

Life Insurance Policy Disclosure – BreadwinnersInsurance.com Press Release #1 – March 2010

The life insurance marketplace has long been characterized by inadequate policy disclosure, especially with respect to cash-value life insurance policies. Fundamentally, the life insurance industry has failed to disclose the annual price of protection and other vital facts of cash-value policies. This failure has created numerous problems for American consumers, and seriously harmed the American economy. Professor Joseph Belth, a leading industry authority who has written about this problem for more than 40 years, states that life insurance is an industry built on secrecy. BreadwinnersInsurance.com believes the life insurance industry's long-running refusal to provide appropriate disclosure of cash-value policies has been not only unacceptable but shortsighted.

In recent years, we have all witnessed the economic crippling problems caused by bad and inadequate information in the mortgage and equity markets. While the problems in the life insurance marketplace are not of the same scale, they are insidious and profoundly harmful. Good and appropriate disclosure, after all, is a requirement of the modern 21st century American marketplace. Moreover, if any financial product has ever called for good disclosure, it is cash-value life insurance – a bundled product that has been notorious for its huge undisclosed sales costs, and a product, which when properly understood, is typically “priced after it has been purchased.” Inadequate disclosure has facilitated widespread misrepresentations and misconceptions, and has led to the tremendous failure of the cash-value life insurance industry to provide acceptable value to American consumers. Inadequate disclosure has, most notably, also facilitated the appropriation of the benefits of the product's unique tax privileges by the industry and its agents. No market for a consumer financial product should have ever been allowed to operate with such problems – or to have remained for so long so dysfunctional.

Today, BreadwinnersInsurance.com begins to provide good disclosure about cash-value life insurance policies. The root of this age-old industry problem arises from the facts that the premium of a cash-value policy is not the product's financial cost - as its premium is comprised of both insurance and savings components, and the industry's failure to provide the necessary information about such for consumers to make informed choices. No one can deny that without good information about a product's cost, consumers cannot make informed choices. But, no one has previously provided this necessary disclosure.

Policies' Present Value Costs

As shown in Tables 1, this disclosure approach calculates **the present value costs** of policies' sales illustrations. Table 2 shows this approach applied to one policy's actual historical performance. Understanding policy illustrations and understanding an insurer's policies' historical performance are two separate, necessary and vital steps in understanding cash-value policies. No buying decision should ever be based simply on a policy illustration, and it would be a mistake for multiple reasons to purchase a policy based simply upon the cost figures shown in Table 1. In addition to the fact that

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these costs are based simply upon policy illustrations – the limitations of which are more fully described in the attached report – cash-value life insurance policies have investment/savings component, and information about this component is also vital to understand before choosing a good policy. In particular, the specific rate of return used by the insurer in building the policy illustration will have little relevance or significance to its actual performance over future decades. The fundamental benefit of this disclosure approach is that it enables individuals to better understand cash-value policies. Such understanding of policies’ costs, their investment components, and related insurer operating practices, enables consumers to properly assess comparative value, and to ask more insightful and meaningful questions both before and after a purchase. **Cost disclosure and illustrated investment returns are not divining rods, but rather spotlights and probes to understanding and knowledge.**

Disclosure of the present value costs of these policies reveals a most significant fact. Table 1’s figures are the present value costs per thousand dollars of coverage as shown in current life insurance policy sales illustrations on a 40 year old male whose health qualifies him for the insurer’s best health class. As shown by Table 1, all of these cash-value policies except for TIAA-CREF in years 1-10 have costs significantly larger than the costs of the individual term policy. **These cost differentials are what life insurance consumers have always needed.** Markets don’t work, and in fact just can’t work, without buyers having good information. **Please also note that,** in contrast with the life insurance industry’s defective interest-adjusted indices which have always been invalid to use in comparing what the industry classified as different types of policies, Table 1 shows the illustrated costs for different types of policies: term, whole life, universal life, and could include any other “type” of life insurance policy one desires to analyze.

Similar analysis for an individual of any age, gender and health can be calculated by applying this approach to the relevant illustration and/or actual historical results. Again, it is with this essential information and analytical framework that consumers will now be capable of making better decisions. It will now be up to informed consumers to determine what cost is an acceptable cost when purchasing a cash-value policy. Price disclosure is not optional in a properly-functioning competitive marketplace.

Sales Compensation: What the industry has always hidden in its fight against appropriate disclosure

Sales compensation is and has long been the primary reason for the current differences between the costs of the term insurance policy and the costs of cash-value policies. The exact extent of such, however, has never been widely-publicized, or so powerfully presented. BreadwinnersInsurance.com’s further detailed analysis of the historical performance of a cash-value policy (see Table 3) shows that nearly 50% of these policies’ total costs over their first 20 years were for sales and marketing costs. The magnitude of the sales costs on the above policies makes it easy to understand why the industry and its agents have for so long fought against disclosure. Now, it would seem, with this disclosure, the life insurance industry and its agents will finally have to start operating within a properly-functioning marketplace and allow the virtues of fair competition to be fully manifested. (cont. bottom page 5)

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Present Value Costs Per Thousand of Coverage as Illustrated in Life Insurers' Current Sales Illustrations

On a 40 Year Old Male for Selected Policies in these Life Insurer's Best Health Class

Three Fundamental Rules of Buying Life Insurance

Table 1

Rule #1: Use policy illustrations and analysis of such to understand a policy and its financial mechanics.

Rule #2 Do not buy simply based on a policy illustration or analysis of a policy illustration.

Rule #3: Demand and obtain the information necessary to evaluate the likelihood of a policy providing competitive performance in the future.

| 20 Yr Level Premium | | AXA - | | | | | Mass | |
|---------------------|-------|----------|-----------|----------|----------|--------------|--------|----------|
| Years | Term* | Allstate | Equitable | Genworth | Guardian | John Hancock | Mutual | Met Life |
| 1 | \$1 | \$8 | \$8 | \$8 | \$15 | \$8 | \$14 | \$13 |
| 5 | \$5 | \$30 | \$20 | \$25 | \$37 | \$18 | \$28 | \$27 |
| 10 | \$8 | \$37 | \$18 | \$20 | \$43 | \$27 | \$33 | \$27 |
| 20 | \$13 | \$67 | \$16 | \$23 | \$55 | \$40 | \$66 | \$31 |

| Typical Employer Group** | | North-western | | | | | | |
|--------------------------|---------|---------------|---------|-------------|------------|---------|-----------|--|
| Years | Group** | NY Life | PacLife | Penn Mutual | Prudential | SunLife | TIAA-Cref | |
| 1 | .6 | \$14 | \$8 | \$13 | \$8 | \$8 | \$1 | |
| 5 | 4 | \$31 | \$26 | \$28 | \$17 | \$22 | \$4 | |
| 10 | 12 | \$32 | \$40 | \$33 | \$20 | \$24 | \$9 | |
| 20 | 32 | \$58 | \$52 | \$38 | \$28 | \$27 | \$22 | |

Details below list: Life Insurer, Policy Name/Type, Annual Premium, Health Class Name, Investment Portfolio Structure, Current (Jan 2010) Interest or Dividend Rate Used in Illustration, Avg. 20 Yr Illustrated At-Risk Amount (in thousands), and Relevant Footnote References (see attached supplemental materials).

*Many ins. offer 20 Yr Level Term w/ a \$1000 or less premium; above costs based on \$1000 annual prem. Footnote 4.

**Typical Employer Group with increasing premiums every fifth year. Footnote 5.

Allstate - Flexible Premium Adjustable UL, \$7500, Preferred Elite, New Money, 4.85%, 956

AXA - Athena UL, \$7500, Preferred Elite NT, New Money, 4.75%, 917, Footnote 1 & 2

Genworth - LifeReady UL II, \$7500, Preferred Best No Nicotine, New Money, 4.65%, 922, Footnote 1

Guardian - Whole Life 99, \$15080, Preferred Plus NT, General, 7.00%, 934

John Hancock - Performance UL, \$7500, Super Preferred Non-Smoker, New Money, 4.75%, 933

Mass Mutual - Legacy 100 Whole Life, \$13990, Ultra Preferred, General, 7.00%, 913

MetLife - Whole Life, \$13230, Elite Non-Smoker, General, 6.25%, 928,

New York Life, Whole Life, \$13970, Select Preferred, General, 6.14%, 908

Northwestern - 90 Life (a.k.a. All Base Adjustable CompLife), \$17750, Premier, General, 6.15%, 967, Footnote 3

PacLife - VersaFlex UL, \$7500, Super Preferred Non-Smoker, New Money, 5.45%, 949

Penn Mutual - Flexible Choice Whole Life, \$13390, Preferred Plus, General, 6.34%, 904, Footnote 6

Prudential - PruLife UL Plus, \$7500, Preferred Best, New Money, 5.05%, 9

SunLife - Universal Protector Plus, \$7500, Super Preferred Non-Smoker, New Money, 4.85%, 925, Footnote 1

TIAA-CREF - Intelligent Life UL, \$7500, Preferred Plus Non-Tobacco, General, 5.00%, 904

Analysis of Ameriprise, Nationwide, State Farm and other leading life insurers forthcoming.

General Notes

Policies analyzed all had an initial death benefit of \$1 million dollars. Any error inadvertent; corrected upon notice.

