Jon and Lorraine

Insurance Analysis

Life Insurance Portfolio Summary

Jon

- Lincoln National Variable Universal Life
  - Death Benefit: $750,000 (level death benefit option)
  - Annual Premium: $14,306
  - Approximate cash values as of end of policy yr. 13:
    - Accumulation: $121,559
    - Surrender value: $117,008
    - 15 yr. declining surrender charge period
  - Male age 43, current age 55
  - Health class: Preferred

- American General Elite Universal Life
  - Death Benefit: $450,000 (level death benefit)
  - Annual Premium: $17,500
  - Policy issue date: 7/10/08 (age 51)
  - Approximate cash values as of end of policy yr. 4:
    - Accumulation: $18,511
    - Surrender value: $6,811
    - 20 yr. declining surrender charge period
  - Health class: Preferred Non-Tobacco
  - Death benefit guarantee under certain conditions

- American General Elite Universal Life
  - Death Benefit: $750,000 (level death benefit)
  - Annual Premium: $17,500
  - Policy issue date: 7/28/08 (age at issue 51 but one of the inforce illustrations notes Male 52)
  - Approximate cash values as of end of policy yr. 4:
    - Accumulation: $10,232
    - Surrender value: $0
    - 20 yr. declining surrender charge period
  - Health Class: Preferred Plus
  - Death benefit guarantee under certain conditions

The Efficient Edge ◆ 120 S. LaSalle ◆ Suite 1710 ◆ Chicago IL ◆ 60603 ◆ P: 312.368.7560 ◆ peter.steger@efficientedge.net
Peter F. Steger CLU, ChFC, REBC – Principal, The Efficient Edge

- Hartford Universal Life with Secondary Guarantee
  - Death Benefit: $300,000
  - One-time payment of the following:
    - 1035 tax-free transfer: $46,319
    - One-time premium payment in year 1: $7,359.94
  - Policy issue date: 3/25/10
  - Health class: Preferred Non-Nicotine

- **Totals**
  - **Death Benefit: $2,250,000**
  - **Premium: $50,000 (approximate on-going premium)**
  - **Cash value (excluding Hartford policy):**
    - **Accumulation: $150,300**
    - **Surrender: $123,800**

Lorraine

- Lincoln National Variable Universal Life
  - Death Benefit: $650,000
  - Annual Premium: $777
  - Approximate cash values as of end of policy yr. 13:
    - Accumulation: $63,562
    - Surrender value: $60,273
  - 15 yr. declining surrender charge period
  - Female age 42, current age 54
  - Health class: Preferred
  - MEC

Recommendations and Observations

Overview

- The insurance companies are solid financially and acceptable.
- Jon has $2,250,000 and it looks like he is spending about $50,000
    - He could leverage that amount of premium to larger death benefits
    - If death benefit is a priority then you should examine how to best increase Jon's death benefit for the premium currently being spent
    - If cash value is a priority then you need to discuss the purpose and make sure this is the best way to fund his purpose and what the implications are for long term death benefits depending on the plan for future loans/withdrawals
        - Based on my experience when attempting to use life insurance to build up cash value it means that the design and intention is for future use of the money, to tap into those funds to generate some tax-free income flow via policy loans but this long term strategy is full of land mines
- Insurance on Lorraine should be discussed as to the purpose and need for life insurance on her
    - Premium dollars being spent on her may be better spent on Jon
    - If there is a need for life insurance on Lorraine then you need to discuss the following:
        - Length of the need
        - Amount
        - Best way to finance the need for life insurance on Lorraine
            - Term insurance for the length of time needed
            - Permanent insurance if there is a need for a death benefit on Lorraine that is perceived or desired for her lifetime
- I would recommend the following:
    - A "fresh" analysis of their needs for life insurance
    - I do not believe Jon needs to fund any life insurance at such a high level, maximize death benefit per premium dollar spent
    - If there are compelling reasons I am not privy to that indicate the need or goal to continue to grow cash value inside VUL policies then I would do the following:
        - Consider funding Jon's policy over the shortest period of time at the maximum amount of premium without causing a MEC
        - Look at new VUL policies that may be more efficient
    - Discuss the use of an ILIT based on his estate planning needs to remove life insurance from estate
        - If this road is taken then I would maximize death benefit for the gifts being made into the trust
        - I would not continue the VUL policies and develop an exit strategy based on an updated assessment of his needs for life insurance
        - You can keep the Universal Life policies with American General, consider adjusting the premium flow and find a way to move them into the trust
        - The Hartford is good to keep but you will want to consider moving this policy into the trust, if appropriate

