

## Frequently Asked Questions

### What is the Policy Evaluation Program?

It is a program designed to provide pertinent information for, and a systematic analysis of, a permanent life insurance policy that is presently in force. The program is designed to give life insurance consumers an understanding of their policy performance, with an eye toward maximizing value. It is a program that was precipitated by dramatic changes in the life insurance marketplace in the last decade. All life insurance policies should be periodically reviewed to gauge actual policy performance against original expectations to make sure that the policy will reach the intended goals. Variable products are out of scope for the Policy Evaluation Program and comments on such products are provided for educational purposes only. Variable products can only be sold by registered representatives of FINRA member firms.

### Is there any cost for this service?

No, this is a complimentary service.

### What are the components of the Program?

A report is generated on each policy that consists of the following:

- An introduction that succinctly discusses the changes that have occurred in the life insurance marketplace.
- In-force ledgers of the existing policy with different funding options or goals.
- A one-page spreadsheet analysis of the "in-force" ledgers showing the Internal Rate of Return (IRR) of the death benefit and assumed cash values at various intervals, the number of years that the policy will stay in-force under current assumptions, and the number of years the policy is guaranteed\* to stay in-force.
- If appropriate, the report may include optional policy alternatives, but only if there is a distinct client advantage.

*All life insurance policies should be periodically reviewed to gauge actual policy performance against original expectations and to make sure that the policy will reach the intended goals.*

### What is an in-force ledger?

Different from an annual statement, which is a snap-shot of a policy's performance, an in-force ledger is a "re-projection" of the values of a permanent life insurance policy that is already in-force. An in-force ledger uses a policy's cash values as of the date of the "in-force" ledger and then projects values into the future based on premium levels and other variables that can be chosen. It is a way to analyze the performance of the policy versus the original projections. The effect on the policy of changing premium levels, death benefits, etc., can be analyzed.

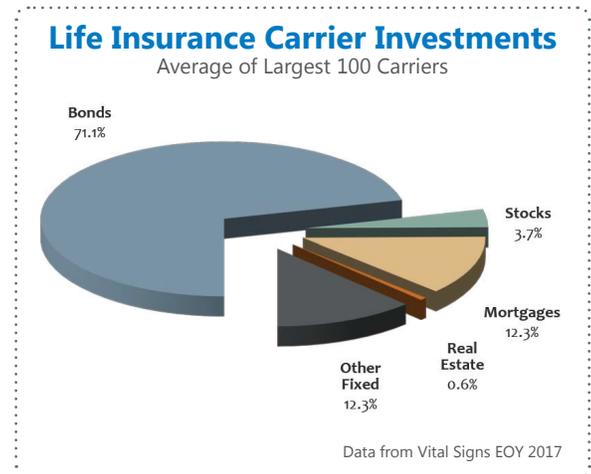
\*Any guarantees mentioned are subject to the claims paying ability of the issuing company.

## Frequently Asked Questions, cont.

### What factors may affect the performance of existing permanent life insurance policies?

There are three major factors that affect the performance of a life insurance policy:

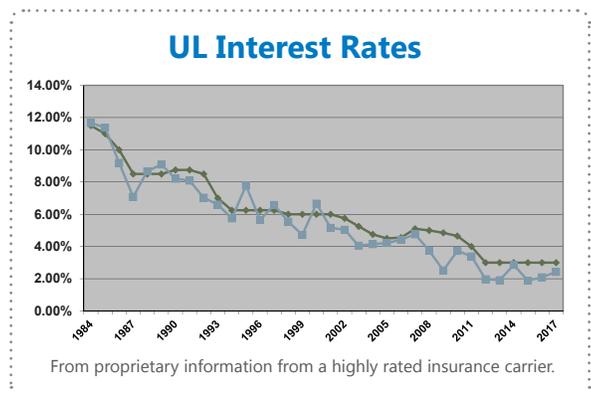
- The first is the interest rate return on the underlying investment that provides the cash value in the policy. In Universal Life (UL) and Whole Life (WL) policies this investment account is in insurance company-directed investments. As you can see from the chart on the right, it consists mostly of bonds, with some real estate assets. In Variable and Variable Universal Life (VUL) policies the cash value is invested in separate accounts with the asset classes chosen by the policyowner.
- The second factor is the expenses in the policy, including the acquisition costs (commissions, underwriting expenses, etc.)
- And the third factor is the actual mortality charges within the policy.



