Product Update: ULSG and Term UL

Actuaries' Club of the Southwest
2011 Spring Meeting
June 23-34, 2011

Stephanie Grass, Towers Watson

TOWERS WATSON

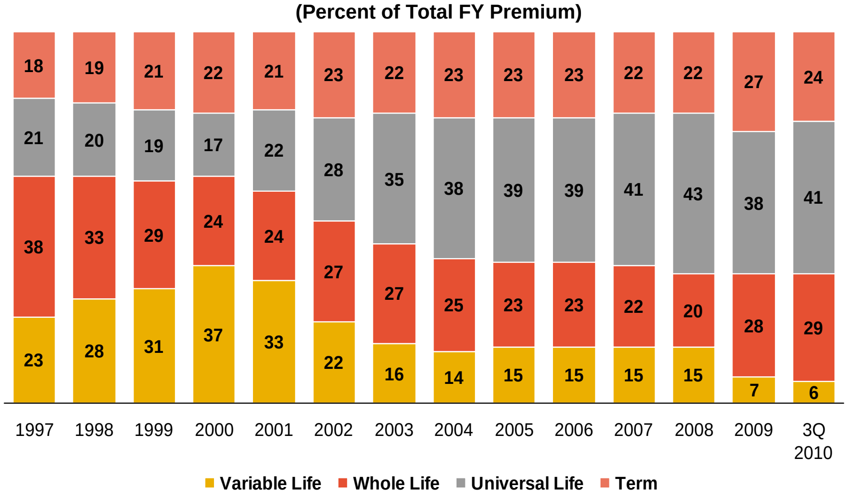
Agenda

- General Market Update
- Trends in Product Design
- Recent Regulatory Developments
- Q&A

General Market Update

In 2010, universal life products increased in market share, at the expense of term life products

Market Share of Individual Life Insurance by Product Type (Percent of Total FY Premium)



Source: LIMRA International. Based on first-year premium. Results based on policies issued would be significantly different.

Overall life insurance sales were down significantly in 2009, but have begun to rebound in 2010

- Life sales through 4Q 2010 were up 4% relative to 4Q YTD 2009
  - After 2 quarters of increases, third and fourth quarter sales were flat
  - Attributable to strong performance in universal life and whole life sales
- UL annualized premium sales increased 10% in 2010, with sales of UL policies soaring up 21% in 2010
  - At the expense of term life, experiencing the largest annual decline for term life insurance premiums on record
    - — Likely due to the introduction of Term UL products
  - Term UL sales and drop in sales to older buyers resulted in lower average cost for UL coverage
  - 60% of UL writers increased their premium sales from 2009, including 15 of the top 20 UL writers
    - — Products featuring long-term secondary guarantees lost 5% of the UL market share in 2010
    - — Non-guaranteed UL sales experienced double digit growth (up 27%), mostly due to a continued increase in IUL sales

Source: LIMRA

After increasing premiums in late 2009, very few price changes were observed in 2010 for top single life ULSG writers

Top 20 Single Life ULSG Premiums
Male Best Nonsmoker 65, $1 Million Face Amount

Statistic	Jul-07	Jul-08	Jul-09	Jan-10	Jul-10	Jan-11
25th Percentile	19,144	18,695	18,728	18,796	18,867	18,863
Median	19,348	18,908	18,895	19,184	19,180	19,098
75th Percentile	19,753	19,093	19,088	19,725	19,620	19,753
Mean	19,386	18,817	18,848	19,307	19,247	19,348
% change						
25th Percentile		(2.3)	0.2	0.4	0.4	(0.0)
Median		(2.3)	0.0	1.5	(0.0)	(0.4)
75th Percentile		(3.3)	0.3	3.3	(0.5)	0.7
Mean		(2.9)	0.6	2.4	(0.3)	0.5

Source: Blease Research's Full Disclosure Reports, Towers Watson analysis

In late 2010, there were some targeted price increases for survivorship products, while a few companies elected to discontinue sales of their survivorship product all together