The Efficient Edge ◆ 120 S. LaSalle ◆ Suite 1710 ◆ Chicago IL ◆ 60603 ◆ P: 312.368.7560 ◆ peter.steger@efficientedge.net
Peter F. Steger CLU, ChFC, REBC – Principal, The Efficient Edge

Jon – Variable Universal Life (VUL) with Lincoln National

- You are currently funding this policy at a high level premium of $14,306
- As my report will indicate VUL policies work best if funded at a high level but you sacrifice death benefit leverage per premium dollar being spent
- You fund these policies at a high level if the priority is cash value growth but due to internal costs and age of the policy the market performance of the funds have to perform at a very high and consistent level. Market volatility negatively impacts the policies and hinders cash value growth performance and expectations are never met. Based on my analysis I would recommend developing a strategy for exiting this policy.
- There are no guarantees in your policy so proper funding and monitoring of returns is critical to its long term viability
- If an ILIT is to be used, generally people want to maximize death benefit for the premium dollar spent and know that the insurance will not lapse prior to their death. VUL policies are very difficult to manage on a minimum premium basis, in fact, they will most likely lapse.
- In hindsight, Jon bought these policies just prior to the worst decade of the market so the policies long term viability have been compromised, or another way to think about it, the performance expectations will most likely never be met.
- I would recommend to run the illustrations at different rates of return – 5%, 6%, 7%
- I would also recommend that if a VUL policy still is desired to meet their needs that the open market be analyzed. My report indicates why.
- From a death benefit perspective you are not gaining any leverage by overfunding. The death benefit stays level until such time that the cash value reaches close enough to the death benefit which is called the "corridor" and then the death benefit will increase in order to meet the IRS definition of life insurance. Crediting rates will have to significantly increase in the UL policies and stay at a high level and in the VUL policies the market returns will have to be consistently high enough (greater than 8%) in order for this strategy to pay off soon enough to benefit the family. This is highly unlikely.
- There is a surrender charge applicable for another couple of years so you may want to consider waiting until such charge no longer exists. The surrender charge amounts are so stated in the policy illustration

Lorraine – VUL with Lincoln National

- Please refer to my comments above about Lorraine and her life insurance
- Her policy seems to be a MEC from the information I have been provided so there are tax implications based on this status
    - Any withdrawals prior to 59.5 are made on a LIFO basis so if there is a gain the gain would be distributed first and there would be a 10% penalty
    - If you surrender the policy prior to 59.5 and there is a gain in the policy there is ordinary income tax due on the gain and a 10% penalty
    - There probably is not a gain in the policy but you need to request a statement of gain or verify the cost basis to find out. If there is no gain this will allow a "clean exit" from this policy.

The Efficient Edge ◆ 120 S. LaSalle ◆ Suite 1710 ◆ Chicago IL ◆ 60603 ◆ P: 312.368.7560 ◆ peter.steger@efficientedge.net
Peter F. Steger CLU, ChFC, REBC – Principal, The Efficient Edge

- In general, life insurance on one's spouse has a finite time frame usually based on the age of their children. You have cash value tied up in a policy on Lorraine that could be used to leverage more death benefit for Jon, if appropriate.
- There is a surrender charge applicable for another couple of years so you may want to consider waiting until such charge no longer exists if you decide you want to exit. You could pay $0 premiums for the balance of the surrender charge period and look at some term insurance if you need a death benefit on Lorraine either now or at the time of surrender. The surrender charge amounts are so stated in the policy illustration