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Table
2

Actual Historical Performance - Analyzed

Northwestern
90 Life \$250,000 issued 20 Years ago (1989) to a 45 Year Old Male, Best Health
Annual Premium \$5815 Paid All Years

| Year | Age During Year | Insurance | Cash- Value | Annual Dividend Rate | Total Annual Costs | At-Risk Amount (in 000s) | Ann. Cost/ M\$AR | Cum. PV Cost /M\$AR |
|------|-----------------------|-----------|----------------|---|--------------------------|--------------------------------|------------------------|---------------------------|
| 1990 | 45 | 251425 | 408 | 10.00% | 5444 | 248 | 22.0 | 22.0 |
| 1991 | 46 | 253954 | 5134 | 10.00% | 1556 | 247 | 6.3 | 28.0 |
| 1992 | 47 | 256890 | 10188 | 9.25% | 1624 | 245 | 6.6 | 34.0 |
| 1993 | 48 | 260927 | 15823 | 9.25% | 1520 | 243 | 6.3 | 39.4 |
| 1994 | 49 | 265684 | 21955 | 8.50% | 1403 | 242 | 5.8 | 44.2 |
| 1995 | 50 | 271380 | 28709 | 8.50% | 1310 | 240 | 5.5 | 48.5 |
| 1996 | 51 | 278019 | 36119 | 8.50% | 1235 | 239 | 5.2 | 52.3 |
| 1997 | 52 | 285871 | 44344 | 8.50% | 1064 | 239 | 4.5 | 55.5 |
| 1998 | 53 | 295056 | 53487 | 8.80% | 998 | 239 | 4.2 | 58.3 |
| 1999 | 54 | 305332 | 63521 | 8.80% | 919 | 239 | 3.8 | 60.8 |
| 2000 | 55 | 316703 | 74519 | 8.80% | 844 | 239 | 3.5 | 62.9 |
| 2001 | 56 | 328867 | 86417 | 8.80% | 907 | 239 | 3.8 | 65.2 |
| 2002 | 57 | 341858 | 99309 | 8.60% | 787 | 240 | 3.3 | 67.0 |
| 2003 | 58 | 354658 | 112782 | 8.20% | 889 | 239 | 3.7 | 69.0 |
| 2004 | 59 | 366807 | 126628 | 7.70% | 1022 | 238 | 4.3 | 71.1 |
| 2005 | 60 | 378831 | 141112 | 7.50% | 1176 | 236 | 5.0 | 73.5 |
| 2006 | 61 | 391554 | 156699 | 7.50% | 1160 | 233 | 5.0 | 75.8 |
| 2007 | 62 | 404738 | 173322 | 7.50% | 1284 | 230 | 5.6 | 78.2 |
| 2008 | 63 | 418387 | 191040 | 7.50% | 1425 | 226 | 6.3 | 80.9 |
| 2009 | 64 | 429215 | 207946 | 6.50% | 1601 | 221 | 7.2 | 83.7 |
| | | | | 8.43% | Averages | 238 | | |
| | | | | Approx % of Insureds' Peers who Died During 20 Years) | | | | 5% |

Estimated Allocated Costs of Analyzed Historical Performance

Table 3

\$250,000 Northwestern 90 Life issued 20 Years ago (1989) to a 45 Year Old Male in the Best Health Class

| Age During Year | Total Annual Costs | Agent Compensation* w/ Max. Bonus | Other Sales/Field Mgmt* Costs | <u>Estimated</u> | | | Cumulative PV of Allocated Expenses* |
|-----------------------|--------------------------|---|--|---------------------------|---------------------------------|---|---|
| | | | | <u>Mortality</u> Costs | <u>Admin/Operating</u> Costs | <u>Prem Tax & DAC & Fed'l Inc. Taxes - 3.0%</u> | |
| 45 | 5444 | 3722 | 930 | 152 | 466 | 174 | 5445 |
| 46 | 1556 | 696 | 145 | 340 | 200 | 174 | 6926 |
| 47 | 1624 | 696 | 145 | 458 | 150 | 174 | 8399 |
| 48 | 1520 | 464 | 145 | 586 | 150 | 174 | 9712 |
| 49 | 1403 | 464 | 145 | 569 | 50 | 174 | 10866 |
| 50 | 1310 | 464 | 145 | 476 | 50 | 174 | 11893 |
| 51 | 1235 | 232 | 145 | 633 | 50 | 174 | 12814 |
| 52 | 1064 | 232 | 145 | 462 | 50 | 174 | 13570 |
| 53 | 998 | 232 | 29 | 513 | 50 | 174 | 14246 |
| 54 | 919 | 232 | 29 | 433 | 50 | 174 | 14838 |
| 55 | 844 | 116 | 29 | 474 | 50 | 174 | 15356 |
| 56 | 907 | 116 | 29 | 537 | 50 | 174 | 15886 |
| 57 | 787 | 116 | 29 | 417 | 50 | 174 | 16324 |
| 58 | 889 | 116 | 29 | 519 | 50 | 174 | 16796 |
| 59 | 1022 | 116 | 29 | 652 | 50 | 174 | 17312 |
| 60 | 1176 | 116 | 29 | 806 | 50 | 174 | 17878 |
| 61 | 1160 | 116 | 29 | 791 | 50 | 174 | 18409 |
| 62 | 1284 | 116 | 29 | 914 | 50 | 174 | 18969 |
| 63 | 1425 | 116 | 29 | 1056 | 50 | 174 | 19562 |
| 64 | 1601 | 116 | 29 | 1231 | 50 | 174 | 20195 |

Figures Below are Present Value Totals Using a 5% Discount Rate

| | | | | | | |
|--------|------|-----------|------|----------------|------|-------|
| | | combined | | | | |
| | | w/ column | | combined w/ | | |
| 20,195 | 9340 | to left | 8572 | column to left | 2283 | 20195 |

Note: Life insurers typically report that actual first year expenses exceed the premium paid by policyholder thereby requiring some surplus funds to be allocated to cover such. In subsequent years, the surplus is replenished. The above approach could accommodate such accounting transactions, but such details were omitted to simplify this presentation.

In addition, this analysis will also help consumers to recognize the many misleading sales myths which have been used by agents to sell cash-value policies. Agent sales presentations are often structured to distort consumers' choices with misinformation, half-truths, deceptive questions, and other persuasive techniques that have been documented to cause common decision-making errors. For instance, in contrast with the consumers' past mistakes arising from the misleading dichotomy regarding renting

versus owning life insurance, consumers will no longer need to be confused by such. They will know that every policy is comprised of term insurance, they will be able to meaningfully compare costs, and they will recognize that the financial costs of coverage increase with age every year.

The Road Ahead After Good Disclosure Become Widespread

Consumers will still need to assess whether a term policy, a cash-value policy, or some combination of the two is best for their individual situation. Some individuals, given that many routinely pay some sales loads on many similar savings/investment products, may no doubt accept some extra costs when purchasing a cash-value policy; there can be very sound financial reasons for such. However, the decision to purchase a cash-value policy will now be able to be made by an appropriately-informed consumer, and such knowledgeable buyers will set in motion the steps to improve the value buyers obtain from cash-value policies. That is what is achieved by good disclosure. That is what can only be achieved by good disclosure, all of which again underscores the importance of this analytical approach and framework of present value costs.

Good information will merely enable life insurance consumers to seek what buyers in properly functioning marketplaces always seek – better value. And again, evidence extensively and amply documents that consumers by and large have previously not been able to distinguish good value policies from bad. After all, why do so many consumers currently buy and/or continue to hold policies whose costs are two or three times as large as that of an alternative? The introduction of good information and fair disclosure practices upon financial markets has a strong history of achievement. We believe the life insurance marketplace will now provide one more proof of this truth.

Everyone knows that comparative few individuals on their own initiative buy life insurance. Such, however, has never justified the industry's disclosure failures. There is, and always will be, a vital role for agents in helping individuals assess their needs, obtain good policies, and provide on-going service. And good, productive work warrants and can command appropriate compensation. Furthermore, the industry's track record of insufficient market penetration does not provide any support to continue its general sales practices. In light of these facts, we invite the life insurance industry and its agents to embrace good disclosure not only because it is right but because it is imperative for the industry if it is to really achieve its private and social objectives. Life insurance, after all, is an essential product. The effects of appropriate policy cost disclosure could soon be widespread. Again, the secrets revealed by disclosure cannot be put back in a bottle. BreadwinnersInsurance.com welcomes an opportunity to work with the life insurance industry and its fellow agent peers committed to disclosure so that life insurance policies are more effectively marketed, so that they gain the widespread use and acceptance good life insurance deserves, and so that agents can truly function as genuine professionals.

BreadwinnersInsurance.com also urges the NAIC, the ACLI and their affiliates/members to overhaul the Life Insurance Buyer's Guide. The Guide's description of "different types of policy" is inadequate if not

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downright misleading, and its failure to mention cash-value policies' tax privileges is a shocking shortcoming.

We also urge the life insurance industry to revamp and simplify its cash-value policy sales illustrations, to incorporate the meaningful present value cost summary information that we have provided, and to provide relevant historical financial information with respect to their policies' historical performance and current practices so that consumers have the necessary essential information to make informed choices. Again, cash-value policies have valuable tax privileges, but the industry should not try to continue to appropriate the value of such by extracting excessive commission compensation to which no informed buyer would knowingly consent. In fact, if the industry continues to try such, BreadwinnersInsurance.com believes it will inevitably fail, as economic theory and financial history shows such excessive value extraction cannot occur from informed buyers in a properly-functioning competitive marketplace.