Of the three factors noted, the one that more significantly affects the actual performance of the policy versus that projected in the sales illustration is the interest rate obtained. The actual expenses and mortality charges used in original illustrations are easier to project and predict than the investment return. In all illustrations there is an assumed projection and a guaranteed projection. The assumed projection is a “best guess” of what will occur in the policy going forward using the current assumptions for expense, mortality and investment return. The guaranteed projection uses only those factors that are guaranteed when it projects the outcome. If the actual current interest rate that is obtained in the policy is less than the projected rate, the policy will not perform as well as expected.

### How have actual investment returns affected the expected performance of existing policies?

Over the course of the last 30+ years, the interest rates credited to UL policies for the most part have dropped, as demonstrated by this chart. The chart represents the actual credited interest rates on a particular UL policy issued by a major life insurance carrier. When the company introduced their UL policy in 1984, the current interest rate was almost 12%; since that time, the current rate has dropped.



## Frequently Asked Questions, cont.

*According to a 1998 article in Trusts and Estates magazine, in 75% of trust policies that were at least 5 years old, the death benefit could be increased by 40% without any increase of premium. Although no more recent studies exist, no industry developments indicate any dramatic change to this trend.*

WL policies operate somewhat differently than UL policies. The underlying investment returns are just one component of any dividends that a whole life policy may receive. Dividends represent a "return of premium" that is dependent on not just the insurance company's investment returns, but also the "gains" in the mortality and expenses where the company's actual experience proves less costly than what was illustrated.

Typically in Variable Life and Variable Universal Life (VUL) policies, the investment returns depend on the performance of the separate accounts chosen by the policyowner based on risk tolerance, liquidity needs, time horizon and goals for the policy. The separate accounts are managed by fund managers, similar to many open ended funds, and can invest in a mix of stocks, bonds or other products based on the investment and risk tolerances of the underlying fund.

Lower returns in the underlying investment of the life insurance policies purchased may cause actual policy cash values to be lower than the original

illustrated values. If investment returns lag for an extended period of time, the policy may lapse, or a higher premium may need to be contributed for the policy to reach the original goals.

Premium Needed to Fund Policy to Age 100 at Different Credited Interest Rates	
at 7%	at 4%
\$14,208	\$25,058

Assumes \$2.5M Universal Life policy for a male, age 45 and preferred non-smoker, paying premium all years with \$100,000 cash value at age 100.

As you can see from the table to the right, the investment return in the policy can dramatically affect the amount of premium that needs to be contributed to reach a goal.

The analysis above shows the affect of an interest crediting rate on the performance of a Universal Life policy. The 7.5% credited rate approximates the rate paid on UL policies two decades ago. The 4% rate is in line with what most UL policies are crediting today. As you can see, it would take approximately 34% more premium at the lower interest rate to keep the policy from lapsing before age 100, assuming the lower interest rate and the lower premium funding the policy lasts only to age 83 which is less than expected mortality.

## Frequently Asked Questions, cont.

### **Have recent events in the capital markets affected my permanent policy's performance?**

Possibly. Market results can and will affect a policy's performance. In the case of variable products, less than anticipated market results may not allow a policy to equal its originally projected results.

As shown in the previous section, general account products tend not to be as affected by market fluctuations as variable account products due to their underlying investments. Nevertheless, fluctuations in the marketplace may cause the respective current dividend scales and current interest rates of return for whole life and general account universal life products to be lower than projected.

If crediting rates are not met, a policy may not meet the policy owner's needs. The recent volatility in the capital markets has only served to make the need for current policy review all the more critical.

### **How have the expense and mortality charges in a life insurance policy changed?**

Over the last 10 to 15 years, both the expense and mortality costs for life insurance policies have dropped. The mergers and acquisitions within the life insurance marketplace have affected expenses within the policy, which include all of the costs of issuing a policy. This has created a much more efficient marketplace, as technology and economies of scale reduce the costs of doing business. Commissions to the agent have been reduced as life insurance manufacturers react to a more competitive marketplace. Lastly, demutualization, in which a life insurance carrier changes from a mutual company (owned by the policyholders) to a stock company (owned by the shareholders) has created more efficient policies for two reasons: (1) Demutualization opens up the capital market for the life insurance carrier to expand and acquire other companies; (2) Once it becomes a stock company, the carrier is forced to become more competitive since it must answer to stockholders.