Jon – Universal Life with American General

- You have 2 policies for different death benefits of $450,000 and $750,000 but based on the information I received you are paying the same premium, why or what was the original thinking/purpose?
- With crediting rates so low, paying a high premium does not make much sense to me
    - You need to reevaluate premium flow into these contracts
    - I would run an illustration based on a minimum premium or a limited premium payment schedule to guarantee the death benefit to an appropriate age such as 100 or 105 based on life expectancy information in my report.
    - The current crediting rate is just about at the guaranteed level; 3.05% vs. 3% (guaranteed crediting rate)
        - You could run the illustrations assuming the 3% at the current charges to see the impact
        - Note that the charges can escalate so you want to devise a premium plan that will guarantee the death benefit under the guaranteed assumptions.
- These policies have a 20 yr. surrender charge period that is fairly significant at this time so I would work with these policies and keep them inforce but consider adjusting the premium flows

Jon – Universal Life with Hartford

- This policy is a one-time payment Universal Life policy with a guarantee f death benefit for $300,000. It is good to go.

Policy Designs

Variable Universal Life (VUL)

Variable Universal Life came into the market in the 1980's during the stock market boom. The insurance industry designed this product as another attempt to react to the investment and economic landscape at the time. This is a pure performance based life insurance policy relying on proper funding and market returns. There are many moving parts within the policy design.

Let's think in terms of 3 major components; expenses, mortality, and cash value. Each company has built into the product their own internal cost structure for profit margins, fees, lapse assumptions, commissions, etc. The expense ratio and mortality cost components built into the policy are charged to the policy on a "current" basis with a maximum level set in the policy contract. The cash value will fluctuate with the market returns based on the investments chosen.

The issue in properly analyzing VUL policies lies in the fact the policy illustrations are made in a static environment. The current market conditions and cost factors are "frozen" and assumed never to change on a go-forward basis. The linear rate of return assumed builds an expectation for the consumer as to the probable success of the product yet as the economic and market conditions ebb and flow they will impact the cash value returns and possibly the other cost factors which could compromise the future viability of the contract. The product lives in a dynamic environment affected by the economic and market conditions and yet the illustration system can not accommodate how these different economic conditions impact the product.

Here is how it works:

Premiums are paid into the policy and premium loads are deducted before the funds are deposited. There are upfront expenses paid the insurance company, and federal and state premium taxes paid from each premium payment. This will amount to 5% for your contract. The "net" amount is then invested in the funds chosen from among all the choices available. Monthly deductions are made for administrative expenses, cost of insurance (COI), Mortality & Expense and the funds have their own management/expense fees deducted (daily) which range from .30% to 1.74% (yet the illustration assumes .83% which may not be the actual case).

The COI charges increase on an annual basis and are not guaranteed. The COI factor is a cost/$1000 of the net amount at risk (NAR). The NAR is calculated as the difference between the death benefit and the cash value. As the COI cost factor increases the NAR MUST decrease in order for the policy not to lapse. The NAR will fluctuate based on the volatility of market returns and as costs potentially change.

As mentioned above, the problem is the illustration system can not illustrate the dynamics of the market and its corresponding volatility. The other issue is if the market returns are negative the loss is amplified because the COI are deducted monthly and increase over time. If not monitored or properly funded the policy will be in jeopardy. In this type of design the policy will use the cash value to make up any difference between the returns +premiums – COI and other costs. You cash value could actually be increasing yet the policy may be in jeopardy over the long run.

We have access to technology that can Monte Carlo simulate returns based on different asset allocation models and can provide an internal cost analysis (for both UL and VUL). We can also adjust the asset allocations.

