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**Now What?**  
**Surviving Financial Underwriting**

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**Pending Inbox**

**All rush cases – pick one – hurry the clock is ticking**

- 73-year-old: for \$450,000
- 38-year-old: for \$300,000
- 65-year-old: for \$150,000,000
- 49-year-old: for \$15,000,000
- 17-year-old: for \$1,000,000
- 38-year-old: for \$11,000,000
- 42-year-old: for \$2,500,000
- 85-year-old: for \$800,000
- 28-year-old: for \$150,000
- 3-year-old: for \$187,500

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**Too Late**

**Your coworkers got into the queue first**

- The 10 image/page cases are all gone
- Let's hope the cases left are medically clean
- Receive these gifts – no medical issues\*
  - Just financial issues/questions

\*disclosed medical history or issues at any rate

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**73-year-old for \$450,000**

**Age before the beauty of financial challenges**

- Premium is 52% of annual income (application representation)
- Applicant will personally pay premium
- Purpose check-off boxes: income replacement and estate protection
- E-mail response to your quick question: actually asset reallocation of liquid assets to higher return life insurance policy. When can you issue?
- Follow-up questions?
- Everyone knows what liquid assets are, right?

**RGA****17-year-old for \$1 million****The joy of youth – planning for their future**

- Occupation: student – income nominal
- Parents paying premium
- IAI indicates 2 other hits/tries in last 6 months
- Zero in-force; applied elsewhere per your application
- Questions?
- Medical history taken 4 months ago – no significant medical history
- The APS received with file was ordered 6 months ago; broker proactively ordered update. Updated records indicate episode of bingeing and purging within the last 2 months. No follow-up, but everything is fine now.
- Questions?

**RGA****38-year-old for \$11 million****Occupation: housewife**

- Spouse has \$1 million insurance in-force, no additional applied for
- Spouse is certainly NOT uninsurable
- Joint income is \$350,000
- Planning for the future by investing business cash flow in life insurance on the younger spouse
- 1040 first 2 pages received – total income is \$128,450
- The business is paying the premium from cash flow of over \$2 million per year
- Unaudited business financial statement indicates gross revenue of \$2 million, net income of \$110,000 with nominal depreciation

**RGA****Last New Case in Queue****Everyone else has gone to lunch**

- 49-year-old: \$15 million current application
- \$15 million insurance in-force, no replacement
- Inspection interview with applicant
  - States income is \$2.5 million as owner of the company named as policy beneficiary – he is 50% owner
  - Business includes multiple hotels on the East Coast
  - Joint income is \$2.5 million with wife, who is VP of the company
  - States he has about \$21 or \$22 million in-force
  - Declines to authorize contact with accountant
- Tax returns sent including K-1 forms for 2011 and 2010
  - Joint total income in 2011 is \$1,060,000 vs. \$348,000 in 2010
  - Multiple K1 forms reference motels located in Midwest as well as East Coast

**RGA****Sources and Resources****Financial Information**

- The application
- Financial supplement that may or may not be signed/dated
- The producer
- The producer in role as CPA/financial advisor
- Inspection or phone interview
- CPA (certified or not)
- Private bankers who are willing to talk
- Attorneys knowledgeable about finances and planning (interest in outcome?)
- Credit Reports - not just bankruptcy
- Brokerage statements
- Zillow search results
- Income tax returns or transcripts
- Business financial statements

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**Multifaceted Search for Premiums/Commissions**

**Needs-based sales/Asset allocation/Building an estate**

- Purpose of the sale
- Communication
- Source of premiums
- Communication (second verse same as the first)
- Current finances precede projected financial goals/outcomes
  - Stretch goals
  - Low probability of success
  - Fantasy
- Communication (third verse same as the first)
- Shared vs. disparate motivations & objectives

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**Beyond the 1040-EZ**

**Chaos, Wagnerian Storms, and Disarray**

- When in doubt, send copies of the 'the latest' federal returns in random order/signed and dated or not
- 4506T-EZ signed authorization to secure tax return transcript
  - The world as we know it came to an end
    - Or not

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**1040 Review – Income Verification**

**Federal 1040 Form**

<ul style="list-style-type: none"> <li>▪ Producer presented</li> <li>▪ Missing schedules</li> <li>▪ Unsigned often</li> <li>▪ Actually filed with IRS?</li> <li>▪ Produces angst among producers reluctant to return to client</li> <li>▪ Need full schedules, e.g.                             <ul style="list-style-type: none"> <li>▪ Capital Gains -3,000</li> <li>▪ Capital Gains significant change from prior year</li> <li>▪ Partnership/S corp. income</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>▪ Proposed insured signs authorization to secure copy of filed federal tax form – all schedules</li> <li>▪ 4506 – Request for full copy; fee payment required</li> <li>▪ 4506T – Request for transcript</li> <li>▪ 4506T-EZ</li> <li>▪ Reaction to first company to implement documented in 2012</li> </ul>
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*4506T – to boldly go where none have gone before*

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**Beyond Income Verification**

**Federal Tax Forms**

- When the total income or AGI is not enough
- Sources of income
  - Earned income vs. unearned income
  - Investment income
  - Company- or partnership-specific income
- Beyond the net income on first page of 1040
  - Line 17 net income loss may hide substantial income from specific business source
- Estimating net worth from investment income reported
- Explanations for discrepancies
- Advantages and limitations of the tax transcript
  - The missing beauty of Schedule E details
  - The missing K1 forms

