

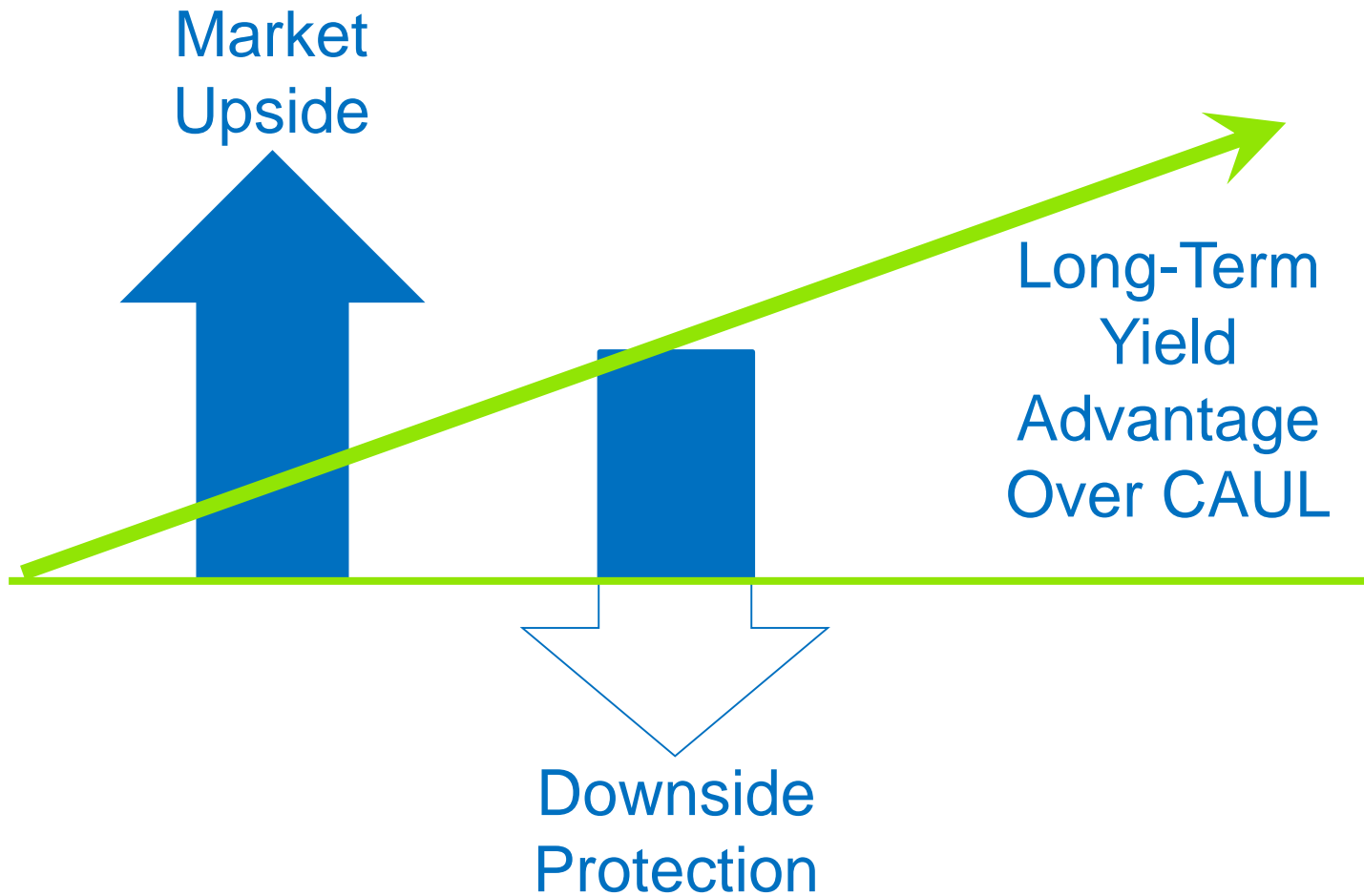


# IUL Basics

Presented by...