The Efficient Edge ◆ 120 S. LaSalle ◆ Suite 1710 ◆ Chicago IL ◆ 60603 ◆ P: 312.368.7560 ◆ peter.steger@efficientedge.net
Peter F. Steger CLU, ChFC, REBC – Principal, The Efficient Edge

Universal Life (UL)

The design is basically the same as above. The cash value is subject to less volatility due to the crediting strategy applied to the cash value. This is also a performance based type life insurance structure. You need to fund the policy so that the NAR can be paid for over the lifetime of the insured.

These policies burst on the scene in 1977 when short term interest rates were close to 20%! It was originally designed and brought to market by E.F. Hutton Life. The high interest rates drove down premiums and for the first time the components of life insurance were not guaranteed as they are in whole life. Expense ratios and mortality costs were charged on a current basis and were not guaranteed but a maximum level was set in the contract. The mortality cost or COI factor increased and was applied to the NAR. If you assume a high interest rate out into the future the assumed premium to fund the NAR was much lower than ever seen. As interest rates came down the crediting rates decreased and the assumptions proved to good to be true and universal life policies became underfunded to quite a surprised consumer.

Universal Life with a Secondary Guarantee (GUL)

The population has grown older and wiser but so have the insurance companies. Universal Life and Variable Universal Life were originally built with no guarantees. Their downfall was the lack of understanding and management. Market conditions, economic uncertainty and the consumer's desire for more certainty produced a new type of design - Life insurance with a secondary guarantee of the death benefit. The products are designed to guarantee your death benefit as long as you pay the stated premium ON-TIME based on the illustration. It becomes more of a transaction based sale or purchase. There is virtually no cash value so in essence you are buying term insurance for a period of time. The leverage per premium dollar is the highest but the flexibility is the lowest.

In today's market place where a majority of the sales are larger policies to an older clientele it seems to make some sense to many to purchase as much death benefit for the least amount of premium. If you understand the transaction then this can be a powerful way to obtain and fund life insurance.

The Efficient Edge ◆ 120 S. LaSalle ◆ Suite 1710 ◆ Chicago IL ◆ 60603 ◆ P: 312.368.7560 ◆ peter.steger@efficientedge.net
Peter F. Steger CLU, ChFC, REBC – Principal, The Efficient Edge

The Life Expectancy (LE) Factor

In building The Efficient Edge I was concerned about life expectancy data because it plays a critical role in properly managing life insurance. It also plays an important role in retirement planning. Part of the science of life insurance is being able to more accurately judge one's life expectancy. Normal life expectancy indicates an age where 50% of a population is alive and 50% are passed. Managing life insurance to normal life expectancy means that many life insurance policies will die before the insured. So I embarked on more research.

I came to realize in my research and in my discussions with different actuarial firms a couple of important factors:

1. Using standard IRS life expectancy tables has been a standard approach for many people. Unfortunately, these tables are often inadequate in their representation of realistic probabilities and are also often misunderstood by the individuals using the tabular data. IRS tables use broad-based mortality data to determine their life expectancy (LE) data. While this is statistically accurate, these tables also take into account the broader population in general, including infant mortality, prisoner LE, and broad socio-economic classes to determine a median LE.
2. Using mortality tables supplied by insurance companies have a couple of problems:
    a. They are used to price a risk and profit from that risk. This is much different than judging life expectancy. An insurance company may say someone is "uninsurable" but they certainly have a life expectancy albeit a short one.
    b. The second discovery was that due to regulatory pricing models and to insure that proper accounting reserves are calculated there is a mortality margin built into insurance company tables, therefore, shortening life expectancy data.

In an effort to enhance our understanding of our clients' LE or longevity, our insurance and annuity analytics company, The Efficient Edge, commissioned an actuarial firm to provide us with graduated probabilities of 50%, 75%, 85% and 95% for male and female individuals, smokers and non-smokers. We asked the actuarial firm to build our LE tables that drew from a population of individuals who were affluent and owned life insurance. We also asked them to strip out the mortality margin (risk pricing vs. LE) built into mortality tables. Our LE tables help us more accurately reflect the socio-economic realities of our client base vs. the population in general. Not surprisingly, the data suggests longer life expectancies than the general population – an important factor when modeling life insurance viability or retirement income sustainability.