Top 20 Survivorship Life ULSG premiums
Male Best Nonsmoker 60 / Female Best Nonsmoker 55
$1 Million Face Amount

Statistic	May-07	May-08	May-09	Nov-09	May-10	Nov-10
25th Percentile	7,683	7,471	7,550	7,500	7,500	7,560
Median	8,067	7,650	7,670	7,616	7,616	7,765
75th Percentile	8,546	7,815	7,817	7,814	7,831	7,817
Mean	8,195	7,627	7,663	7,762	7,716	7,824
% change						
25th Percentile		(2.8)	1.1	(0.7)	0.0	0.8
Median		(5.2)	0.3	(0.7)	0.0	2.0
75th Percentile		(8.6)	0.0	(0.0)	0.2	(0.2)
Mean		(6.9)	0.5	1.3	(0.6)	1.4

Source: Blease Research's Full Disclosure Reports, Towers Watson analysis

ULSG products continue to meet an important market need for affordable, guaranteed long-term insurance coverage

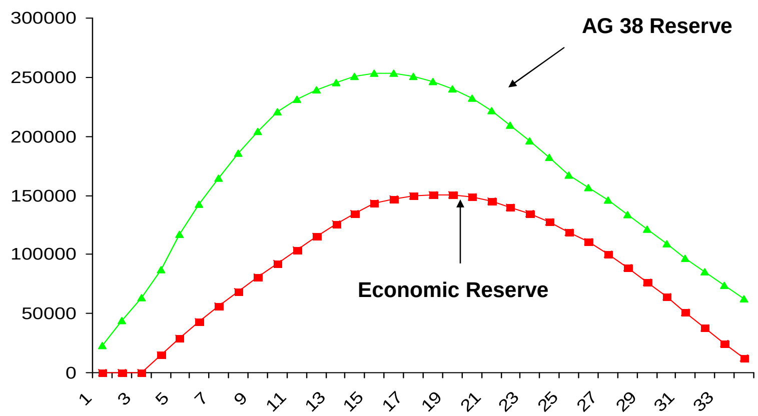
- In the current market environment, however, companies are being challenged to meet this market need
  - Continued low interest rate environment
  - Very low emerging lapse experience
  - Emerging experience on older age mortality
  - Increasing third-party reinsurance rates
  - Market consistent pricing/management is exerting more influence on the market

Many of the ULSG products sold over the last several years reflected the impact of excess statutory reserve financing transactions in their pricing

- While the market for excess statutory reserves financing has returned to some extent, financing is much more expensive today, if available at all
  - Cost continues to be fairly high relative to 3-4 years ago
  - The tenors available are shorter than what was available 3-4 years ago
  - Transactions may involve restrictive provisions
  - Significant execution risk
  - Rating agencies continuously reviewing their approach to reflecting transactions in their analysis of companies
    - Possible limits on total leverage, including operational leverage
- Some companies have or are considering internal deals, backed by surplus notes or parental guarantees
  - Iowa adopted limited purpose subsidiary regulation
    - Captive rules allow Iowa domiciled insurers to secure reserve credit with a parental guarantee
  - Indiana adopted similar regulation
  - Other states likely to follow suit

Illustrative

With AG38 reserve requirements increasing over time and the tightening of the capital markets, companies continue to look for alternatives to relieve the capital strain



While certain companies have elected to scale back in this market, others have elected to continue to meet the ULSG consumer need

- Mechanisms companies have used to scale back
  - Eliminate the sale of the most capital intensive version of the product
    - Last survivor version of ULSG
  - Increase premium rates to cut production
  - Reduce ULSG guarantee period
  - De-emphasis of ULSG relative to other forms of UL
- Other companies have taken a closer look at the valuation requirements
  - X-factors
  - Usage of lapse rates
  - Usage of Preferred 2001 CSO tables
- Several companies have elected a re-design of their secondary guarantee product

Trends in Product Design

The recent trend in ULSG product designs has been towards a multi-fund shadow fund design, or a design with multiple sets of shadow fund charges

