

Field Bulletin



SECURITY MUTUAL LIFE
INSURANCE COMPANY OF NEW YORK
BINGHAMTON • NEW YORK
607-723-3551 • www.smlny.com

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(Replaces Field Bulletin No. 0011220XX 12/2011)

1035 Exchanges

1035 Exchange Form(s)

Form 0011911, *Agreement for Exchange of a Life Insurance Policy to a Life Insurance Policy Issued by Security Mutual Life Insurance Company of New York Under 1035 of the Internal Revenue Code*, should be used when doing a 1035 exchange to a Security Mutual **life insurance policy**.

Form 0004480, *Agreement for Exchange of a Life Insurance Policy or an Annuity to an Annuity Issued by Security Mutual Life Insurance Company of New York Under Section 1035 of the Internal Revenue Code*, should be used when doing a 1035 exchange to a Security Mutual **annuity contract**.

1035 Exchange Guidelines

In conjunction with the new form 0011911, *Agreement for Exchange of a Life Insurance Policy to a Life Insurance Policy Issued by Security Mutual Life Insurance Company of New York Under 1035 of the Internal Revenue Code*, the electronic guidelines form that summarizes external exchange procedures (0011282XX 12/2011, *1035 External Exchange Guidelines for Security Mutual*) has been revised and is attached.

1035 Exchange Procedures

A Section 1035 exchange permits a policyowner to transfer the cash value from one life insurance or annuity contract to another without income tax consequences, provided proper procedures are followed and the policyowner does not receive any property in the exchange. Even if there is no gain in the policy to be exchanged, a 1035 exchange permits the adjusted cost basis of the old policy to be carried over to the new policy. To qualify, however, the insured and owner must be the same on both policies and the exchange must involve:

- A life insurance contract for another life insurance contract or an annuity contract.

The exchange of two single life policies for a policy insuring two lives (survivorship policy) does not qualify as a non-taxable exchange. The IRS has permitted an exchange of a survivorship policy where the first insured has died for a single life policy insuring the life of the surviving insured.

- An endowment contract for an annuity contract.
- An annuity for an annuity.

(An exchange of an annuity for a life insurance policy is not a 1035 exchange and may result in income tax consequences.)

Note: These rules do not apply to any exchange having the effect of transferring property to any non-United States person.

Product: In order to accommodate the transfer of values, the Security Mutual product must be able to accept unscheduled deposits.

- The Security Mutual product for an exchange of a policy **with no outstanding loan** should be either a Universal Life or Whole Life with Paid Up Additions Rider plan of insurance.
- The Security Mutual products for an exchange of a life insurance policy **that has an outstanding loan** balance must be Security XLC or Capital UL Max.

Underwriting: Full evidence of insurability based on age and amount applies.

Replacement Compliance: Full compliance with appropriate state replacement regulations will be necessary. Refer to the “Forms Required by State” section of SecurityLink for replacement guidelines and required forms.

Field Compensation: Compensation will be paid in accordance with contract terms.

Procedure: In order to process an exchange, the field representative should obtain:

1. The completed state-specific application with wording in the “Special Instructions” section to indicate “This is a 1035 exchange.” Suggested wording to avoid amendment:
 - 1035 Exchange proceeds only; or
 - 1035 Exchange proceeds plus planned premium; or
 - 1035 Exchange proceeds plus planned premium plus lump sum deposit of \$ _____ ; or
 - 1035 Exchange proceeds plus lump sum deposit of \$ _____

2. Evidence of insurability based on the insured’s age and amount applied for.

3. The applicable 1035 Exchange Form should be signed (original signature(s) only) by the owner(s), collateral assignee, etc., and submitted to the Home Office. This agreement contains a number of conditions and should be read carefully by the owner(s) before signing.

If the owner is a corporation or other business entity, provide the full name of the entity followed by the signature and title of the authorized party. If the owner is a trust, provide the full name of trust and trust date, followed by the signature(s) of the trustee(s). Insert the title “Trustee(s)” following the signature(s).