Mortality charges have dropped yearly as medical improvements and better health habits contribute to a longer life for most Americans. According to a 1998 article in Trusts and Estates magazine, in 75% of trust policies that were at least 5 years old, the death benefit could be increased by 40% without any increase of premium. Although no more recent studies exist, no industry developments indicate any dramatic change to this trend. The lower mortality costs resulted in more efficient policies. We continue to see this today. A copy of the article is available upon request.

### **How are the expense and mortality gains reflected in existing life insurance policies?**

As stated before, permanent life insurance policies are issued with the expectation that the policy will use the current life insurance costs, including mortality expenses. Improvements to the mortality costs in the life insurance marketplace are typically not reflected in existing policies, but may be in newer policies, as the carriers introduce new products. So, the gains that can be seen in the marketplace may or may not be reflected in the policies owned by existing policyholders. Because of the competitive nature of the marketplace, many insurers use the gains that are created to lower costs on new policies.

## Frequently Asked Questions, cont.

### What will the Policy Evaluation Program tell me about my existing policies?

The final report will provide you with the guidance needed to see if your policies are on track to reach their goals. If they are on track, then no further steps will be needed. If however, they are not on track to reach their goals, an analysis will be made to show options. Typically, these will include raising or lowering premium levels or altering the goals in the policy. This can be accomplished usually by raising or lowering the death benefit.

### What will I have to do to take part in the Program?

Your insurance professional will be asked to fill out a Policy Evaluation Program Fact Finder. An in-force ledger for the policy will be required if available. You may be asked to sign a document allowing your insurance professional to gather information about your policie(s) from the life insurance carrier(s) issuing the policie(s). And if warranted, you may be asked to fill out information on your present health situation.

### Are carrier ratings important?

If you are making the decision to replace an existing policy with a new policy based on a sales illustration that relies on "guaranteed assumptions," understand that the policy guarantees will be only as strong as the carrier backing them. Review the ratings of the selected carrier against this listing of top ratings. A company's ratings should be monitored for change.

In addition to the ratings, it is wise to select a carrier that has a favorable Comdex rating. The Comdex rating is the average percentile ranking for all of the ratings received by a company. As such, it is not another rating, but rather an objective scale that can be used to easily compare the ratings of different companies.

Rank	AM Best	Fitch Ratings	Standard & Poors	Moody's
1	A++ (Superior)	AAA (Exceptionally Strong)	AAA (Extremely Strong)	Aaa (Exceptional)
2	A+ (Superior)	AA+ (Very Strong)	AA+ (Very Strong)	Aa1 (Excellent)
3	A (Excellent)	AA (Very Strong)	AA (Very Strong)	Aa2 (Excellent)
4	A- (Excellent)	AA- (Very Strong)	AA- (Very Strong)	Aa3 (Excellent)
5	B++ (Very Good)	A+ (Strong)	A+ (Strong)	A1 (Good)
6	B+ (Good)	A (Strong)	A (Strong)	A2 (Good)
7	B (Fair)	A- (Strong)	A- (Strong)	A3 (Good)
8	B- (Fair)	BBB+ (Good)	BBB+ (Good)	Baa1 (Adequate)
9	C++ (Marginal)	BBB (Good)	BBB (Good)	Baa2 (Adequate)
10	C+ (Marginal)	BBB- (Good)	BBB- (Good)	Baa3 (Adequate)
11	C (Weak)	BB+ (Moderately Weak)	BB+ (Marginal)	Ba1 (Questionable)
12	C- D (Weak)	BB (Moderately Weak)	BB (Marginal)	Ba2 (Questionable)
13	D (Poor)	BB- (Moderately Weak)	BB- (Marginal)	Ba3 (Questionable)
14	E (Under State Supervision)	B+ (Weak)	B+ (Weak)	B1 (Poor)
15	F (In Liquidation)	B (Weak)	B (Weak)	B2 (Poor)
16		B- (Weak)	B- (Weak)	B3 (Poor)
17		CCC+ (Very Weak)	CCC+ (Very Weak)	Caa1 (Very Poor)
18		CCC (Very Weak)	CCC (Very Weak)	Caa2 (Very Poor)
19		CCC- (Very Weak)	CCC- (Very Weak)	Caa3 (Very Poor)
20		CC (Extremely Weak)	CC (Extremely Weak)	Ca (Extremely Poor)
21		C (Distressed)		C (Lowest)

All ratings shown are current as of July 02, 2018

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