- This design is a mechanism for dealing with three core challenges in being a player in the ULSG market
  - Meeting consumer price demands
  - Achieving company profit objectives
  - Establishing reserves for the secondary guarantee that are adequate, but not excessive
- Based on a review of publicly available company filings, approximately 80% of the top 10 companies (based on competitive premium ranking) are currently utilizing this product design
- While multi-fund designs have recently become more prevalent, this shadow fund design has been around for at least 8 years

Key components of a multi-fund shadow fund design

- The policy will not lapse due to insufficient funds if the Shadow Fund Account (“SFA”) less policy debt is equal to or greater than zero.
- The SFA is determined in the same way as the UL policy value, but using SFA charges, interest rates and order of operations
- The SFA consists of three sub-accounts (SFA I, II and III)
  - SFA = SFA I + SFA II + SFA III
  - SFA III account commonly referred to as the “catch-up” account
- Typically premiums paid are allocated to the sub-accounts as follows:
  - All premiums received during the first policy year are allocated to SFA I
  - Premium paid in the second and later policy years are allocated to SFA II and SFA III as follows:
    - — Premium is allocated to SFA II if the SFA for the prior policy month in which premium is received is greater than zero
    - — Premium is allocated to SFA III if the SFA for the prior policy month in which premium is received is less than or equal to zero
    - — There may also be a limit on the premium that is allocated to SFA III and the excess is allocated to SFA II

Key components of a multi-fund shadow fund design – cont'd

- SFA monthly deductions commonly consist of:
  - SFA monthly per policy administrative fee
  - SFA monthly per unit expense charge
  - SFA COI charge
- Commonly two sets of SFA COI charges (i.e. Table A and B)
  - Table A charges are commonly lower than Table B charges
  - If the SFA for the prior policy month is greater than zero, the Table A (or lower set of COI charges) apply
  - If the SFA for the prior policy month is less than or equal to zero, the Table B (or higher set of COI charges) apply
  - Also common to have two sets of SFA COI charges on a single fund design
- Allocation of monthly deductions
  - Common to work backwards
    - — Start by deducting from SFA III until zero, then SFA II until zero, then from SFA I
    - — To the extent, there is an amount remaining to be deducted, the remainder is commonly deducted from SFA III, which then becomes negative

Advantages offered by the multi-fund shadow fund design

- For a single fund shadow fund design, there is often tension between managing reserve strain and mitigating certain premium patterns when setting design levers
- The multi-fund shadow fund design provides additional design levers to better manage this tension
  - With a multi-fund shadow fund design, can price out most policyholder premium anti-selection
    - — Shortens the time the no-lapse guarantee persists under various premium pattern scenarios involving premium suspension
    - — Discourages "catch-up" anti-selection
  - Provides an ability to better price the secondary guarantee using "first principles"
    - — Secondary guarantee loads and charges designed to cover policy benefits and expenses
- Certain of the advantages of the multi-fund shadow fund design are achievable with modification to the single fund shadow fund design
  - E.g. two sets of SFA COI charges on a single fund design

The trend towards multi-fund shadow fund designs has evolved into the term product line

- Aware of at least four companies that have introduced a new term product using a UL chassis (known as "Term UL")
  - Death benefit guarantee provided through **multi-fund shadow fund design**
  - Only level death benefit option offered
  - Extended issue age ranges
  - Sales, service and customer experience similar to traditional term
  - Significant additional administrative requirements relative to traditional term
  - Provides added policyholder flexibility over traditional term products
- Certain companies completely replaced their existing traditional level term product, while others used as an addition to their existing term portfolio

It is still too soon to know if Term UL will become a common chassis for level term insurance

Term UL has been designed to compete with level term life insurance

Male Standard No Nicotine Use, Issue Age 35, $250,000 Face Amount
Level Pay 20-year Guarantee Premium