Based on our LE tables, a male age 54 and a female age 53 in good health have the following LE probabilities:

	Male	Female
•	50% (normal LE): 85.9	87.7
•	75%: 92.9	94.5
•	85%: 95.5	97.1
•	95%: 99.8	101.3

Now that we have an understanding of the different types of policy designs and Life Expectancy let's turn our attention back to the Kaplan's life insurance portfolio.

The Efficient Edge ◆ 120 S. LaSalle ◆ Suite 1710 ◆ Chicago IL ◆ 60603 ◆ P: 312.368.7560 ◆ peter.steger@efficientedge.net
Peter F. Steger CLU, ChFC, REBC – Principal, The Efficient Edge

Lincoln National - Variable Universal Life (VUL)

Jon - $750,000

There are no guarantees built into the policy. Its long term viability will be based on premium funding, market returns, internal cost assumptions and their possible increase/decrease. The illustrations were run at an 8% assumed rate of return on a linear basis. In my experience, most variable life insurance that assumes an 8% return will work at a variety of funding levels but most likely will not reflect reality.

There were 3 scenarios run for Jon's policy:

1. Assuming a $14,306 annual premium
2. Assuming $0 premiums paid going forward
3. Assuming an annual premium of $10,882

Scenario #1

Based on the illustration, the current premium of $14,306 is the maximum level premium based on IRS premium guidelines. The IRS sets guidelines as to how much premium can be deposited into life insurance policies. Therefore, funding at this level is a wise choice but does not guarantee the death benefit (in the illustration Lincoln indicates that the "No-Lapse" provision premium is $14,306.33 (an issue to verify meaning). It does provide for a "cushion" for funding the policy long term as it will experience return volatility that will impact the cash value and the funding of the NAR. The faster you close the gap between the death benefit and cash value the more safety in the policy because you eliminate much of the insurance cost drag and possibility of lapse. I would recommend you run the policy at this funding level at lower rates of returns – 5%, 6%, 7% to better understand the impact of lower returns.

The death benefit is level so by overfunding you are focused on cash value growth. The rate of return assuming a gross 8%, $14,306 annual premium since inception:

	Cash Value	Death Benefit
•	13 yrs.(age 54): -6.29%	18.66%
•	20 yrs.(age 62): -1.58%	8.49%
•	30 yrs. (age 72): 1.06%	3.39%
•	40 yrs. (age 82): 2.96%	3.16%
•	50 yrs. (age 92): 3.86%	3.96%

If we look at the net returns starting from today, assuming 8% gross return, $14,306 annual premium

	Cash Value	Death Benefit
•	10 yrs.(age 64): .99%	29.04%
•	20 yrs.(age 74): 2.66%	8.49%
•	30 yrs. (age 84): 4.16%	6.58%
•	40 yrs. (age 94): 4.78%	6.28%

The Efficient Edge ◆ 120 S. LaSalle ◆ Suite 1710 ◆ Chicago IL ◆ 60603 ◆ P: 312.368.7560 ◆ peter.steger@efficientedge.net
Peter F. Steger CLU, ChFC, REBC – Principal, The Efficient Edge

There is a 15 year surrender charge period so if there are any changes that you would like to make in terms of the amount of death benefit or withdrawals there will be a partial surrender charge impact on values.

I would also recommend an analysis of the investment choices. Based on my experience investment choices within these designs are rarely managed. You would also like to factor in the proper charges based on the current or future investment choices, if the software can accommodate.

Scenario #2

Paying in $0 premium is not a viable or wise option even though at 8% gross return it seems to be viable. Volatility will have a tremendous impact and the policy will be more sensitive to market returns. The probability of lapse under this premium scenario is very high based on my experience.

Scenario #3

Based on the material it looks like the "target" premium is $9,682, which is the commissionable premium amount. Since the policy premium is at the maximum level dropping down to a premium level of $10,882 which is slightly above the targeted premium is a premium level that will also maintain the policy at 8%. I would again want to examine different return scenarios.