BreadwinnersInsurance.com also invites those individuals and groups (civic-minded individuals, consumer groups, etc.) that have long cherished the objectives of good disclosure to consider working with BreadwinnersInsurance.com on their own life insurance needs and to help others learn about the value, expertise, and service that BreadwinnersInsurance.com provides.

Finally, BreadwinnersInsurance.com invites the mainstream financial media to spotlight the profound problems in the life insurance marketplace. For example, calling attention to the fact that most of the cash-value policies sold have had undisclosed and unacceptable sales costs, and yet there have long been alternative versions of policies, often from the same insurers, that could have provided drastically better value (see Table 10 of attached, supplemental materials). This virtually-unpublicized fact is an unmistakable indictment of the industry's current practices. The life insurance industry has also been challenged by the public's insufficient usage of its products, a matter that may well have gone hand-in-hand with its disclosure failures. Nonetheless, we ask the media to devote significant attention to both these matters: the vital role of good life insurance and the importance of appropriate policy disclosure. While the issues regarding health insurance are undoubtedly a more significant financial concern for the nation – and a matter about which there is great complexity and vigorous debate – the longstanding problems in the life insurance industry could soon be problems of an era past. And in these most challenging times, that would be a milestone most worthy of contributing to and celebrating.

A table of supplemental materials to this Press Release is shown on the next page.

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Supplemental Materials to Life Insurance Policy Disclosure Press Release: Notes, Formulas, Etc.

Financial authorities teach that the best way to analyze and compare costs that occur over many years is to calculate their present values. Present value calculations take into account the time value of money. In calculating these policies' Present Value Costs a 5% discount rate has been applied to the deconstructed stream of annual costs implicit in each life insurer's policy illustration. No one needs to be a financial expert to use Present Value Cost analysis; **everything else being equal, a lower cost is better than a higher cost.**

This report's Present Value Costs are presented based on the annual cost per thousand dollars of coverage (at-risk amount) over the first 20 years for the illustrated policies for a 40 year old male in excellent health. Similar measurements can be reported for any illustrated or actual historical performance for any individual. Presenting these costs per thousand dollars of coverage facilitates individuals being able to make rough estimates of the costs for different sized policies, \$350,000, \$900,000, etc.

This report's Present Value Cost analysis provides insight and understanding about insurers' policies, whether illustrated policies or actual historical results, so that one can make useful comparisons and/or ask meaningful questions about such cost. A series of such questions is presented separately below (page 23).

While there can be much uncertainty regarding the future performance of any financial product, the range of performance with respect to a cash-value policy's costs can be much more bounded than its range of investment performance. Policy costs are largely a function of selling costs and claim costs; the former determined by contracts between insurers and their agents, and the latter fairly predictable based on actuarial science and insurer operating practices.

Although this report focuses upon the disclosure of the implicit costs in policies, it is equally imperative, given cash-value policies' investment component, to obtain information regarding the past and future possible performance of this component. The specific rate of return used by the insurer in building the policy illustration will have little relevance or significance to the actual performance of the policy over future years and decades. **It is therefore crucial that any prospective buyer of a cash-value policy understand everything that is normally necessary to understand (i.e., rates of return and other investment-related factors to assess a policy's attractiveness and suitability) regarding purchasing any other investment-related product, such as a long-term investment in a mutual fund.** The simplicity of this analytical framework for understanding cash-value life insurance is that it puts the spotlight upon factors about which consumers should demand relevant information.

Formulas below are used to calculate a policy's present value costs per thousand dollars of coverage.

- 1) **Annual Illustrated Costs** = (Prior Year-End Cash-Value + Premium Paid) - (Current Year-End Cash-Value / (1+illustration's compounding rate))
- 2) **Annual At-Risk Amount in Thousands** = ((Prior Year-End Death Benefit - (Prior Year-End Cash-Value + Premium Paid)) + (Current Year-End Death Benefit – Year-End Cash-Value)) /2) /1000 Note: Dividing by 2 averages the beginning of year and end of year values. Dividing by 1000 just expresses the measurement in a more conventional size or metric, that is Cost per thousand dollars of coverage, a.k.a. at-risk amount.
- 3) **Annual Cost per thousand Dollars of Coverage** = Annual Illustrated Costs / Annual At-Risk Amount in thousands. Just Equation 1 divided by Equation 2.
- 4) **The present value cost of any particular Year N** = Year N's Annual Cost / (1 + 5%) ^ (N-1) These present value costs are calculated using a 5% discount rate. For example, the present value cost of the 10th years cost involves discounting the 10th year's annual cost by (1+5%) raised to the 9th power. This converts the cost illustrated as being paid in the 10th year by the compounding that, at the specified 5% discount rate, would have occurred over 9 years. This amount is therefore a present value that would have grown into the amount needed to pay the 10th year's annual cost – a cost which is due at the start of the 10th year.
- 5) The **Present Value Cost** over any specified duration (1, 5, 10 or 20 years) is the cumulative sum of the present value costs of the individual years up to the specified duration. In summary, a policy's present value cost per thousand dollars of coverage (PV Cost/M\$AR) for the first year is simply the cost per thousand for that first year. A policy's illustrated cumulative present value cost over 5, 10, or 20 years is simply the stream of that policy's Annual Costs/M\$AR over the particular duration converted into a present value.

Two Applications of the Above Formulas

The two spreadsheets (Tables 4 & 5) below show use the above formulas. Please note that the illustration's stream of annual costs is first calculated by using the illustration's compounding rate. That is, to take apart a policy illustration, so that its costs can be identified, one has use the compound- ing rate that was used to create the illustration to disassemble it. Consumers can now ask their agent to provide this type of cost information for any policy being recommended or they can contact Brian Fachtel, founder of BreadwinnersInsurance.com and developer of this analytical approach.

Prudential UL with \$7500 Ann. Prem. On 40 Yr Old Male in Best Health Table 4

Policy Surrender Value w/ Int. Rate of 5.05% first 10 yrs & 5.45% thereafter

| Years | Age | Death Benefit | Cash Surrender Value | Total Annual Cost | At-Risk Amount | Cost/M\$AR | Cum. PV Cost/M\$AR |
|-------|-----|---------------|----------------------|-------------------|----------------|------------|--------------------|
| 1 | 40 | 1000000 | 0 | 7500 | 996 | 7.5 | 7.5 |
| 2 | 41 | 1000000 | 4014 | 3679 | 994 | 4 | 11.1 |
| 3 | 42 | 1000000 | 9920 | 2071 | 989 | 2 | 13.0 |
| 4 | 43 | 1000000 | 16045 | 2146 | 983 | 2 | 14.8 |
| 5 | 44 | 1000000 | 22506 | 2121 | 977 | 2 | 16.6 |
| 6 | 45 | 1000000 | 31035 | 463 | 969 | 0 | 17.0 |
| 7 | 46 | 1000000 | 39599 | 840 | 961 | 1 | 17.6 |
| 8 | 47 | 1000000 | 48502 | 929 | 952 | 1 | 18.3 |
| 9 | 48 | 1000000 | 57776 | 1003 | 943 | 1 | 19.1 |
| 10 | 49 | 1000000 | 67431 | 1087 | 934 | 1 | 19.8 |
| 11 | 50 | 1000000 | 77996 | 966 | 924 | 1 | 20.5 |
| 12 | 51 | 1000000 | 89022 | 1075 | 913 | 1 | 21.1 |
| 13 | 52 | 1000000 | 100520 | 1197 | 901 | 1 | 21.9 |
| 14 | 53 | 1000000 | 112515 | 1320 | 890 | 1 | 22.7 |
| 15 | 54 | 1000000 | 125023 | 1454 | 877 | 2 | 23.5 |
| 16 | 55 | 1000000 | 138058 | 1600 | 865 | 2 | 24.4 |
| 17 | 56 | 1000000 | 151651 | 1745 | 851 | 2 | 25.3 |
| 18 | 57 | 1000000 | 165826 | 1895 | 838 | 2 | 26.3 |
| 19 | 58 | 1000000 | 180610 | 2051 | 823 | 2 | 27.4 |
| 20 | 59 | 1000000 | 196043 | 2199 | 808 | 3 | 28.4 |