Rank	Company Name	Product Name	Annual Premium
1	Savings Bank Life	T-20/20	302.50
2	Protective Life	Secure-T - 20 Year No Lapse UL	323.84
3	Cincinnati Life	LifeHorizons Termsetter 20	325.00
4	Genworth	Colony Term UL 20 (200K+)	330.22
5	American General	Select-a-Term - 20 Year	331.50
6	Transamerica	TransTerm UL 20	337.50
6	Hartford Life	Bicentennial Term 20	337.50
7	TIAA-CREF	20-year Level Term	338.00
8	Banner Life	OPTerm 20	340.00
9	ING	TermSmart 20	340.50

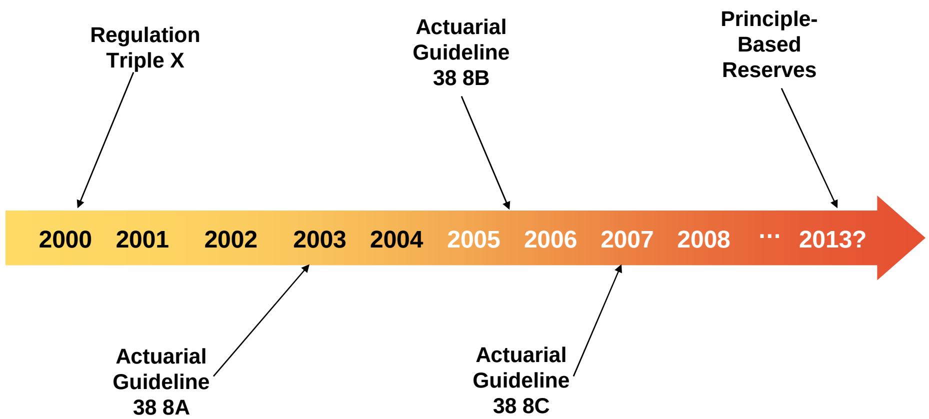
Source: Term4Sale.com as of 05/09/2011

For certain companies, the complexity of the multi-fund shadow fund design outweighs the advantages

- Complicated for agents and consumer to understand
  - Due to lack of understanding, could get caught in the “catch-up” account, requiring a significant premium payment to re-activate the secondary guarantee
  - For Term UL, may be a lack of understanding of what is being purchased
    - Additional field and policyholder education required to gain an understanding of added flexibility
- More complex administrative system capabilities are required
- While better able to mitigate anti-selective premium pattern behavior, additional design complexity requires numerous premium pattern pricing sensitivities to avoid potential pricing “holes”
- Regulatory risk

Recent Regulatory Developments

Reserve requirements for ULSG products have changed over time, and have generally been increasing



NY 147 is consistent with the latest revision to AG 38, with some applicability dates differing.

Triple X and AG 38 Reserve Terminology

- Regulation Triple X introduced segmentation
  - Each segment is a self supporting entity in the reserve calculation
  - Whenever Gt > Rt a new segment begins
    - Gt =ratio of successive guaranteed premiums
    - Rt = ratio of successive valuation mortality rates
- Minimum Triple X Reserve mortality is adjusted by X factor in first segment only
- Regulation Triple X defines the calculation of the minimum gross premiums as:
  - *"For purposes of this section, the minimum premium for any policy year is the premium that, when paid into a policy with a zero account value at the beginning of the policy year, produces a zero account value at the end of the policy year. The minimum premium calculation shall use the policy cost factors (including mortality charges, loads and expense charges) and the interest crediting rate, which are all guaranteed at issue."*
- Remaining steps of AG 38 8C can be summarized as follows for a shadow fund

Total AXXX reserve = Triple X Reserve +
(SF Value/SF to Fund Guarantee grossed up by 0.93) * (NSP - Triple X Reserve) – Applicable Surrender Charge

On November 30, 2010, the NYSID sent an inquiry to UL writers licensed in NY

- Request for all UL forms including a secondary guarantee with a shadow account structure with multiple sets of COI charges, expenses or credited rates:
  - List of all UL forms whereby the Company's reserve methodology is not based on the lowest set of charges or highest set of credited rates applied to the shadow account in determining the minimum gross premiums, including the date the form was first available for sale, the approximate number of policies issued, and the total face amount and reserves as of 9/30/2010.
  - For each form, a copy of the actual policy form for the policy with the largest face amount and a supporting reserve calculation as of 12/31/2010 using the Company's current reserve methodology and a second calculation using the lowest set of charges and highest set of credited rates to calculate the minimum gross premiums.
- Complete response required within 10 business days

At time initial request was made, many companies believed that any action taken by the NYSID would be prospective only.