4. A copy of the trust agreement where applicable.
5. The old policy or policies should be returned to the Home Office or check box 1(b) in Section B on the applicable Exchange Form.
6. All state-specific replacement paperwork.
7. Conditional Insurance Receipt or Temporary Insurance Receipt (issue state specific) if money is taken with the application.

Upon receipt of the above requirements, the following will occur:

1. If the Company approves the new policy for insurance in a standard or better rating class, or in a rated class that had previously been requested and accepted in writing, the Company will request surrender of the old policy.
2. If the new policy is approved with a rated premium, the Company will await the confirmation of acceptance by the owner prior to beginning the surrender process.
3. The Company will issue the new policy for delivery upon receipt of the 1035 proceeds.
4. If surrender cannot be effected, the old policy will be reassigned to the policyowner and the Company’s obligations under the exchange agreement will terminate.
5. If the policyowner declines acceptance, or returns the new policy under the “Free Look” provision, the Company will, in its discretion, either cooperate with the policyowner in attempting to reinstate the policy(ies) with the prior insurer or deliver all payments made with respect to the new policy to the policyowner.

Special Notes

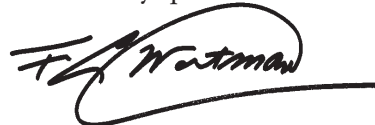
1. Approximate processing time for exchanges is 30 days from receipt of paperwork in good order at the company that issued the contract to be exchanged. Clearly, conservation will be attempted, and you should be prepared for a significant delay before the surrender proceeds are received and applied to the Security Mutual policy.
2. An exchange of a life policy issued prior to June 21, 1988, that would be a modified endowment contract if issued after the effective date of IRC Section 7702A (i.e., fails the 7-pay test), will lose its grandfathered status. It is unlikely that such an exchange will be in the client's best interest.
3. Security Mutual will not pay premiums if any become due on the old policy(s). If the client wishes assurance that there is no break in coverage before issue of the new policy, the client should be instructed to pay the premiums on the in-force policy, although it might be prudent to pay the minimum modal permitted.
4. Please note that some insurance carriers will **not** transfer the outstanding loan balance on life insurance products. Such carriers will surrender the loan first, with the balance of the funds transferred to Security Mutual. This treatment may create an adverse tax consequence. To avoid this outcome, Security Mutual will contact the replaced carrier to verify how the transaction will be handled from a tax reporting perspective. The Company will not proceed with the surrender of the existing policy(s) if the treatment creates an adverse tax consequence unless specifically directed, in writing by the owner and agent, to do so.
5. While 1035 exchanges allow for tax-free treatment, some situations can result in immediate taxation. For example, the receipt of any cash or "boot" not poured into the new contract will result in income tax to the extent of any gain in the contract.

A Word of Caution

Our willingness to participate in external 1035 exchanges is conditioned on the assumption that such exchanges will not constitute a major part of any particular agent's business. Security Mutual takes a strong anti-replacement posture. Specialization in 1035 exchanges is not an acceptable marketing technique. Further, the Company's participation in the transaction is an accommodation to the policyowner. Security Mutual assumes no responsibility or liability for any related tax treatment or consequences under Internal Revenue Code Section 1035. Clients should be encouraged to seek the independent advice of a competent tax advisor before proceeding with any exchange.

The forms attached to this bulletin are available electronically through the Librarian section of SecurityLink.

Please contact the New Business Department at 1-800-346-7171 with any questions.



Frederick L. Wortman, CLU, ChFC, FLMI,
ACS, RHU, AIAA, REBC, AIRC, APPA
Executive Vice President, Administration and
Chief Compliance Officer

Attachments:

- 0011911XX – Agreement for Exchange for a Life Insurance Policy to a Life Insurance Policy Issued by Security Mutual Life Insurance Company of New York Under Section 1035 of the Internal Revenue Code
- 0004480XX – Agreement for Exchange of a Life Insurance Policy or an Annuity to an Annuity Issued by Security Mutual Life Company of New York Under Section 1035 of the Internal Revenue Code
- 0011282XX – 1035 External Exchange Guidelines for Security Mutual

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