923 Avg. At-Risk Amt

NY Life Whole Life w/ \$13,970 Ann.Prem. on 40 Yr Old Male,Best Health

Illustration run at 6.14% Rate in 2009

Table 5

| Years | Age | Death Benefit | Cash Surrender Value | Total Annual Cost | At-Risk Amount | Cost/M\$AR | Cum. PV Cost/M\$AR |
|-------|-----|---------------|----------------------|-------------------|----------------|------------|--------------------|
| 1 | 40 | 1000000 | 0 | 13970 | 993 | 14 | 14.1 |
| 2 | 41 | 1002000 | 590 | 13414 | 994 | 13 | 26.9 |
| 3 | 42 | 1006000 | 12315 | 2957 | 991 | 3 | 29.6 |
| 4 | 43 | 1010000 | 26683 | 1146 | 982 | 1 | 30.6 |
| 5 | 44 | 1015000 | 42548 | 566 | 971 | 1 | 31.1 |
| 6 | 45 | 1021000 | 60448 | -433 | 960 | 0 | 30.8 |
| 7 | 46 | 1028000 | 79102 | -108 | 948 | 0 | 30.7 |
| 8 | 47 | 1035000 | 98544 | 229 | 936 | 0 | 30.9 |
| 9 | 48 | 1043000 | 118876 | 515 | 923 | 1 | 31.2 |
| 10 | 49 | 1052000 | 140150 | 803 | 911 | 1 | 31.8 |
| 11 | 50 | 1062000 | 159750 | 3611 | 900 | 4 | 34.3 |
| 12 | 51 | 1072000 | 180386 | 3769 | 890 | 4 | 36.7 |
| 13 | 52 | 1084000 | 202083 | 3963 | 880 | 5 | 39.2 |
| 14 | 53 | 1097000 | 224891 | 4172 | 870 | 5 | 41.8 |
| 15 | 54 | 1111000 | 248843 | 4413 | 860 | 5 | 44.4 |
| 16 | 55 | 1126000 | 273993 | 4670 | 850 | 5 | 47.0 |
| 17 | 56 | 1143000 | 300417 | 4925 | 840 | 6 | 49.7 |
| 18 | 57 | 1162000 | 328204 | 5169 | 831 | 6 | 52.4 |
| 19 | 58 | 1182000 | 357459 | 5393 | 822 | 7 | 55.1 |
| 20 | 59 | 1202000 | 388236 | 5652 | 812 | 7 | 57.9 |

908 Avg. At-Risk Amt

Additional Comments

1. The Limitations of Policy Illustrations - The Present Value Costs reported in Table 1 are derived from a life insurer's sales illustrations. **Again, no one should base a buying decision based on illustrations or calculations based on illustrations. Illustrations are not intended to be credible projections of future performance.** Policy illustrations typically contain many non-guaranteed numbers, and therefore **one has to use any analysis of illustrated policy values with an understanding of the limitations inherent in life insurer's sales illustrations.** A policy illustration is just that, an illustration of a scenario of assumptions. It is not intended to be a forecast or projection. Nonetheless, the range of reasonable illustrated costs is limited, and consequently some illustrated costs raise questions by being outside the normal range.
2. Policy Guarantees vs. Illustrated Performance – The spreadsheet below (Table 6) highlights, that despite many insurers' fanciful sales illustrations, cash-value policies' guarantees provide very little real value to consumers. This observation is not meant to be critical, but just to state the obvious. Insurers' guarantees with respect to maximum charges and minimum interest are designed, understandably so, to be beyond the most extreme scenario imaginable. While some, we believe, have wrongly criticized life insurers on this point, alleging that all the value that such policies provide are simply what is guaranteed and/or confusing/mistaking such guarantees for actual possible performance results, **BreadwinnersInsurance.com believes that the most important significance of this fact is recognizing/understanding the discretion that life insurers have with respect to determining costs and crediting earnings or interest.** This is what we mean when saying most cash-value life insurance policies are "priced" after having been purchased.
3. For example, the guarantee of a death benefit after the first year is contingent upon the payment of the second annual premium and/or the policy having a positive cash-surrender value. Each year, the financial performance of the policy depends upon the insurer's decision with respect to the charges incurred and the interest paid to grow the cash-value. Again, it is a life insurer's exercising of this discretion year after year following the sale of the policy which is what is meant when it is said that cash-value life insurance is "priced" after being purchased.
4. Table 7 below show the difference between two insurer's (Guardian and Axa's) guaranteed maximum costs and their illustrated costs. The difference between the Guardian's Guaranteed and Illustrated 20th Year PV Costs are "mortality savings" Guardian is currently assuming will be contributed to its future dividends. Again, while these potential maximums represent unrealistically conservative worst case scenarios, and truly ought to be viewed as unrealistic, the significant difference between illustrated costs and potential maximum costs shows the potential discretion/authority insurers hold in determining the size of mortality costs borne by the policyholders. Indeed, understanding this discretion opens-up a discussion (beyond our present scope) regarding the differences between mutual and stock life insurers.

What is CASH-VALUE LIFE INSURANCE? Insight from an empty illustration

The typical cash-value policy is PRICED AFTER PURCHASE. Insurers DETERMINE COSTS and RATE as they operate or see fit. Surrender Charges Lock in Consumer

Boxed in items show the only things that life insurers typically guarantee in a Universal Life policy; whole life guarantees are often expressed a little differently, but they are operationally fundamentally similar.

Bolded items show aspects impacted by insurer's discretion

| Yr | Prem | Max Costs | Actual Charges ??? | Bal. of Prem | Policy Value b.o.y. | Guar. Min. Inv. Earnings Rate (i.e.3%) | Actual Inv. Earnings (??? %) | Policy Value e.o.y. | Surrender Charge | Net Cash Value | Insurance Amount a.k.a. Death Benefit |
|----|------|-----------|--------------------|--------------|---------------------|--|------------------------------|---------------------|------------------|----------------|---------------------------------------|
| | a | | b | | c* | | d | e = c + d | f | = e - f | 1,000,000 |
| 1 | 7500 | 7,500 | ? | | ? | | ? | ? | 27,240 | ? | |
| 2 | 7500 | 6,138 | ? | | ? | | ? | ? | 26,150 | ? | |
| 3 | 7500 | 3,079 | ? | | ? | | ? | ? | 25,060 | ? | |
| 4 | 7500 | 3,235 | | | | | | | 23,970 | ? | |
| 5 | 7500 | 3,420 | | | | | | | 22,880 | ? | |
| 6 | 7500 | 3,630 | | | | | | | 21,790 | | |
| 7 | 7500 | 2,909 | | | | | | | 20,430 | | |
| 8 | 7500 | 4,074 | | | | | | | 19,060 | | |
| 9 | 7500 | 3,273 | | | | | | | 16,340 | | |
| 10 | 7500 | 3,439 | | | | | | | 13,620 | | |
| 11 | 7500 | 2,765 | | | | | | | 10,890 | | |
| 12 | 7500 | 3,029 | | | | | | | 8,170 | | |
| 13 | 7500 | 3,382 | | | | | | | 5,440 | | |
| 14 | 7500 | 4,682 | | | | | | | 2,720 | | |
| 15 | 7500 | 3,289 | | | | | | XXX | 0 | XXX | |
| 16 | 7500 | 5,745 | | | | | | | 0 | | |
| 17 | 7500 | 6,312 | | | | | | | 0 | | |
| 18 | 7500 | 6,920 | | | | | | | 0 | | |
| 19 | 7500 | 7,438 | | | | | | | 0 | | |
| 20 | 7500 | 8,040 | | | | | | | 0 | | |

*in the first year, c = a - b
 * in subsequent years, c = prior year's e + (a-b)

Whatever a Policyholder has at XXX depends upon above "a"s, "b"s and "d"s

Guarant'd Death Benefit Amount can extend past first year if subsequent prem. is paid and/or if there is sufficient Policy or Net Cash Value

For a **functioning** Universal Life Insurance Illustration Creation Spreadsheet contact BreadwinnersInsurance.com

The Difference Between Guaranteed and Illustrated Costs Table 7

Guardian Whole Life Policy

John Hancock UL Policy

\$1 million policy on 40 Yr Old Male, Best Health

(see Table 1 Notes for details on these two policies)

| Years | <u>Guaranteed</u> | <u>Illustrated</u> | <u>Guaranteed</u> | <u>Illustrated</u> |
|-------|-------------------|--------------------|-------------------|--------------------|
| | <u>Max. Cost</u> | <u>Costs</u> | <u>Max. Cost</u> | <u>Costs</u> |
| 1 | 15,080 | 15,080 | 7,500 | 7,500 |
| 2 | 15,080 | 14,575 | 6,138 | 4,528 |
| 3 | 4,792 | 4,244 | 3,079 | 2,343 |
| 4 | 2,943 | 2,421 | 3,235 | 2,475 |
| 5 | 3,138 | 2,626 | 3,420 | 2,580 |
| 6 | 2,883 | 2,388 | 3,630 | 2,654 |
| 7 | 3,082 | 2,619 | 2,909 | 1,776 |
| 8 | 3,285 | 1,769 | 4,074 | 2,793 |
| 9 | 3,387 | 895 | 3,273 | 1,925 |
| 10 | 3,498 | 32 | 3,439 | 1,992 |
| 11 | 3,647 | 328 | 2,765 | 1,162 |
| 12 | 3,844 | 654 | 3,029 | 1,353 |
| 13 | 4,116 | 1,036 | 3,382 | 1,560 |
| 14 | 4,413 | 1,434 | 4,682 | 2,690 |
| 15 | 4,791 | 1,899 | 3,289 | 1,060 |
| 16 | 5,210 | 2,405 | 5,745 | 3,250 |
| 17 | 5,640 | 2,938 | 6,312 | 3,410 |
| 18 | 6,091 | 3,503 | 6,920 | 3,578 |
| 19 | 6,398 | 4,011 | 7,438 | 3,741 |
| 20 | 6,760 | 4,591 | 8,040 | 3,906 |

5. The Impacts Upon Calculated PV Costs from Idiosyncratic Cash-Value Growth Patterns - Some insurers have their policies' cash-surrender values grow in a somewhat idiosyncratic manner in their policies' early years. The significance of these irregularities with respect to the calculation of annual costs is that they merely shift the discounted value of such costs between years. Given that these irregularities are typically off-set or "zeroed-out" by a policy's 15th or 20th year, they have no impact upon the policy's calculated 20 Year PV Costs.