Policies issued by American General Life Insurance Company, a member company of AIG

# Value Proposition



## IUL History

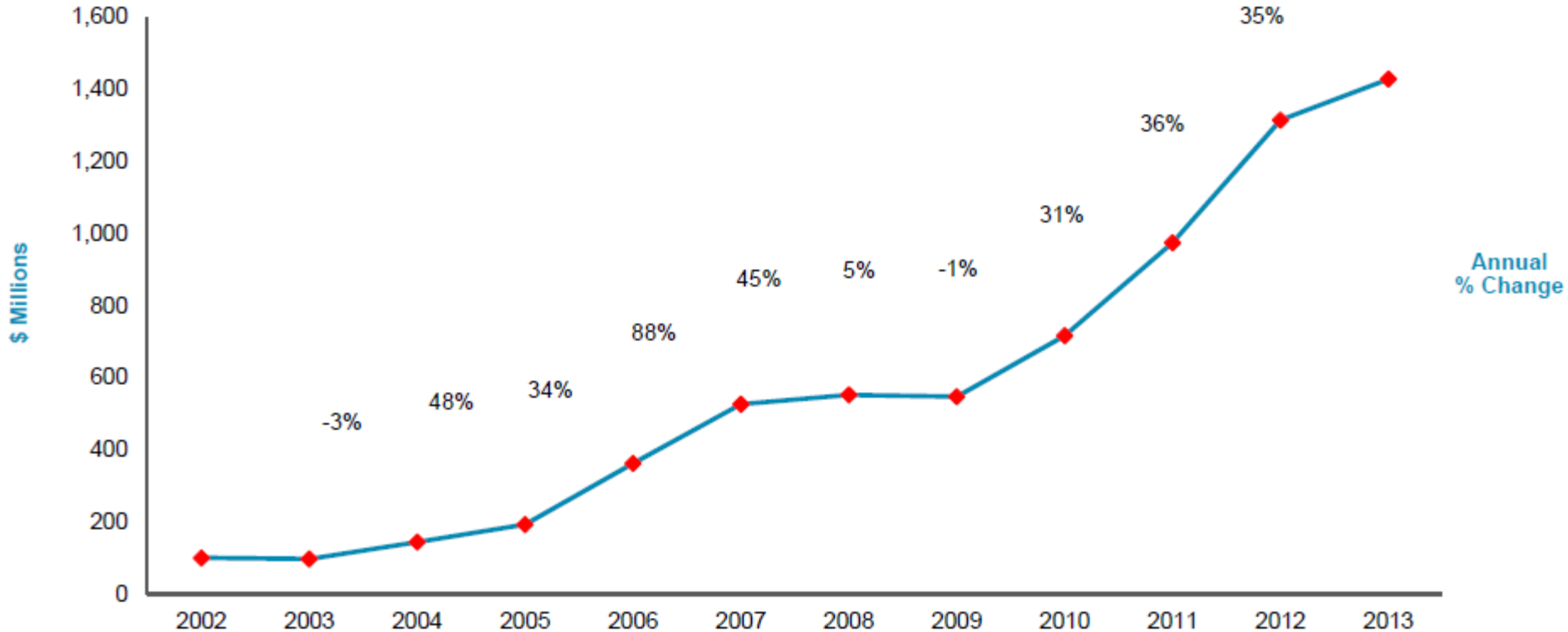
- Transamerica Occidental Life Insurance Company rolled-out the first-ever Index UL in January of 1997 – in response to rising market conditions and the growing popularity of the similarly-structured index annuity, introduced just two years prior.\*
- Index Universal Life’s design was identical to that of traditional UL (which was developed in the 1970’s), but offered the purchaser the ability to earn limited interest based on the performance of a stock market index (without being subject to the losses of the stock market itself).\*



\*Source: Sheryl J. Moore’s NAIC Comment on IUL Illustrated Rates November 5, 2014 Article

# Index UL Market Overview

IUL Production Has Shown Significant Growth In The Last Decade



Total IUL sales represented 39% of universal life sales during 2013 and 14% of total individual premium



Source: Wink's Sales and Market Report and LIMRA

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# What is IUL?

- A life insurance policy that combines the features & benefits of a traditional UL but uses a different crediting method for determining interest
- Index interest is based, in part, on the movement of a stock/bond market index over a specific time period
- Potential to earn index interest is based on increases in an index, while offering a minimum interest rate guarantee (normally 0% - 2%)
- Potential for higher than average crediting rates compared to traditional UL





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# IUL Overview

Different method for determining and crediting

Non-guaranteed interest

- **Fixed UL:** declared interest - by carrier
- **Index UL:** indexed interest - reference stock market index

General account product

- No policy owner investments in separate accounts (unlike VUL)
- Policy owner only chooses allocation to index crediting account
- No securities license required



# Interest Crediting





# Index Strategies

An index strategy uses a formula that calculates interest based in part on the movement of a stock/bond market index, such as the S&P 500 Index.

