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. As you know, any replacement recommendation should be in the customer's best interest. In developing this guide, we have provided information 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 our guidelines and policies, as well as replacement regulations in all states where you do business. Please remember that the Compliance department is here as a resource for you. If you have questions, contact us, and we will help you find the answer.

POSITION ON REPLACEMENTS

Global Atlantic 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 our policies and contracts as well. At the same time, we acknowledge that not all replacements are improper, and indeed, some may be appropriate based on an individual customer's needs and objectives. In considering any replacement recommendation, the best interests of the customer must be paramount.

It is also important that you understand the very broad definition of a replacement (outlined below), and that you are completely transparent with both the customer and us whenever a replacement transaction is occurring. Do not try to disguise a replacement transaction by:

- Failing to identify it as a replacement
- Failing to recognize that a "financed purchase" is a replacement
- Recommending that the customer take a large withdrawal or policy loan to fund a new policy and allowing the existing policy to lapse at a later time
- Recommending that the customer surrender the policy/contract outside the I.R.C. Section 1035 process, or otherwise failing to acknowledge that a replacement is occurring, and then subsequently using those proceeds in conjunction with the purchase of a new policy

WHEN IS A SALE ALSO A REPLACEMENT?

Replacement regulations apply not only when existing coverage or contracts are surrendered or otherwise terminated. Many other situations are also covered within replacement regulations and laws. A majority of states have adopted the NAIC Life Insurance and Annuities Replacement Model Regulation. Our guidelines are derived, to a large extent, from the Model Regulation. It is also vital that you understand what is considered a replacement transaction and what the applicable requirements are for each state in which you do business.

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

A client applies for any type of life insurance policy or annuity contract (or applies for a face amount increase on an existing policy); AND

The client owns an existing policy or contract, including any life insurance policy we issue, even if still within the free-look period, or 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

The agent knows, *or with a reasonable amount of inquiry should know*, that an existing policy or contract has been or *will likely be*:

1. Lapsed, forfeited, surrendered, partially surrendered, assigned to the replacing insurer or terminated
2. Converted to reduced paid-up insurance, continued as extended term insurance, or reduced in value by use of a non-forfeiture benefit or other policy value

3. Amended to effect either a reduction in benefits or in the term of coverage
4. Reissued with any reduction in cash values
5. Used in a "financed purchase"

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

Again, it is critical that you understand there is a broad definition under the Model Regulation and it applies not just to full surrenders of life insurance policies or annuity contracts, but also extends to new policies or contracts purchased with ***any*** funds (e.g. withdrawals or partial surrenders) from existing policies or contracts.

The Model Regulation Replacement Form is very instructive in this regard. It presents two key questions:

1. Are you considering discontinuing making premium payments, surrendering, forfeiting, assigning to the insurer, or otherwise terminating your existing policy or contract? ❑ YES ❑ NO
2. Are you considering using funds from your existing policies or contracts to pay premiums due on the new policy or contract? ❑ YES ❑ NO

Note from Question #1 that, in addition to life-to-life replacements and annuity-to-annuity replacements, the regulation also applies to life-to-annuity replacements and annuity-to-life replacements.

Note also that Question #2 underscores the fact that **any time you use any funds from an existing policy or contract to pay premiums on a new policy or contract, you have a replacement situation.**

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."

SUITABILITY OF REPLACEMENTS

In order to determine if a replacement is beneficial to the client, you and your client together should 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. If the benefits of the replacement appear to be in the best interests of the client on both a short-term and long-term basis, the replacement ***may*** be justified.

Factors to Consider Before Recommending a Replacement:

The foundation for any replacement transaction must be that the agent's recommendation is in the best interests of the customer. With each replacement transaction, an agent should be able to show that alternatives to replacement were discussed with the customer and that there is a demonstrable benefit to the customer from the replacement recommendation. The considerations for and evaluation of a replacement transaction are inextricably tied to suitability. And, it's important to remember – "newer isn't necessarily better."

Before recommending a replacement, always obtain proper documentation of the existing coverage. This may include an in-force illustration, annual statement, or a letter from the existing company.