6. Some idiosyncratic irregularities in a policy's cash-values growth pattern can be part of a life insurer's pricing strategy, known as lapse-supported pricing, whereby policyholders who discontinue their coverage are effectively overcharged; and such overcharges can be used to subsequently subsidize the costs in later years for policyholders who continue their coverage. Such an approach can be recognized,

for example, by the 5 Year PV Cost being large in comparison with the 20 Year Cost (sometimes, in fact, the 5 Year's Cost is actually illustrated larger than a later year's cost). Obviously, such matters are better to understand before buying any policy.

7. Differences Between A Policy's Cash-Value and its Account Value or Policy Value - Some policy illustrations show both an account value (also called a policy value) and a surrender cash-value. For purposes of calculating costs, the surrender cash-values are used, as this provides the costs that someone who discontinues the policy at such duration will have borne. Furthermore, given that the account value and surrender cash-value are equal after the expiration of the surrender charge period, there is no effect upon the calculated 20 year present value costs; that is, all variations in annual costs from the different patterns of growth of the policy's value (cash-value or account value) have been netted-out. Prior to the end of the surrender charge period, though, costs calculated upon Account Value and Surrender Cash-Value differ by the impact/extent of the surrender charge. In light of the facts that: 1) the creation of this label or expression, namely, the policy's Account Value, is largely to obscure the up-front expenses insurers incur in currently marketing their policies in this marketplace of inadequate disclosure, 2) in fact, a policy's Account Value, in a non-variable policy, is a purely fictional creation of the insurer given its complete control over the financial performance of the policy, and 3) the significant lapse rate of many policies, a policy's Surrender Cash-Value provides a much more meaningful measurement of a policy's Present Value Costs than its Account Value does. Again, given that a policyholder never gets the Account Value until he/she has paid/borne all the costs that the Account Value is intended to hide, and at which point the Account Value is no larger than the Cash-Value, the significance of a policy's Cash-Value is undeniably of greater importance.
8. Understanding Policy Costs – In particular, Life Insurance Policy Claim Costs - An insurer's total expense for a policy includes many different types of costs, such as administrative, claim, and sales costs. While sales costs are largely determined by contractual arrangements with agents and thereby explicitly known, actual claims in future years cannot be known with the same degree of certainty. Claim costs and assumptions about such are a primary factor in the differences in calculated present value costs. Different insurers use different underwriting practices that can range from 1) screening applicants very selectively to try to insure only the healthiest to 2) more broadly accepting applicants with good, but not perfect, health histories to obviously 3) something in between practices 1 and 2. Naturally, there is also an assortment of practices life insurers use in making the claim assumptions embedded in their illustrations. All of which leads to the realization that what the consumer typically buys in a cash-value policy is the insurer's future performance, and therefore what one ought to look for in choosing a policy is a life insurer with a good history/reputation/explanation for controlling claim costs through its effective underwriting and operating practices. Obviously, claim costs, and illustrated assumptions about such, are complicated matters and therefore necessarily matters which are best discussed with a good and knowledgeable agent. Some additional perspective on the importance of claim costs can be understood by reviewing the illustrated costs of three different health classes.

9. Different Health Classes - Insurers often have 10-15 different health classes, much the way auto insurers have different classes for: good drivers, not so good drivers, those with long commutes, etc. At the time of application, a life insurer evaluates the applicant's health profile to determine which health class is appropriate. Some insurers have a best health class that is exceedingly selective (perhaps no more than 10-20% of applicants who think they are in very good health qualify for it), whereas other insurers have a best health class for which 70-80% of applicants qualify. For instance, like most large insurers, MetLife has three different health classes for healthy non-smoking individuals, and the different PV Costs of the top three classes are shown below in Table 8.

Illustrated Costs/M\$AR of Three Different Health Classes

| Cumulative PV Costs/M\$AR | | | |
|---------------------------|-------|-----------|-------------|
| Years | Elite | Preferred | Standard NS |
| 1 | 13.3 | 13.5 | 14.4 |
| 5 | 27.4 | 28.3 | 32.5 |
| 10 | 26.7 | 28.4 | 35.9 |
| 20 | 31.0 | 33.8 | 47.0 |
| Annual Costs/M\$AR | | | |
| Years | Elite | Preferred | Standard NS |
| 1 | 13.3 | 13.5 | 14.4 |
| 2 | 12.3 | 12.5 | 13.4 |
| 3 | 2.9 | 3.1 | 4.0 |
| 4 | -0.4 | -0.2 | 0.7 |
| 5 | 0.1 | 0.3 | 1.2 |
| 6 | -0.9 | -0.7 | 0.3 |
| 7 | -0.4 | -0.2 | 0.8 |
| 8 | 0.1 | 0.3 | 1.3 |
| 9 | -0.3 | 0.0 | 0.9 |
| 10 | 0.5 | 0.8 | 1.7 |
| 11 | 0.2 | 0.4 | 1.4 |
| 12 | 0.7 | 0.9 | 2.0 |
| 13 | 0.1 | 0.4 | 1.4 |
| 14 | 0.6 | 0.8 | 1.9 |
| 15 | 1.0 | 1.3 | 2.4 |
| 16 | 1.4 | 1.6 | 2.8 |
| 17 | 0.7 | 0.9 | 2.2 |
| 18 | 1.2 | 1.4 | 2.7 |
| 19 | 1.8 | 2.0 | 3.4 |
| 20 | 1.3 | 1.6 | 3.0 |

Note 1 The negative annual costs are indicative of increases in cash-value arising from "refunds" of "overcharges" in prior yrs.

Note 2 Normally, the difference in costs between health classes is approximately 15-25%. This chart's differences are a little unusual.

10. Impact upon Present Value Costs of Different Sized Premiums and Premium-Based Costs - Insurers pay premium taxes to the states that are typically about 2% of the annual premium. Consequently, a policy with a larger premium necessarily incurs greater costs for state premium taxes. Many consumer financial products provide compensation to the sales professional as a percentage of the consumer's investment/payment/premium/etc. Consequently, a policy with a \$1000 larger annual premium incurs other, additional expenses, just as a result of its larger premium, that might well be entirely acceptable to the consumer. The Cost Adjustment Factors (Table 9) below can be used and modified to estimate the different impacts upon present value costs of a \$5000 premium subject to an annual 4% charge.

PV Cost/M\$AR of \$5,000 Larger Prem.

| Years | Cost/M\$AR |
|-----------------------------------|------------|
| 1 | \$0.20 |
| 5 | \$0.91 |
| 10 | \$1.62 |
| 20 | \$2.62 |
| Policy At-Risk Amount \$1,000,000 | |

11. Converting Present Value Costs into a Stream of Annual Costs – PV Costs are simply a measurement and comparison tool. One can convert these lump-sum cost figures in a stream of annual costs by making various reasonable assumptions. Similarly, these costs which are expressed on the basis of \$1000 of coverage can multiplied to estimate actual costs of a particular sized policy.

BreadwinnersInsurance.com can provide a spreadsheet whereby a consumer can use PV Costs to construct his/her own policy illustrations based on easy-to-input present value cost data. Such illustrations are merely intended to facilitate consumers' general understanding of the financial mechanics of cash-value life insurance.

Four Additional Examples of The Usefulness of Present Value Cost Analysis of Policy Illustrations

The comparison of two Northwestern policies (Table 10) shows precisely the extent to which sales costs can vary among an insurer's product line. Both 90 Life (also marketed as All Base Adjustable CompLife) and Estate CompLife (ECL) have the same annual premium and can provide virtually-identical coverage, but ECL has significantly lower costs because its premiums can be subjected to a much lower sales charges than those

typically applied. The 20 Yr present value cost difference on a million dollar policy is approximately \$27,000.