Index UL has different index strategies where clients can direct their money in an effort to take advantage of positive movements in a stock market index.



# Evolution of Index Life

## Crediting Strategies

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Annual Point-to-Point

Daily Averaging

Inverse Term End Point

Monthly Averaging

Monthly Point-to-Point

Performance Triggered

Term End Point

Two Year Point-to-Point

Five Year Point-to-Point

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## What is an Index?

- A hypothetical group of securities, typically representing a particular market or sector
- The securities in an index are weighted and measure changes within a particular financial market
- “Price Indices” which exclude dividends
- “Total Return Indices” include dividends



## Potential Index Options

10-Year Constant Maturity Treasury Note	Barclays Bond Index
Barclays US Dynamic Balance Index	Dow Jones-UBS Commodity Index
Euro Stoxx 50	Hang Seng
MSCI EAFE	MSCI Emerging Markets
NASDAQ-100	Russell 2000
S&P 500	S&P 500 Global (BMI)
S&P MidCap 400	S&P Total Return Index
ML Strategic Balanced Index*	

\*Not available in New York.



# Crediting Options



# Crediting Options

1) Declared Interest Account

2) Index Interest Account with Cap Rate

3) Index Interest Account with Participation Rate

4) Index Interest Account with Spread Rate



## Which Option Is Used The Most?

Historically, it was most common to use a participation rate to limit the potential index interest credited to IUL; this pricing lever is only utilized on 22.00% of all crediting methods offered on IUL today.\*

76.00% of IUL crediting methods today use a cap to limit any index interest and the remaining 2.00% of crediting methods use a spread to limit any index interest credited.\*



\*Source: Sheryl J. Moore's NAIC Comment on IUL Illustrated Rates November 5, 2014 Article

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# What Are The Moving Parts?





# 1 Year Point-to-Point



Source: <http://finance.yahoo.com>



# Index Interest Crediting Methods

Whenever the index is above the floor, an account will be credited by either one of two methods:

- **CAP RATE:** The index interest rate up to a specified limit (the 'cap'), such as 12% that can be applied to the policy.
- **PARTICIPATION RATE:** A specified percentage (the participation) of the index's increase used in crediting interest to the policy, (e.g., 60%).
- **SPREAD RATE:** A specified percentage is deducted from an index increase used in crediting interest to the policy (e.g., 4%)

For **ALL** Methods: The account will never be credited with less than the guaranteed 'floor' rate, typically between 0 - 2%, regardless of the performance of the index.



# Understanding Cap Rates

**Example:** Assume a cap of 10% (participation rate of 100%) and a guarantee of 1%:

- If the index increases 8%, policy credited **8%** ( $100\% \times 8\%$ )
- If the index increases 20%, policy credited **10%** ( $100\% \times 10\%$ )
- If the index increases 0%, policy credited **1%** (guarantee rate)
- If the index decreases 10%, policy credited **1%** (guarantee rate)



# Understanding Participation Rates

**Example:** Assuming no cap, a participation rate of 60% and a guarantee of 2%:

- If the index increases 10% policy credited **6%** ( $60\% \times 10\%$ )
- If the index increases 50%, policy credited **30%** ( $60\% \times 50\%$ )
- If the index increases 0%, policy credited **2%** (guarantee rate)
- If the index decreases 10%, policy credited **2%** (guarantee rate)



# Understanding Spread Rates

**Example:** Assuming no cap, a spread rate of 4% and a guarantee of 2%:

- If the index increases 10% policy credited **6%** (10% - 4%)
- If the index increases 50%, policy credited **46%** (50% - 4%)
- If the index increases 0%, policy credited **2%** (guarantee rate)
- If the index decreases 10%, policy credited **2%** (guarantee rate)



# Determining Cap & Participation Rates

- Step 1 - Premium invested in fixed income investments
- Step 2 - Net investment earnings provide guaranteed interest rate
- Step 3 - Remaining earnings purchase one-year or longer call options on the specific index or indices.
  - Price of call options relative to investment earnings is primary factor in determining participation rate
  - This is commonly referred to as a carrier's "option budget"