Considerations for life insurance replacements are somewhat different from those for annuity replacements. 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:

Life Insurance-to-Life Insurance Replacements:

- Underwriting classification of existing policy
- Underwriting classification decision on proposed policy
- Original issue age vs. attained age
- Death benefit provided by existing policy
- Death benefit provided by proposed policy
- Surrender charges incurred if existing policy is replaced
- Surrender charges of proposed policy (duration and amount)
- Guaranteed and non-guaranteed values
- Use of 1035 exchange process to prevent taxable gain, preserve carryover of cost basis
- Tax implications for the client (including discharge of outstanding policy loan)
- Policy Charges including Cost of Insurance

- Available riders and their associated costs/benefits
- Matching ownership/beneficiary arrangements
- Financial status of client
- Retirement income needs of client
- Policy loan interest rates (both current and guaranteed)

Annuity-to-Life Insurance Replacements:

- Not a tax-free exchange under I.R.C. Section 1035
- Identified need for life insurance/objective to be accomplished
- Has the original need/objective for the annuity disappeared/changed
- Age of applicant at time of purchase
- Can life insurance be issued on a favorable underwriting basis
- Can the customer meet the ongoing premium payment obligation

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, preserve carryover of 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, preserve carryover of cost basis

ALTERNATIVES TO REPLACEMENTS

You should always consider whether alternative solutions to your client's needs and objectives 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:

- 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 death benefits, 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

NOTE: Although some of these options may still constitute replacement transactions, they may represent more suitable recommendations for the customer.

AGENT RESPONSIBILITIES

The NAIC Life Insurance and Annuities Replacement Model Regulation requires additional duties for agents in states which have adopted it:

- You must ask the applicant if he/she has any existing policies or contracts even if no replacement is proposed
- You must complete the replacement disclosure form ("Important Notice: Replacement of Life Insurance or Annuities") and obtain the signature of the applicant
- You must ask the applicant if he/she would like the replacement disclosure form to be read aloud
- You must sign the form as well
- You must provide a copy of the signed form to customer at time of application
- You must provide copies of all sales materials that you used in the sales process to the customer at time of application
- You must certify to us that you left all sales materials used with the applicant (owner)

- You are responsible for providing copies of all such materials when requested by a state insurance department
- You must deliver the policy in a timely manner and return the Delivery Receipt promptly to the Home Office. Be aware that under the Model Regulation, a customer has an expanded "free look" period of 30 days for any policy identified as a replacement

It is vitally important that you have a clear understanding of the requirements for a replacement transaction *in each state for which you are licensed to sell life insurance and annuity products*. Your compliance with and completion of all requirements when you make a replacement recommendation is critical in assisting us 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
- Can readily articulate the primary reason for the replacement recommendation (why it is suitable for the customer and in the customer's best interests)

In states that require it, use the replacement comparison forms required in those states. For all cases, make sure that you complete all of the questions on the Agent Report related to replacement transactions. We also urge you to submit a cover letter with the application on any replacement case and clearly explain the basis for the replacement recommendation.

MONITORING REPLACEMENT BUSINESS

We take our replacement monitoring responsibility seriously, and we want our producers to be diligent in making only appropriate replacement recommendations that are suitable for the customer. You are in the best position to evaluate each individual customer's needs, objectives, and current life insurance in force. As a life insurance professional, it's important to be able to demonstrate the reasonableness of every product recommendation you make, and that responsibility is heightened in the case of replacements. We review replacement cases in the course of the new business and underwriting process, and we examine the information provided on the application, as well as your responses on the Agent Report. We may request additional information about your recommendation, and in some cases, may decline to issue the case. Replacement activity is increasingly an area of significant focus by state regulators, as evidenced through bulletins, inquiries, surveys and market conduct examinations. We regularly monitor replacement activity for signs of inappropriate replacements, including twisting and churning, and addresses situations that are excessive or inappropriate.

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
- State investigations and market conduct examination results

We also seek to detect both internal and external *undisclosed* replacements. As part of our agent monitoring process, the 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
- Disciplinary action up to and including termination

Please protect your reputation with your clients, us and state regulators. Disclose all replacement transactions and refrain from engaging in inappropriate replacement activity. Above all, make sure that the client fully understands the reasons for any replacement recommendation you make and that you are able to support any and all such recommendations through proper documentation.

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