Note: Borrowing money from these policies make it difficult for long term survival. You would have to manage the borrowing process. If this is something that is of interest then we can expound on it.

Lorraine - $650,000

I discovered that the policy seems to be a MEC (Modified Endowment Contract). A MEC means that the death benefit remains tax-free but any loans or withdrawals are taxed as ordinary income on a LIFO basis and if done prior to 59.5 there is also a 10% penalty. This contract may have been bought under the 1035 exchange rules – would want to verify. I would also request a statement of gain upon surrender.

What is the purpose of the coverage on Lorraine? Does the purpose still hold true today? I would recommend a more thorough discussion about the need for life insurance on Lorraine.

The policy is also subject to a 15 year surrender charge period. If the decision is to surrender the policy I would want to discuss waiting until the surrender charge period is complete and what, if any, premium to deposit.

There were 3 inforce illustrations sent to me:

1. This showed a premium of $777 paid annually. This policy has a high probability of lapsing at this premium level. At the 8% assumed rate the policy is left with $1,000 of cash value at age 100 therefore leaving no room for error. The impact of market volatility will most likely cause this policy to lapse. The information told me that starting in the 13th year (current) the policy is a MEC.

2. The second illustration showed a premium of $2,000 annually. You can see from the illustrations the sensitivity of the assumption being made of an 8% return. The extra premium of $1,223 vaults the cash value to a point where the NAR is driven down fast enough that the policy will actually perform and not lapse. As a matter of fact, it illustrates that the corridor that needs to exist between the death benefit and cash value as defined by the IRS is actually met and drives the death benefit higher (at age 94).
3. The third and last illustration shows the guideline annual premium being paid which at most any interest rate assumption will work (the policy will not lapse).

Variable life policies work if you adequately fund the policy. The better the performance the quicker you reach the corridor and thus the insurance cost drag is minimized and the death benefit will accelerate. You may think of this as an inflation adjusted death benefit opportunity. Maximum flexibility in terms of cash value is reached with this strategy.

Considerations and discussion points:

- Review the investments
- Review the purpose
- Understand the risks of the policy design and asses if this is how design should be a part of your life insurance portfolio
- Run the illustrations at various assumed rates of return
- Consider a Monte Carlo analysis

American General Life – Universal Life (GUL)

Jon has two policies; one written on 7/10/08 for $450,000 of death benefit and the second written on 7/28/08 for $750,000. Why were they written as two separate polices? I noticed that one was written with a health classification of Preferred Non-Tobacco and one was written with a health classification of Preferred Plus. We would want to verify if there is a difference in these underwriting classes from American General. A Preferred Plus generally means the best underwriting class followed by Preferred. The difference is lower premium and mortality costs. Another question I would have is why is the same premium being paid for different death benefit amounts?

There is a significant difference in the accumulation value based on the identical premium being paid. This may be due to the timing of premiums that were paid or that one policy had some money initially transferred under the 1035 rules. I do not believe it is solely based on the difference in death benefit. The difference is too big to be based on the cost of insurance at such a young age.

Policy # - $450,000

I reviewed 2 inforce illustrations:

Scenario #1

The current premium of $17,500 is in excess of the guideline annual premium of $10,538 so the policy is being overfunded. The illustration will show a decrease in premium for a couple of years (years 11&12) due to IRS guidelines as to how much premiums can be deposited into the contract for the said death benefit so as not to "MEC" the policy. The illustration then shows the premium reverting back to $10,538 for the remainder of the insured's lifetime. Overfunding is a means of building up the cash values within the particular policy design.