In December 2010, NYSID sent a follow-up inquiry to the same companies

- Requested confirmation that the Company's reserve methodology will be **corrected as of 12/31/2010** such that the lowest set of charges and highest credited rates are applied to the shadow account in determining the minimum gross premiums, and an estimation of the aggregate impact by January 7, 2011
- Companies were provided an alternative to schedule a meeting with the NYSID to be held in the first two weeks of January 2011, with a requirement that the aggregate impact be provided three business days prior to the meeting
  - Prompted a series of calls with LICONY
  - Followed by a series of meetings with Company representatives

At the meetings, the following key arguments from company representatives were made

- The impact on reserves as of year-end 2010 was estimated to be very onerous for certain companies
  - The projected increase in reserves appears to be primarily attributable to additional deficiency reserves (i.e. not tax deductible)
- Reserves calculated in accordance with AG 38 8C or the second amendment to NY 147 have a stand-alone asset adequacy requirement
  - Assumptions underlying the asset adequacy testing were a key point of discussion in the NYSID meetings
- The timing of the request was considered to be impractical by many companies
  - Changes required to valuation systems, which would have required adequate testing before year-end reporting
  - Companies subject to the NAIC Model Audit Rule (i.e., statutory Sarbanes-Oxley)
- Companies further questioned the retroactive nature of the request
  - Regulators and auditing firms had historically never questioned the approach used in the calculation of minimum gross premiums

The NYSID ultimately made a decision to postpone any action taken.
No additional reserves were required as of December 31, 2010.

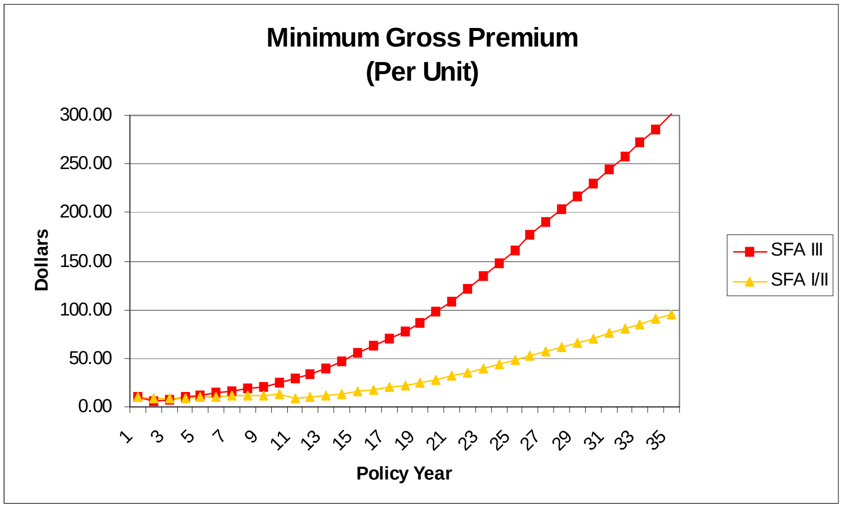
Illustrative

Reserve Example - Specifications

- Model Point Specifications
  - Policy issued to Male Best Nonsmoker, Issue Age 65
  - Specified Amount of Death Benefit: $1,000,000
  - Level no-lapse premium payable to attained age 100
    - Premium equal to $18,750
- Secondary Guarantee Design Specifications
  - Multi-fund shadow fund design
  - Front-end load equal to 7% of premium in all sub-accounts
  - Per policy charge of $5 per month in all sub -accounts
  - Per unit expense charge of $0.50 per month in first 10 policy years (SFA I/ II only)
  - SFA III COI rates are equal to 100% of 2001 CSO S&U ANB mortality
  - SFA I and SFA II COI rates are equal to the SFA III rate in policy year 1 and then 28% of the 2001 CSO S&U ANB mortality
  - Crediting interest rates equal to 5.5% for SFA I and SFA II and 4% for SFA III