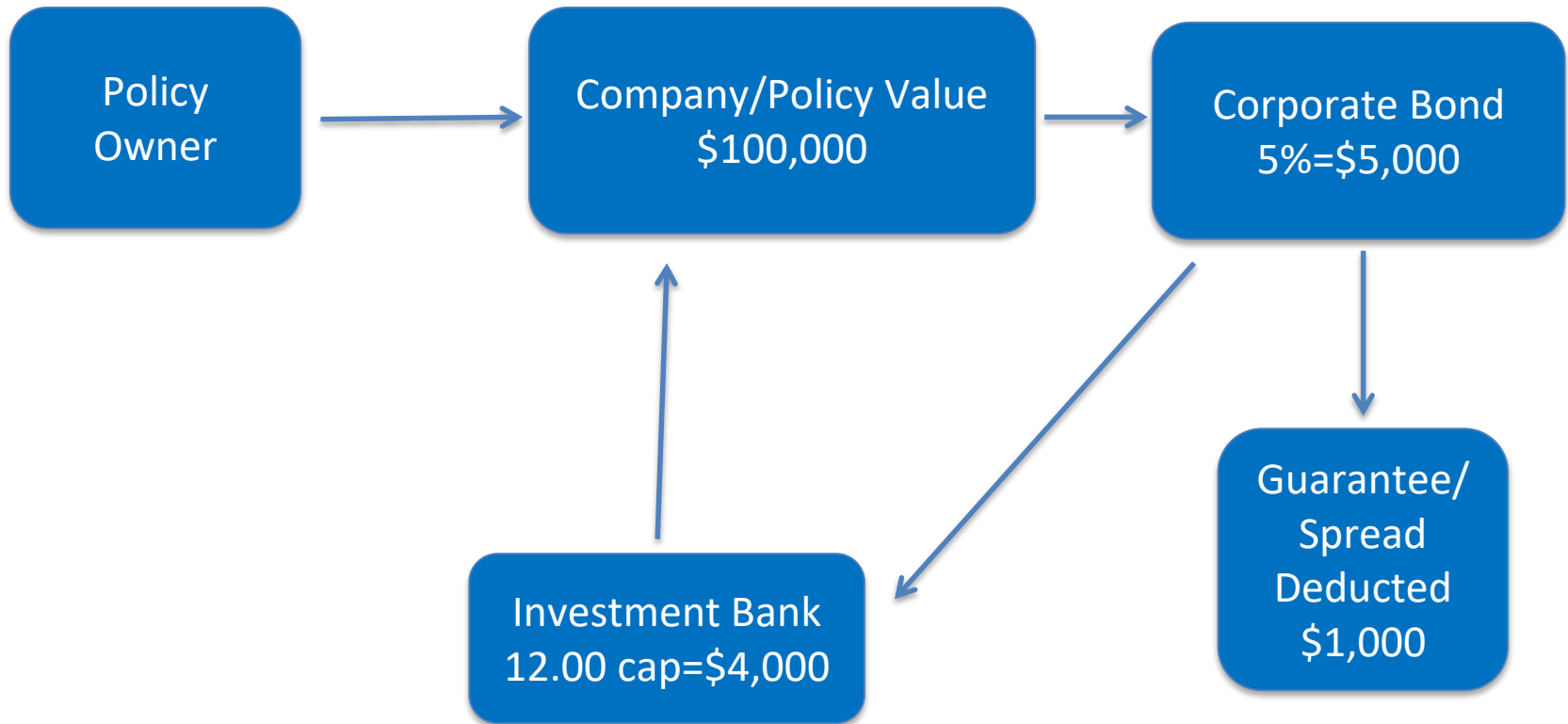


# What Happens Next?

- Market rises, call options are exercised
  - Policy credited with index interest
  
- Market decreases, options expire (worthless)
  - Policy credited with guarantee, or
  - Other selected policy options



# IUL Cap Setting Process



Policy Cash Value	Corporate Bond Rate of Return	Cost of Index Option	Cap Rate
\$100,000	5%	\$4,000	12%





## Which Strategy

- The best strategy is the one that is **most aligned** with the client's opportunity cost & risk tolerance preferences
- Companies **primarily focus** on the historical performance of a strategy using the current cap (or spread or participation)
- We know these index parameters **can and will change** over time
- What may not be clear is that some strategies **have to change more** than others when market conditions change.