| <u>"Blended" ECL Pol. Illustration Values & Analysis</u> | | | | <u>Whole Life Ill. Values and Analysis</u> | | | |
|--|------------------|----------------------|--------------|---|------------------|----------------------|---------------|
| Years | Death Benefit | Surrender Cash-Value | Annual Costs | Table 10 | Death Benefit | Surrender Cash-Value | Annual Costs |
| 1 | 1,034,000 | 15,573 | 3,079 | Two Northwestern policies w/ the same \$17,750 Ann. Prem. for 40 Yr Old Male in Best Health | 1,005,000 | 1,251 | 16,571 |
| 2 | 1,068,000 | 32,301 | 2,893 | | 1,011,000 | 14,917 | 4,948 |
| 3 | 1,100,000 | 50,672 | 2,315 | | 1,019,000 | 29,469 | 4,905 |
| 4 | 1,131,000 | 70,104 | 2,380 | | 1,029,000 | 44,958 | 4,866 |
| 5 | 1,162,000 | 90,673 | 2,434 | | 1,040,000 | 61,448 | 4,820 |
| 6 | 1,191,000 | 112,440 | 2,497 | | 1,054,000 | 79,301 | 4,491 |
| 7 | 1,219,000 | 135,486 | 2,554 | | 1,071,000 | 98,608 | 4,156 |
| 8 | 1,246,000 | 159,870 | 2,628 | | 1,090,000 | 119,463 | 3,816 |
| 9 | 1,272,000 | 185,675 | 2,702 | | 1,111,000 | 141,938 | 3,498 |
| 10 | 1,298,000 | 212,988 | 2,777 | | 1,135,000 | 166,141 | 3,173 |
| 11 | 1,323,000 | 242,306 | 2,470 | | 1,160,000 | 192,153 | 2,871 |
| 12 | 1,346,000 | 273,330 | 2,562 | | 1,188,000 | 219,986 | 2,662 |
| 13 | 1,370,000 | 306,140 | 2,677 | | 1,218,000 | 249,739 | 2,466 |
| 14 | 1,392,000 | 340,833 | 2,804 | | 1,250,000 | 281,507 | 2,292 |
| 15 | 1,414,000 | 377,523 | 2,933 | | 1,285,000 | 315,409 | 2,122 |
| 16 | 1,434,000 | 416,286 | 3,105 | | 1,322,000 | 351,523 | 2,002 |
| 17 | 1,455,000 | 457,273 | 3,256 | | 1,361,000 | 389,523 | 2,318 |
| 18 | 1,475,000 | 500,613 | 3,414 | | 1,402,000 | 430,280 | 1,922 |
| 19 | 1,494,000 | 546,435 | 3,587 | | 1,444,000 | 473,002 | 2,432 |
| 20 | 1,512,000 | 594,861 | 3,788 | | 1,488,000 | 518,068 | 2,699 |
| Age 90 | 4,451,994 | 3,856,049 | | 3,992,429 | 3,458,042 | | |
| Years | At-Risk Amt | Cost/M\$AR | Cum PV | | At-Risk Amt | Cost/M\$AR | Cum PV |
| 1 | 1,017 | 3.0 | 3 | | 995 | 16.6 | 17 |
| 2 | 1,018 | 2.8 | 6 | | 991 | 5.0 | 21 |
| 3 | 1,034 | 2.2 | 8 | | 984 | 5.0 | 26 |
| 4 | 1,046 | 2.3 | 10 | | 978 | 5.0 | 30 |
| 5 | 1,057 | 2.3 | 12 | | 972 | 5.0 | 34 |
| 6 | 1,066 | 2.3 | 13 | | 968 | 4.6 | 38 |
| 7 | 1,072 | 2.4 | 15 | | 965 | 4.3 | 41 |
| 8 | 1,076 | 2.4 | 17 | | 963 | 4.0 | 44 |
| 9 | 1,077 | 2.5 | 19 | | 961 | 3.6 | 46 |
| 10 | 1,077 | 2.6 | 20 | | 960 | 3.3 | 49 |
| 11 | 1,074 | 2.3 | 22 | | 959 | 3.0 | 50 |
| 12 | 1,068 | 2.4 | 23 | | 959 | 2.8 | 52 |
| 13 | 1,059 | 2.5 | 25 | | 959 | 2.6 | 53 |
| 14 | 1,049 | 2.7 | 26 | | 960 | 2.4 | 55 |
| 15 | 1,035 | 2.8 | 27 | | 960 | 2.2 | 56 |
| 16 | 1,018 | 3.0 | 29 | | 961 | 2.1 | 57 |
| 17 | 999 | 3.3 | 30 | | 962 | 2.4 | 58 |
| 18 | 977 | 3.5 | 32 | | 963 | 2.0 | 59 |
| 19 | 952 | 3.8 | 33 | | 962 | 2.5 | 60 |
| 20 | 923 | 4.1 | 35 | | 962 | 2.8 | 61 |
| | 1,035 | Avg. Over 20 Yrs | | | 967 | Avg. Over 20 Yrs | |

Return of Premium Term (ROP Term) policies and Universal Life policies with No Lapse Guarantee (UL w/ NLG) were omitted because they are not used often used as savings vehicles, which has been the primary longtime use of cash-value policies. Nonetheless, as shown below, (Table 11) ROP term policies can be analyzed the same way. A couple of extra years were shown in this analysis to show the inflexible nature of ROP term policies; that is, if one's needs or financial abilities change such that the policyholder desires to stop coverage years before a duration at which the premium is "returned," the costs can be significantly higher.

Present Value Cost Analysis of Return of Premium Term Policies

Table 11

State Farm's ROP Term for \$1 million on 40 Year Old Male in Top Two Health Classes

| Years | <u>Super Preferred Non-Tobacco</u> | | | | <u>Preferred Non-Tobacco</u> | | | |
|-------|------------------------------------|-----------------------|------------------------|-------------------|------------------------------|-----------------------|------------------------|-------------------|
| | Cost / M\$AR | Cum. PV of Prem. Paid | PV of Refunded Amounts | Net PV Cost/M\$AR | Cost / M\$AR | Cum. PV of Prem. Paid | PV of Refunded Amounts | Net PV Cost/M\$AR |
| 1 | 2.7 | 2.7 | | 2.7 | 3.5 | 3.5 | | 3.5 |
| 2 | 2.7 | 5.3 | | | 3.5 | 6.8 | | |
| 3 | 2.7 | 7.7 | | | 3.5 | 10.0 | | |
| 4 | 2.7 | 10.1 | | | 3.5 | 13.0 | | |
| 5 | 2.7 | 12.3 | -2.0 | 10.3 | 3.5 | 15.9 | -3.5 | 12.5 |
| 6 | 2.7 | 14.4 | | | 3.5 | 18.7 | | |
| 7 | 2.7 | 16.4 | | | 3.5 | 21.3 | | |
| 8 | 2.7 | 18.4 | | | 3.5 | 23.8 | | |
| 9 | 2.7 | 20.2 | -1.7 | 18.5 | 3.5 | 26.2 | -2.8 | 23.3 |
| 10 | 2.7 | 21.9 | -9.8 | 12.1 | 3.5 | 28.4 | -13.2 | 15.2 |
| 11 | 2.7 | 23.6 | | | 3.5 | 30.6 | | |
| 12 | 2.7 | 25.2 | | | 3.5 | 32.6 | | |
| 13 | 2.7 | 26.7 | | | 3.5 | 34.6 | | |
| 14 | 2.7 | 28.1 | | | 3.5 | 36.4 | | |
| 15 | 2.7 | 29.5 | -15.7 | 13.8 | 3.5 | 38.2 | -20.6 | 17.6 |
| 16 | 2.7 | 30.8 | | | 3.5 | 39.9 | | |
| 17 | 2.7 | 32.0 | | | 3.5 | 41.5 | | |
| 18 | 2.7 | 33.2 | -13.6 | 19.6 | 3.5 | 43.0 | -17.8 | 25.3 |
| 19 | 2.7 | 34.3 | | | 3.5 | 44.5 | | |
| 20 | 2.7 | 35.4 | -20.4 | 15.0 | 3.5 | 45.9 | -26.4 | 19.4 |

ROP Term -20, Super Preferred Prem. \$2705, w/ Surrender Values at Yrs 5, 10, 15 & 20 of \$2596, \$15959, \$32662, \$54100

ROP Term -20, Preferred Prem. \$3505, w/ Surrender Values at Years 5, 10, 15 & 20 of \$4417, \$21451, \$42744, \$70100

Note: Present Value of Refunded Amount decreases if is taken in a later year, i.e., receiving 15th year's refund in year 18 has a lower value. All values discounted at 5%.

Table 12 makes clear two common differences between a Universal Life policy with No-Lapse Guarantees and traditional Universal Life policy. First, the UL with a NLG typically can have a significantly greater PV Cost in the first 20 years than a traditional UL policy from the same insurer because these policies with a NLG are designed

to be lapse-supported. Second, UL with NLG typically provide lower interest rates than traditional UL policies because, again, the focus is not to build cash-value for the policyholder. This is another example of the discretion life insurers have with respect to allocating investment returns and/or using investment returns to subsidize insurance costs.

A Comparison of No-Lapse Guarantee Universal Life Vs. Traditional Universal Life Policy Table 12

Both Policies Provide \$1 million Death Benefit to Insured Male Age 40, Best Health

| Sun Universal with Lapse Protection Feature to Age 105 | | | | | Sun Universal Protector Plus | | | |
|--|------------|--------------|------------|------------------|--|--------------|------------|------------------|
| Premium 5,224 | | | | | Annual Premium 7,500 | | | |
| Current Interest Rate 4.30% | | | | | Current Interest Rate 4.85% then 5.5% | | | |
| <u>Current Illustrated Performance</u> | | | | <u>Max. Cost</u> | <u>Current Illustrated Performance</u> | | | <u>Max. Cost</u> |
| Yr. | Surrender | Ann. | Cum. PV | Cum. PV | Surrender | Ann. | Cum. PV | Cum. PV |
| | Cash-Value | Cost / M\$AR | Cost/M\$AR | Cost/M\$AR | Cash-Value | Cost / M\$AR | Cost/M\$AR | Cost/M\$AR |
| 1 | 0 | 5.2 | 5.2 | 5.2 | 0 | 7.5 | 7.5 | 7.5 |
| 2 | 0 | 5.2 | 10.2 | 10.2 | 0 | 7.5 | 14.7 | 14.7 |
| 3 | 0 | 5.2 | 15.0 | 15.0 | 562 | 7.0 | 21.0 | 21.5 |
| 4 | 0 | 5.2 | 19.5 | 19.5 | 7466 | 0.9 | 21.9 | 24.0 |
| 5 | 0 | 5.2 | 23.8 | 23.8 | 15053 | 0.6 | 22.4 | 25.8 |
| 6 | 0 | 5.2 | 27.9 | 27.9 | 23351 | 0.3 | 22.6 | 27.7 |
| 7 | 0 | 5.2 | 31.8 | 31.8 | 31999 | 0.3 | 22.9 | 29.6 |
| 8 | 0 | 5.2 | 35.5 | 35.5 | 41012 | 0.4 | 23.1 | 31.6 |
| 9 | 0 | 5.2 | 39.1 | 39.1 | 50378 | 0.5 | 23.5 | 33.6 |
| 10 | 1804 | 3.5 | 41.4 | 42.5 | 60127 | 0.6 | 23.8 | 35.6 |
| 11 | 6305 | 1.0 | 42.0 | 45.7 | 70871 | 0.0 | 23.9 | 37.3 |
| 12 | 10785 | 1.2 | 42.7 | 47.3 | 82038 | 0.1 | 23.9 | 39.1 |
| 13 | 15194 | 1.5 | 43.5 | 48.8 | 93630 | 0.3 | 24.1 | 41.0 |
| 14 | 19518 | 1.7 | 44.4 | 50.5 | 105659 | 0.4 | 24.3 | 42.9 |
| 15 | 23664 | 2.1 | 45.5 | 52.3 | 118150 | 0.5 | 24.6 | 45.1 |
| 16 | 27544 | 2.6 | 46.7 | 54.4 | 136546 | -4.3 | 22.5 | 45.1 |
| 17 | 31148 | 3.0 | 48.1 | 56.6 | 149787 | 2.4 | 23.6 | 48.2 |
| 18 | 34441 | 3.5 | 49.6 | 59.1 | 163632 | 2.6 | 24.7 | 51.5 |
| 19 | 37457 | 3.9 | 51.2 | 61.6 | 178105 | 2.8 | 25.9 | 54.8 |
| 20 | 40142 | 4.4 | 52.9 | 64.3 | 193221 | 3.0 | 27.1 | 58.3 |

