRANSACTIONS

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There is a focus on replacement transactions by regulators. Many states have adopted the NAIC Model Regulation on Replacement of Life Insurance and Annuities. Most other states have similar requirements. The Model regulation includes a very broad definition for replacements and imposes stringent requirements for producers and companies.

You must have a clear understanding of the requirements for a replacement transaction in each state for which you are licensed to sell annuity products. Your compliance with and completion of all requirements when you make a replacement recommendation is critical in assisting Athene with demonstrating appropriate documentation to regulators in the course of Market Conduct Examinations.

Your own documentation within your client file is also crucial. You should always be in a position to demonstrate that you:

- Conducted a thorough review of your clients' needs/objectives;
- Made a fair and careful comparison of the existing policy/contract with the proposed policy/contract; and
- Can readily articulate the primary reason for the replacement recommendation (why it is suitable for the customer and in the customer's best interest).
- Can demonstrate compliance with the applicable standard of care.

## AGENT RESPONSIBILITIES AND REQUIREMENTS

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The following points highlight what you need to know and do in your sales process with a client when the client has existing life insurance or annuities.

1. **Be familiar with regulations and requirements for all states in which you do business.**
2. **Make sure the replacement question on the application is correctly answered and all information completed.**

3. **Present and explain to the client, prior to filling out and completing an application,** any replacement notice, disclosure statement, or comparison form required by the state and/or Athene. Make sure the client reads and understands the information presented.
4. **Before recommending a replacement, always obtain proper documentation of the existing policy or contract.** This may include an in-force illustration, annual statement, or a letter from the existing company. Never complete the Product Comparison Worksheet without proper documentation, and be sure to retain this information in your files.
5. **Know the IRS rules as it relates to 1035 exchanges and properly complete 1035 exchange paperwork.** Remember: In order for the IRS to recognize a transaction as a 1035 exchange, the premium must be transferred from institution to institution – THE CLIENT CANNOT RECEIVE THE PREMIUM FIRST. If your client intends to effect a total or partial exchange of contracts, do not advise the client to avoid the 1035 exchange process and have the proceeds sent to them. This may result in a taxable event.
6. **Comply with all state requirements** regarding:
  - Completion of replacement forms, including signature requirements.
  - Leaving original or copy of the replacement form with the client.
  - Sending the original or copy of the replacement forms to the home office with the application.
  - Retaining documentation in your records.
7. **Leave with the client copies of all policy illustrations, proposals and other sales materials,** including any handwritten or typed materials, shown to the client during the sales presentation. Retain copies of all sales materials in your files and be able to provide them to Athene and/or a regulator upon request.

## MONITORING REPLACEMENT BUSINESS

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Athene takes its replacement monitoring responsibility seriously. Replacement activity is an area of significant focus by state regulators. Athene regularly monitors replacement activity for signs of inappropriate replacements, including twisting and churning.

Replacement activity is monitored in a number of different ways including, but not limited to:

- reviewing the ratio of replacements in a producer's new business submitted to the company;
- reviewing the number of replacement submissions;
- customer complaints;
- inquiries from other companies; and
- State investigations and market conduct examination results.

We also seek to detect both internal and external undisclosed replacements.

As part of the Agent Business Review process, the Athene Compliance team may identify producers for further review of their replacement activity. As part of the review, additional information may be requested of the producer, such as submission of forms comparing both the past and present policies and providing a further explanation of why the replacement was recommended. Depending on the result of such a review, further action may be required including, but not limited to:

- requirements to provide additional documentation, including a comparison form, for all new replacement business;
- additional training;
- formal and informal warnings; and
- disciplinary action up to and including termination.

Please protect your reputation with your clients, Athene, and state regulators. Failing to disclose replacements or engaging in inappropriate replacement activity will lead to disciplinary action by Athene, up to and including termination, as well administrative licensure actions by state regulators.