**RGA****Federal Tax Returns****Key Entries**

2011 forms chosen as these are the most recent that would be available

**RGA****65-year-old for \$150,000,000****Your coworker chats about sending this case to reinsurance**

- Less than 30 images in the file so far
- Net worth \$1 billion; income \$100,000 per application statement
- Implied ownership in energy business company or companies in addition to owning a large ranch/farm
- Cover letter states premium will be paid by the applicant
- Second cover letter states that the purpose is to partly cover a \$200 million loan and of course the ubiquitous estate tax
- Intrigued, you search the Internet; the home was built in the 1970s and assessed at \$150,000 per Zillow site
- Search on business name – appears to be in the wind turbine energy sector, not the oil or gas boom as you imagined, with articles dating back to 2007 popping up on search, but alas no big announcement of pending deal
- Do you regret not snapping up this case?

**RGA****Business Financial Statements****Core Components**

- Do you know percent of company owned?
- Excel spreadsheet from unknown source
- Audited, Review, Compilation
- Pro forma
- Auditor's cover letter
- Core components
  - Balance Sheet
  - Income Statement
  - Cash Flow Statement (there probably will be none on unaudited financials)
- Bonus round
  - Footnotes
  - Events that occurred after the audit was completed

**RGA****CPA Source Business Financial Statements****Types of CPA statements are not equal**

- Audited
  - The accountant has done extensive analysis and testing and has prepared footnote disclosures plus a complete set of financial statements, expressing an opinion, or declining to provide one (red flag), on the fairness with which the financial statements represent the financial position, the results of operations and the changes in financial position.
- Review
  - The accountant has performed fewer procedures and offers less assurance, indicating only that no material modifications have to be made to the financial statements for them to be in conformity with GAAP.
- Compilation
  - The accountant pulls together financial information for the company, does no testing or analysis of the financial information, and may not prepare footnote disclosures. Compilations are management's representations and the outside accountant provides no assurance on the statement.

**RGA****Business Financials****Who, When, Why, Credentials, Credibility, Credulity**

- Who prepared the statement?
  - Target audience
  - Linkage to outcome current app?
  - Accuracy
  - Relevance – when was it prepared
- Type of CPA statement
  - Audited
  - Review
  - Compilation
- CPA credentials verified?
- Expert valuation
- SEC-filed statements
- Small business
- Privately held vs. publically traded
- Fair market value (FMV)
- Asset value
- Percentage of gross revenue
- Comparable companies sold
- Business income multiples
  - Net Income
  - EBITDA
  - EBIT
  - EBDA

**RGA****Complications****The fly in the eye of the beholder**

- Ownership structure if multilayer – should there be a consolidated statement?
- Management has chosen not to include...in the financial statements although GAAP... (off balance sheet assets and liabilities)
- Audited financial statement with more favorable unaudited year-to-date financial statement
- One of the owners in the partnership or S Corporation owns the building or real estate (receiving the rent or lease)
- One-time losses
- Nonoperational losses
- Restructuring costs
- Small private businesses are unlikely to pay for full audited financial statements

**RGA****Balance Sheet****Assets – Liabilities = Net Worth**

- Bottom line net worth on the balance sheet is NOT the fair market value as any producer will gladly point out to you
- Current Assets/Current Liabilities = Current Ratio
  - Great business; too bad you can't pay your bills, interest - today
- Accumulated depreciation
- Adjustments to assets held
  - Obsolete inventory
  - Oops, overpaid for cousin Bernie's company last year
- Trends are indeterminate absent multiple-year financial statements

**RGA****Income Statement****Estimating FMV from 'Income' & Growth Projections**

- Missing element – estimated growth rate for the company
- Single-year financial statement does not a trend make
- Revenue – (expenses + interest payments + taxes) = Net Income
- Expenses may include owner's above-market salary
- Not all expenses are cash expenses (depreciation & amortization)
- Income from operations vs. other income
- Partnerships and S corporations generally do not show taxes on income statement – pass through
- Net Income; EBIT; EBITDA or EBDA
- Appropriate multiple to use on recurrent income chosen?
  - Risk, growth potential

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**Cash Flow Statement**

**Seldom provided on small private companies**

- Quick sum of Net Income and Depreciation & Amortization
- Free Cash Flow
- Cash from or used in operations
  - Net earnings + depreciation + decrease in accounts receivable + increase in accounts payable – inventory increase
- Cash from or used in investments
  - Used in purchase of equipment
- Cash from or used in financing
  - Used in payment of old loan
  - From new loan
- Since investors look at cash flow trends, public companies may tweak their cash flow statement even at the expense of additional taxes

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**Business Financial Statement**

**Example**

The numbers were 'real'  
The format was copied onto Excel spreadsheet  
The company is imaginary

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**Relax**

**The outlook is not bleak**

- We are not investors pricing the business to buy into it
- We do not have to verify every million of net worth
- Or trace the origin of every grand of income
- If the producer argues for a much higher net worth projection, ask him or her for the data confidence interval – this will also impress or astound your actuary

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**Thank you for your attention.**