Illustrative

Reserve Example – Comparison of Minimum Gross Premiums calculated using the alternative sets of SFA COI Charges



towerswatson.com

Illustrative

Reserve Example – Comparison of AG38 8C Reserves (per unit)

Policy Year	SFA III Minimum Gross Premiums			SFA I/II Minimum Gross Premiums			Difference		
	AG38 Basic Rsv	AG38 Def Rsv	AG38 Min Rsv	AG38 Basic Rsv	AG38 Def Rsv	AG38 Min Rsv	AG38 Basic Rsv	AG38 Def Rsv	AG38 Min Rsv
1	0.0	0.0	0.0	2.2	71.8	74.0	2.2	71.8	74.0
2	3.7	0.0	3.7	17.0	68.1	85.2	13.3	68.1	81.4
3	10.7	0.0	10.7	32.5	64.5	97.0	21.8	64.5	86.3
4	19.7	0.0	19.7	49.8	61.0	110.8	30.1	61.0	91.1
5	35.7	0.0	35.7	75.0	57.5	132.5	39.3	57.5	96.8
10	169.6	0.0	169.6	246.8	37.4	284.2	77.2	37.4	114.6
20	557.5	0.0	557.5	604.6	20.3	624.9	47.1	20.3	67.4
30	764.5	0.0	764.5	786.7	20.3	806.9	22.2	20.3	42.5
35	924.2	0.0	924.2	924.2	0.0	924.2	0.0	0.0	0.0

towerswatson.com

Illustrative

Reserve Example: Comparison of AG 38 8C Reserve (per unit) By premium pattern

PY	Level NLG Premium			Ten Pay NLG Premium			Single Pay NLG Premium		
	SFA III Min Gross Prem	SFA I/II Min Gross Prem	Diff	SFA III Min Gross Prem	SFA I/II Min Gross Prem	Diff	SFA III Min Gross Prem	SFA I/II Min Gross Prem	Diff
1	0.0	74.0	74.0	5.2	74.0	68.8	290.4	295.6	5.2
2	3.7	85.2	81.4	18.0	87.2	69.2	311.8	317.7	5.9
3	10.7	97.0	86.3	61.6	130.6	69.0	333.9	340.6	6.7
4	19.7	110.8	91.1	111.4	178.5	67.1	356.8	364.2	7.4
5	35.7	132.5	96.8	165.6	229.0	63.4	380.5	388.7	8.2
10	169.6	284.2	114.6	492.8	504.8	11.9	492.8	504.8	11.9
20	557.5	624.9	67.4	753.8	765.6	11.9	753.8	765.6	11.9
30	764.5	806.9	42.5	865.9	876.6	10.7	865.9	876.6	10.7
35	924.2	924.2	0.0	924.2	924.2	0.0	924.2	924.2	0.0

While specific action was postponed by the NYSID, the issue is far from over

- The NYSID addressed the issue at the March NAIC meeting
  - The issue was escalated and concern spread across several states of domicile
- LICONY is in the process of preparing a proposal for change to the NYSID
  - It is expected that the proposed solution will form more structure around the asset adequacy testing requirement
  - The proposed solution is expected to be prospective for policies issued 1/1/2012 and later
- Certain states of domicile beginning to take action
  - Texas state insurance department recently submitted a survey to 45 companies
  - Requested similar information to that requested by NYSID
- Companies seem to be in a "wait and see" mode with respect to product changes
  - Currently active in fulfilling specific state insurance department requests
  - Participating in LICONY and ACLI sub-groups formed
  - Hopeful that a compromise (or set solution) will be obtained, while not distracting state and company resources from completing PBR

Questions & Answers

Contact Information

Stephanie Grass, FSA, CERA, MAAA
Consultant, Towers Watson
101 South Hanley
St. Louis, MO 63038
Telephone: 314-719-5915
E-mail: stephanie.grass@towerswatson.com