Universal Life as well as Variable life is a flexible premium design. As long as there is money in the cash value to pay for the current years cost the death benefit remains inforce. By overfunding you are giving yourself a lot of flexibility later to change the required funding. The cash value will grow and close the NAR gap that needs to be funded. This will allow you to pay in fewer premiums or continue to fund and the cash value will grow faster because the insurance cost drag is minimized and the death benefit will escalate once it reaches the corridor. In this particular contract there seems to be a secondary guaranteed death benefit "rider" allowing the death benefit to continue even if there is $0 cash value in the policy as long as certain premium deposits are made on time.

The rate of return on CV with stated the illustrated premium flow (from yr. 1) is the following:

- 20 yrs.: -.76%
- 25 yrs.: .11%
- 30 yrs: .74%

The rate of return on Death:

- 20 yrs.: 3.92%
- 25 yrs.: 2.02%
- 30 yrs.: 1.01%

The crediting rates are so low that the cost structure inside the insurance policy is about a breakeven. If crediting rates go up the returns will improve. I would recommend a discussion about how to best fund these contracts.

The guaranteed columns simply show what would happen if the insurance company were to raise all cost factors to the maximum allowed by contract and if the interest crediting rate were to remain at the guaranteed level of 3% going forward into the future. As you can see, the $10,538 funds the death benefit with $0 cash value at age 100 at the guaranteed assumptions. The death benefit will continue until age 121.

The Efficient Edge ◆ 120 S. LaSalle ◆ Suite 1710 ◆ Chicago IL ◆ 60603 ◆ P: 312.368.7560 ◆ peter.steger@efficientedge.net
Peter F. Steger CLU, ChFC, REBC – Principal, The Efficient Edge

Scenario #2

The second illustration that I reviewed illustrated the minimum premium going forward that would need to be paid to guarantee the death benefit to age **100** even though there is $0 cash value in the guaranteed column by age 72 (year 21 of the policy) and under current assumptions there will be $0 cash value by age 84. That minimum premium is $4,340.

The timing of the premiums is critical under these contractual conditions. The lower the premium you pay the less flexibility there is in terms of loans or withdrawals but the return on death is significantly enhanced.

Rate of return on death:

- 20 yrs.: 8.25%
- 25 yrs.: 5.88%
- 30 yrs.: 4.38%

Policy # - $750,000

I reviewed 4 illustrations:

Scenario #1

The current premium is the same at the $450,000 policy, as stated above. The $17,500 premium is funding the policy at the maximum guideline level premium amount as so stated under the Guaranteed Premium Test (GPT).

Again, this is a well funded policy. You are overfunding the secondary guaranteed death benefit and funding, at the current cost structure, at the highest level premium allowed so that the NAR is shrinking as fast as it can and will reach the corridor at age 88 based on a 3.05% linear return (the guaranteed minimum crediting rate is 3%). Overfunding is a means of building up cash values within the particular policy design.

At the $17,500 funding level under the guaranteed assumptions the policy cash value will run down to $0 by age 86 but the death benefit is guaranteed to age 121. The premium can continue until age 104 with the last year being reduced to $13,176 to accommodate IRS premium test rules.

Rate of return on CV:
20 yrs.: -1.56%
25 yrs.: -.57%
30 yrs.: .02%

Rate of return on death:
20 yrs.: 6.80%
25 yrs: 3.93%
30 yrs: 2.21%
40 yrs: 1.17%

Scenario #2 & #3

The illustration showed an annual premium of $7,890 that would guarantee the death benefit under current return and cost assumptions to age 121 but under guaranteed return and cost assumptions the death benefit lapse at age 69. To solve this issue, the computer generated the minimum premium amount of $8,000 which would need to be paid to guarantee the death benefit to age 121 under the guaranteed cost assumptions. ONLY an extra $110 per year needs to be paid to guarantee the death benefit to age 121 under both the guaranteed and current assumptions.

Scenario #4

If you pay $8,883 annually this will allow you to only have to pay this amount until age 100 and the death benefit is guaranteed under both scenarios (guaranteed and current) to age 121.