* Notice that the Policy with Lapse Protection has significantly greater costs over the first 20 years, but yet most likely provides significantly greater value (has lower cumulative costs) if held until age 80 through 105. An example of the effect of Lapse Supported Pricing.

* SunLife Universal Protector guaranteed not to lapse until age 106.

* SunLife Universal Protector Plus, even though premium approximately 40% greater, lapses under the worst case (guaranteed minimum performance) at age 73.

Penn Mutual's Whole Life policy in Table 1 shows 20 year costs that are approximately 60% of Northwestern's. Is such performance by Penn Mutual vis-à-vis this competitor credible? This question is not asked to single out Penn Mutual. It is really just one version of the many questions that consumers need to demand any and every

life insurer answer. Fundamentally, why will your policy actually perform better than Insurer B's? In this comparative case between Penn Mutual and Northwestern, historical policy performance information can provide some insight. Table 13 shows the historical performance for a Penn Mutual policy issued 20 years ago

Penn Mutual's Actual Historical Performance - Analyzed

Table 13

\$250,000 with \$5088 Ann. Premium issued 20 Years ago (1989) to a 45 Year Old Male, Best Health

| Year | Age During Insurance | Cash-Value | Annual Dividend Rate | Total Annual Costs | At-Risk Amount (in 000s) | Ann. Cost/M\$AR | Cum. PV Cost /M\$AR |
|------|----------------------|------------|----------------------|--------------------|--------------------------|-----------------|---------------------|
| 1990 | 45 | 250810 | 9.93% | 4851 | 248 | 19.6 | 19.6 |
| 1991 | 46 | 252260 | 9.93% | 3301 | 248 | 13.3 | 32.3 |
| 1992 | 47 | 254426 | 9.93% | 40 | 246 | 0.2 | 32.4 |
| 1993 | 48 | 257068 | 9.70% | 113 | 242 | 0.5 | 32.8 |
| 1994 | 49 | 259926 | 9.20% | 443 | 239 | 1.9 | 34.4 |
| 1995 | 50 | 263266 | 8.50% | 1281 | 235 | 5.4 | 38.6 |
| 1996 | 51 | 267371 | 8.50% | 1147 | 233 | 4.9 | 42.3 |
| 1997 | 52 | 272134 | 8.00% | 1395 | 231 | 6.0 | 46.6 |
| 1998 | 53 | 277920 | 8.00% | 1129 | 229 | 4.9 | 49.9 |
| 1999 | 54 | 283842 | 7.40% | 972 | 227 | 4.3 | 52.7 |
| 2000 | 55 | 290280 | 7.40% | 1356 | 225 | 6.0 | 56.4 |
| 2001 | 56 | 297333 | 7.40% | 1294 | 224 | 5.8 | 59.8 |
| 2002 | 57 | 305023 | 7.40% | 1395 | 222 | 6.3 | 63.3 |
| 2003 | 58 | 312311 | 6.48% | 1289 | 220 | 5.8 | 66.4 |
| 2004 | 59 | 318647 | 5.74% | 1219 | 218 | 5.6 | 69.2 |
| 2005 | 60 | 325551 | 5.74% | 1280 | 215 | 6.0 | 72.0 |
| 2006 | 61 | 332572 | 6.30% | 2164 | 212 | 10.2 | 76.7 |
| 2007 | 62 | 339604 | 6.30% | 2482 | 209 | 11.9 | 81.9 |
| 2008 | 63 | 345985 | 6.34% | 3139 | 205 | 15.3 | 88.3 |
| 2009 | 64 | 352569 | 6.34% | 3616 | 201 | 18.0 | 95.4 |
| | | | <u>7.72%</u> | Avg. | 226 | | |

in 1989 to a 45 year-old male (just like Table 2 shows for Northwestern.) Table 14 shows a side-by-side comparison of the historical performance of these two insurers. The upshot of such comparison is that Penn Mutual would seem to need to explain how it expects to drastically transform its underwriting and operating BreadwinnersInsurance.com

results to produce the better illustrated performance in Table 1. Improvement is, of course, possible, but Tables 13 and 14 seem to call for some real evidence from Penn Mutual. This abbreviated analysis merely demonstrates that it is essential to remember all of the caveats with respect to life insurance policy illustrations: they are not projections, they are not meant to be credible, they are not the basis for making a purchasing decision, etc. etc. etc. They are only intended to convey “the way the policy works” under an assumed scenario. In that sense they are merely the basis for asking the fundamental question: Why will one policy actually perform better than another policy?

Comparison between Penn Mutual and Northwestern Policies

(See Tables 2 and 13 for specific policy historical information)

| Years | At-Risk Amt (000s) | | Annual Costs | | Ann. Cost/M\$AR | | Dividend Rate | |
|----------------|--------------------|------------|--------------|--------------|-----------------|-----------|---------------|--------------|
| | NW | PM | NW | PM | NW | PM | NW | PM |
| 1 | 248 | 248 | 5444 | 4851 | 22.0 | 19.6 | 10.00% | 9.93% |
| 2 | 247 | 248 | 1556 | 3301 | 6.3 | 13.3 | 10.00% | 9.93% |
| 3 | 245 | 246 | 1624 | 40 | 6.6 | 0.2 | 9.25% | 9.93% |
| 4 | 243 | 242 | 1520 | 113 | 6.3 | 0.5 | 9.25% | 9.70% |
| 5 | 242 | 239 | 1403 | 443 | 5.8 | 1.9 | 8.50% | 9.20% |
| 6 | 240 | 235 | 1310 | 1281 | 5.5 | 5.4 | 8.50% | 8.50% |
| 7 | 239 | 233 | 1235 | 1147 | 5.2 | 4.9 | 8.50% | 8.50% |
| 8 | 239 | 231 | 1064 | 1395 | 4.5 | 6.0 | 8.50% | 8.00% |
| 9 | 239 | 229 | 998 | 1129 | 4.2 | 4.9 | 8.80% | 8.00% |
| 10 | 239 | 227 | 919 | 972 | 3.8 | 4.3 | 8.80% | 7.40% |
| 11 | 239 | 225 | 844 | 1356 | 3.5 | 6.0 | 8.80% | 7.40% |
| 12 | 239 | 224 | 907 | 1294 | 3.8 | 5.8 | 8.80% | 7.40% |
| 13 | 240 | 222 | 787 | 1395 | 3.3 | 6.3 | 8.60% | 7.40% |
| 14 | 239 | 220 | 889 | 1289 | 3.7 | 5.8 | 8.20% | 6.48% |
| 15 | 238 | 218 | 1022 | 1219 | 4.3 | 5.6 | 7.70% | 5.74% |
| 16 | 236 | 215 | 1176 | 1280 | 5.0 | 6.0 | 7.50% | 5.74% |
| 17 | 233 | 212 | 1160 | 2164 | 5.0 | 10.2 | 7.50% | 6.30% |
| 18 | 230 | 209 | 1284 | 2482 | 5.6 | 11.9 | 7.50% | 6.30% |
| 19 | 226 | 205 | 1425 | 3139 | 6.3 | 15.3 | 7.50% | 6.34% |
| 20 | 221 | 201 | 1601 | 3616 | 7.2 | 18.0 | 6.50% | 6.34% |
| Summary | 238 | 226 | 20195 | 21826 | 84 | 95 | 8.43% | 7.72% |
| Adv. NW | | 5.2% | | 7.5% | | 12.2% | | 71 bp |

Summary Value Notes: At-Risk and Dividend Rates are Annual Averages; Costs are Present Values discounted at 5%

Questions to Consider When Evaluating Cash-Value Life Insurance Policies –

Below are just a few of the many questions that should be able to be answered about any cash-value policy you own, you manage as trustee, you recommend as an advisor or agent, and/or you are thinking of

buying.