# Policy Loan Types

- **Fixed Loan** – both the loan rate and the borrowed funds are fixed
- **Participating Loan** – Two types where both the loan rate and the borrowed funds participate in an index –
  - **True Variable Loan** - loan charge rate set by the Moody's Corporate Bond Average while the funds continue to participate in the index account
  - **Participating Loan**- Participating loan has a current loan rate while the funds continue to participate in the index account (less aggressive type of loan structure)



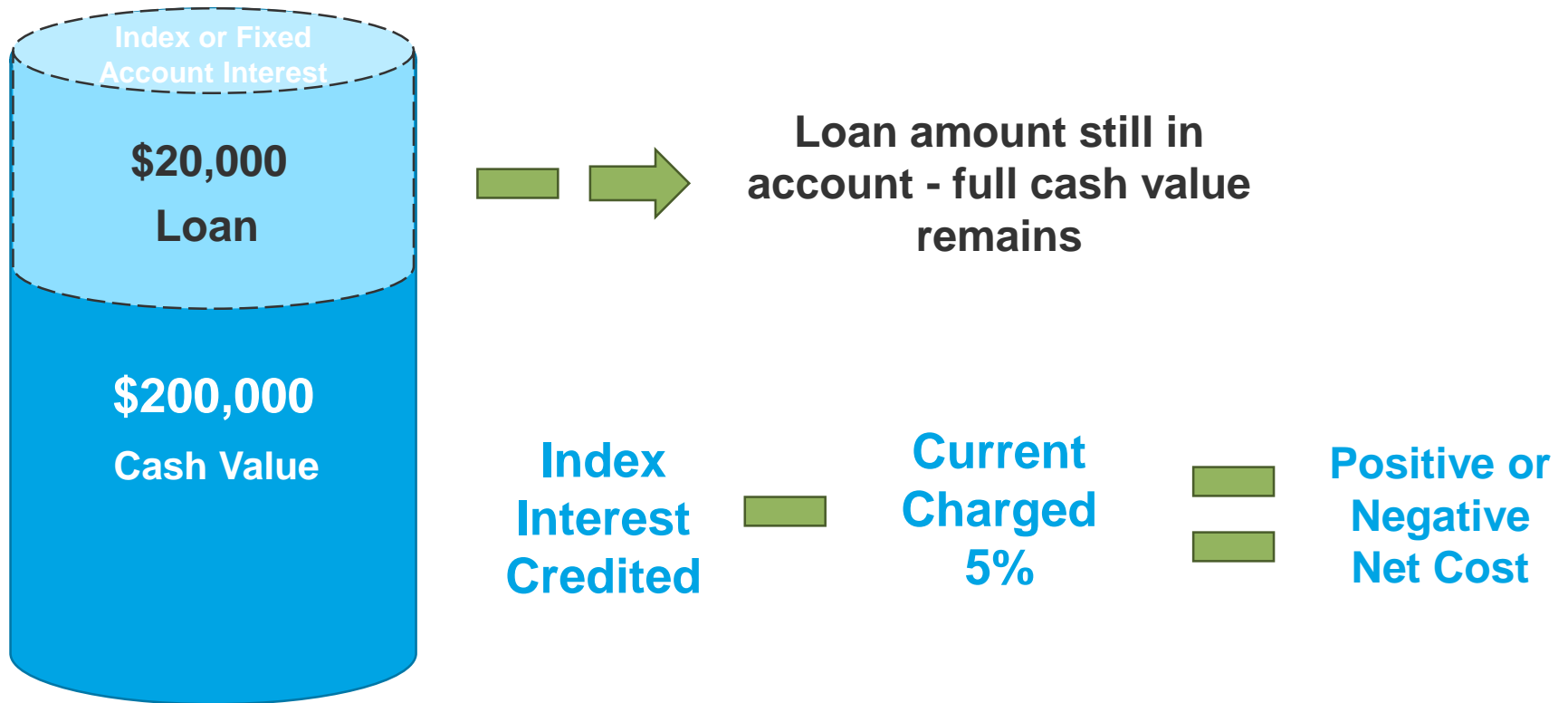
# Policy Loan Types

## Participating Loan

- Available in any policy year as long as there is positive cash surrender value
- Current declared rate – 5%
- Can be changed after policy issue
- Loaned amounts are NOT removed from accounts and are still eligible for index or excess interest
- Participate in index returns = potential for positive arbitrage

# How It Works

## Participating Loan



# Participating Loan Example

A	B	C
Hypothetical Index Interest Credited	Current Loan Interest Charged	Spread = A-B



# Questions



## Important Information

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