Additional notes:

- Both of the policies have 20 year surrender periods
- Depending on the purpose you may want to reexamine how to best leverage the premium dollars being spent
- The surrender charge makes it difficult to explore the open market at this time
- If premium flows decrease you want to better understand the "guarantee of death benefit provision"
    - Generally with these provisions the critical component is the timing of premium payments – they need to be paid on-time
    - If premium payments are late there generally is a provision that will allow the make up of "interest to buy back the guarantee

Hartford Life Insurance – Universal Life (GUL)

Jon - $300,000

This is a pure one-time payment Universal Life policy with a secondary guarantee of death benefit for $300,000. The cash value transferred ($46,319) + the one-time annual premium ($7,360) has contractually paid up the $300,000 death benefit. The cash value will decline to $0 by the 19th year the guaranteed assumptions (3% crediting rate/guaranteed cost structure) and by the 27th year under the current assumptions (3% crediting rate/current cost structure). The cash value is used to support and fully pay for the policy death benefit guarantee to age 120. Any changes made need to be assessed in terms of the guarantees built into the contract.

Hartford desires to sell their life insurance division along with some other divisions to focus on property and casualty products and distribution. This should not have an impact on this particular policy since it was a one-time payment and by contract is fully paid-up for $300,000.

The Efficient Edge ◆ 120 S. LaSalle ◆ Suite 1710 ◆ Chicago IL ◆ 60603 ◆ P: 312.368.7560 ◆ peter.steger@efficientedge.net
Peter F. Steger CLU, ChFC, REBC – Principal, The Efficient Edge

Supplement
Some concluding thoughts……

I do not know any more than what the information tells me. My analysis is unbiased and objective. Let me share some thoughts:

- The VUL policies need to be examined in terms of the overall game plan for their life insurance program
- The VUL illustrations need to be run at different return and premium flow assumptions
    - VUL works well if the investments and premium flows are managed
    - Overfunding VUL is a good idea to build up cash value but more importantly to provide a hedge against future market volatility but since the performance has not met expectations based on the last decade of market volatility and anemic returns these policies need to be reassessed
    - You may want to consider a Monte Carlo simulation especially if there is a desire to reduce premium flows
- Lorraine's VUL has a high probability of lapsing at the current premium level of $777. It is also a MEC, does this pose any problems? Does she need the life insurance? If so, is there a better way to provide her life insurance coverage? If not, what do you do? This will depend on a more in-depth discussion.
- If VUL will remain in your insurance portfolio you may want to consider analyzing the open market now for the following reasons:
    - Your current VUL is 13 yrs. old
    - Over the last decade products have become more efficient
    - Company consolidation, IPO's have brought about more focus on distribution and profits driving down costs
    - Margins have been decreasing because companies are distributing through more channels
    - People are living longer therefore premiums are being paid longer and death benefits will not have to be until farther out in the future
    - Mortality costs have decreased
    - A "fresh" look at you medically and if you are preferred then the insurance company can make new assumptions in regards to your "new" life expectancy which will be reflected in lower costs
    - There are VUL contracts now that offer a death benefit guarantee
- Jon seems to be overfunding all but the Hartford policy, why?
- If premium flow (cash flow) is a concern or there is a desire to explore decreasing premium commitments then we will need to discuss how to best accommodate lower premium payments
- Jon has $2,250,000 and it looks like he is spending about $50,000
    - He could leverage that amount of premium to larger death benefits
    - If cash value is a priority then we need to discuss the purpose and make sure this is the best way to fund his purpose and what the implications are for long term death benefits depending on the plan for future loans/withdrawals
    - Please refer to rates of return above
- Due to the surrender charge periods that exist any open market exploration needs to factor in this impact
- Is there an ILIT involved? If so, there should be a discussion about the pros/cons of overfunding.
- Hartford policy is good to go

The Efficient Edge ◆ 120 S. LaSalle ◆ Suite 1710 ◆ Chicago IL ◆ 60603 ◆ P: 312.368.7560 ◆ peter.steger@efficientedge.net
Peter F. Steger CLU, ChFC, REBC – Principal, The Efficient Edge