- 1) What are the policy's current annual costs?
- 2) How are the annual costs likely to change in the future?
- 3) On what basis are those estimated future costs credible?
- 4) How do such current and estimated future costs compare with alternative policies' costs? Are the costs competitive?
- 5) How does the insurer determine the earnings/interest it credits to its policies cash-value? What are the insurer's investment management fees and/or other charges which it deducts from its earnings?
- 6) Does the insurer have different investment categories, and how do they operate?
- 7) What are the insurer's historical crediting rates?
- 8) What is the insurer's actual historical performance on policies issued 20 years ago? What is the insurer's currently-illustrated future on-going performance on policies issued 20 years ago?
- 9) How does the insurer expect performance on currently issued policies to differ from that of the policies issued 20 years ago? What is the basis for such expectations?
- 10) Does the insurer's sales illustration reflect lapse-supported pricing, and what would be the impact of eliminating the effects of lapse-supported pricing? What mechanism /contractual guarantee does the insurer provide to reassure policyholders that the illustrated benefits of lapse-supported pricing will actually accrue to the policyholders?
- 11) Are there any unique contractual features that need to be understood? In particular, with a UL policy with a no-lapse guarantee, how does the mechanism work, and what annual information does the insurer automatically provide to the policyholder about such?

Caveats

- 1) Variations in Policies' Coverages - The benefits of the compared policies are not exactly the same. Specifically, the average coverage amount, a.k.a. the **average At-Risk Amount**, (which is the difference between a policy's death benefit and its annual cash-value), **differs slightly from policy to policy, from year to year**. Although this report's PV Costs are calculated on the basis of "per thousand dollars of coverage," thereby eliminating the impact of policies' slight At-Risk differences, two cash-value policies in any year can have slightly different coverage or at-risk amounts. Measures of a policy's total costs are, of course, a function of both the policy's PV costs per thousand dollars of coverage and the policy's specific annual At-Risk amount pattern.
- 2) **Other small variations in benefits can exist among policies**. For example, ancillary benefits such as rules on: 1) receiving accelerated death benefits when terminally ill, 2) on accessing cash-values, i.e., loan rates, etc. and 3) the availability of optional riders, etc. are a few the common minor variations among policies. Consequently, just as when shopping for any other product, when shopping for life insurance, it makes sense to consider the "full package" of benefits of different policies when comparing costs. A good agent can help select among policies of comparable acceptable costs to find the one with ancillary benefits that could be most relevant to a particular consumer.
- 3) **Comparisons of Present Value Costs for individuals at different ages** can only be done with a thorough understanding of this analytical process. For instance, present value costs of 20 years of coverage for a 40 year old versus 20 years of coverage for a 45 year old must take into account that the different starting and ending ages of the two alternatives, and in particular that there are only fifteen overlapping or common years in this comparison. Present Value costs cannot be directly compared at different ages. To accurately compare such different present value costs involves "translating" the lump-sum, single value cost(s) into a stream of annual costs and then making sure to correctly match-up and compare the alternatives' annual costs. For more information on this subject contact Brian Fachtel at BreadwinnersInsurance.com.
- 4) **Rate Related** - To calculate each insurer's illustrated annual costs, the rate of return used in creating the illustration is the rate used in de-constructing it or reverse engineering it. To the extent that the rate is not net of all investment-related expenses, then the calculated present value costs include such costs. Until life insurers adopt a convention for reporting crediting rates, there can be some inconsistencies in calculated PV costs among insurers. The overall consequences of such, however, are relatively insignificant because an exaggerated rate (gross rather than net) results in exaggerated costs. In essence, any possible desire to exaggerate either of a policy's two fundamental components (costs or compounding rate) to make it look better than it really is results in making the other component look worse than it really is. This observation again indicates the importance of understanding both of the fundamental

components of cash-value policies, and how any particular insurer manages such. Again, this highlights an area which a good agent can provide additional value.

- 5) **Rate Related, Addendum** - It must also be acknowledged that there are various ways in which an insurer can structure a cash-value policy to have policyholders bear costs. One approach is to separately manage the policy's components, that is, to directly charge the necessary costs and credit the net earned rate. Another approach, though, can be to use one component to subsidize the costs of the other, for example, an insurer could take a bigger margin on its investment management activities, say crediting policyholders half a percent less on their cash-values, and thereby using this margin to subsidize claim costs. While certain aspects of business management can be deemed proprietary, historical financial results regarding publicly-sold products can hardly be considered proprietary. Consumers are reminded of the age-old admonition to be leery of those who claim to have built a better financial mousetrap arising from some *indescribable* process (recall Madoff). For example, insurers that use lapse-supported pricing ought to be willing to answer various questions about this approach that can very much be a two-edged sword.

Footnotes to Table 1

Footnote 1 – These policies appear to be built with lapse-supported pricing approach. Their costs for 20 years appear less than their costs for 5 years, an obvious impossibility. Furthermore, given their very low total 20 year costs and knowledge of their sales expenses, their illustrated costs seem unreasonably low, which again indicates lapse-supported pricing. Lapse-supported pricing, in Breadwinners-Insurance's opinion, is neither inherently good nor bad. Policyholders, however, need to understand it, and determine if such an operating practice is attractive to them. As stated above, lapse-supported pricing can be a two-edged sword.

Footnote 2 – Considerations Arising From an Analyzed Illustration. The costs shown for AXA's Athena UL policy illustration certainly make it look attractive. But again, only after one understands the assumptions embedded in the policy illustration, can one ask the necessary probing questions. Regarding the Athena UL policy, BreadwinnersInsurance.com posed a series of questions to AXA's sales support team. For example: 1) What are the lapse assumptions used in creating the current Athena illustration and can you provide an illustration showing the performance based on zero lapses? 2) When was the Athena product line introduced, and what are the main differences between the old product line and the new Athena policy? and 3) What information can you provide with respect to how the interest rate is determined and what historical track-record performance information is available? AXA asserted that the answer to questions #1, #3, and several others "are not available." And, with respect to question #2, AXA asserted that "Athena was introduced as a more cost-effective and flexible alternative" to the prior product line, which AXA stated "had become unprofitable." Clearly, AXA's responses provide valuable additional insight regarding the fundamental question regarding the BreadwinnersInsurance.com

attractiveness of the Athena UL policy. Although in its commercials, AXA's 800 Gorilla can seem like an endearing and most-likable creature, its Athena UL policy is one about which there is much uncertainty.

Footnote 3 – See above discussion (Page 17 and Table 10) of examples showing the usefulness of present value cost analysis in choosing between an insurer's different policies. Life insurers market many policies, and understanding that the insurer's different policies can have very different sales costs can be very important. Northwestern's 90 Life policy was shown in Table 1 because it has consistently been the company's most-sold policy.

Footnote 4 – The generic twenty year level premium policy was chosen for comparative purposes in Table 1 because of its simplicity and its prevalence in the current marketplace. Similarly, the \$1000 annual premium was chosen as a representative generic policy. There are, in fact, insurers that offer 40 year old males 20 year level premium coverage for \$1 million with an annual premium of between approximately \$700 and \$1300. Naturally, the reported costs in Table 1 could be proportionately adjusted. A cost advantage of 20 Year Level Premium term policies arises because these policies are typically built with lapse-supported pricing. This enables their costs over 20 years to be lower than the costs over 20 years of an annually increasing premium policy. Twenty Year Level Premium term policies also typically do not allow the coverage to be continued after the 20th year, or only allow such at exceptionally high costs. Consequently, an Annually Increasing Premium term policy (although currently not all that common in today's marketplace) can be a more appropriate comparison with the cash-value policies shown in Table 1. A typical, Annually Increasing Premium term policy might have total present value costs over 20 years of \$17, in contrast with the 20 Year Level Premium's cost of \$13. Whichever type of term policy one uses to compare with the costs of the cash-value policies, the conclusion is the same. Cash-value policies currently extract much greater costs than term policies. The real question is: what will occur in the marketplace once consumers are provided with this appropriate disclosure?

Footnote 5 – Employer group policies typically have premiums that increase every fifth year. This policy's age bands and respective costs (for \$1 million of coverage) began at ages 36-40 at \$50/month, and increased at ages 56-60 to \$450/month. Many incorrectly assume that group policies have an advantage because of volume, but the claim costs do not significantly decrease as volume increases because insurance is a risk-based product, not a mass-production product. Group policies are based on average health, so they can be attractive for individuals deemed less healthy than their peers, (i.e. smokers, etc.), but for healthier individuals they are often significantly more expensive, especially after age 45.

Footnote 6 – Penn Mutual, in its current illustrations of new policies, may still be using an approach where it builds-up the policyholder's cash-value deliberately slowly. Such deliberate slow building certainly seems to have been the case in the whole life policy issued in 1989, analyzed and compared in Tables 13 and 14. Notice that the historical policy's calculated cost in year 2 is quite large. Insurers can choose to do such, as described above as part of a lapse-supported pricing approach, or with the BreadwinnersInsurance.com

intention of directly refunding such “overcharges” to the very same policyholder in subsequent years. In this way an insurer can have greater control over the value that the policyholder receives. For example, is the “overcharge” refunded in the immediate following years, or retained to perhaps subsidize costs in later years should claims appear abnormally large? Answers to such questions are not, however, found in illustrations. They are instead examples of the important questions consumers, advisers, trustees, and agents need to know. For example, what evidence can be provided to demonstrate that the insurer is committed to following through and distributing the results of such illustrated performance to the policyholders?

The End.

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