JAMIESON FINANCIAL SERVICES

DUE CARE BULLETIN

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Life insurance due care requires an understanding of the factors that impact policy performance and drive product selection.

M Financial Group continues to lead the industry in life insurance due care and client advocacy, providing valuable insight and analysis that delivers significant value to clients.

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Equity Index UL Primer

Equity Index Universal Life (EIUL) is the most recent evolution of life insurance product types. The development of EIUL was driven from the success and popularity of indexed annuity products, which were first introduced in the mid-1990s. Indexed products provide a crediting rate based in part on the market return of an equity index (or several indexes) with a guaranteed minimum floor.

EIUL is marketed as a UL product with the potential for an enhanced crediting rate that can drive superior product performance. However, EIUL is a complex product that requires an understanding of new terminology, index crediting rate mechanics, and the ultimate affect on product performance.

This Bulletin includes an overview of the characteristics of EIUL products, a description of different index strategies, examples of how different index strategies work, and other items to consider with an EIUL product. An appendix with key index product terminology and a grid of index strategy mechanics provided by EIUL products offered by M Carriers, is included.

The following is a general overview of EIUL products:

Primary Uses?	Permanent need for death benefit where flexibility in premium or death benefit is important, and a desire for an enhanced crediting rate tied in part to equities but with reduced volatility as compared to a VUL product
Guaranteed Coverage for Life?	Typically not
Ability to Vary Death Benefit?	Yes, within limits
Number of Insured Lives?	Both single life and survivorship are available
Level Premiums?	Yes, but not necessary
Flexible Premiums?	Yes
Low Initial Premiums?	Yes, within limits
High Early Cash Values?	Typically Yes
Guaranteed Minimum Interest	Yes (Both the Fixed Account and the Indexed Account have a guaranteed minimum interest rate)

Product Description

EIUL has the same open architecture product engine as both UL and VUL. A policy will stay inforce as long as the account value is greater than zero. The account value is equal to the previous account value + premium - loads + credited investment earnings.

The difference between EIUL and both UL and VUL is in how investment earnings are credited. The EIUL account value is comprised of funds allocated to both the fixed account and index account(s). The fixed account crediting rate is identical to a UL crediting rate. The indexed account crediting rate is typically based in part upon the market value growth of an equity index, subject to a Growth Cap, a Growth Floor, and a Participation Rate.

Comparison of Crediting Rates

	UL	EIUL	VUL
General Account or Separate Account	General Account: Funds are not protected from creditors upon carrier insolvency	General Account: Funds are not protected from creditors upon carrier insolvency	Separate Account: Funds are protected from creditors upon carrier insolvency
Allocation of Funds	Funds allocated to fixed account which is managed by the carrier	Funds allocated by policyholder to the fixed account or index account(s). Both the fixed account and index account are managed by the carrier	Funds allocated by policyholder into available investment options managed by carrier or a 3rd party investment manager
Fund Type	Investment grade bonds and mortgages	Investment grade bonds and equity index call options	Units of equity funds and/or bond funds are purchased and sold
Valuation of Funds	Book Value (Amortized Cost), which provides more stable earnings than Market Value accounting	Market Value	Market Value
Risk Transfer to Policyholder	Partial risk tranfer as carrier provides a guaranteed minimum crediting rate	Partial risk tranfer as carrier provides a guaranteed minimum crediting rate	100% of fund risk, including negative returns, transferred to policyholder
Crediting Rate Formula	Book value earnings of portfolio less spread, subject to guaranteed minimum crediting rate	Percentage change in market value of equity index, typically subject to a participation rate, cap, and floor	Units held in portfolio times market value, i.e., percentage change in market value of equity fund
Includes Dividend Income	n/a	No - percentage change in equity index does not include dividends	Yes - market value does include dividends from equity funds, including reinvestment. Dividends typically provide 1% to 3% of additional annual return

Key Index Strategy Terminology (Appendix A)

Appendix A of this Bulletin contains descriptions of basic Index Strategy terminology, including Index Account, Segment, Growth Rate, Index Credit, Growth Cap, Growth Floor, and Participation Rate.

M Carrier Index Strategies (Appendix B)

Appendix B of the Bulletin contains a summary of Index Strategy mechanics for the M Carrier Index products.

EIUL Considerations

In addition to understanding key EIUL terminology, the following items should be noted when reviewing EIUL products, as they can impact product performance:

Index Returns Do Not Include Dividends - A big difference between EIUL and VUL, is EIUL Index returns typically do not include dividend income, which historically accounts for an additional annual return of 1% to 3%. Variable products provide ownership in the underlying index fund, which would include the additional dividend income.

Value Received Upon Surrender Will Not Include Index Credit For Existing Index Segments - The value received upon surrender for a particular Segment will equal the value at the beginning of the Segment Term, less policy charges, plus any Interim Interest credited (see below) during the Segment Term. Any Index Credit that will be credited at the end of the Segment Term will not be provided since the Growth Rate is not known at time of surrender. This can be more of an issue for Index Strategies that have an Index Term greater than one year. As an example, if the Segment Term is 5 years, and there is one year left in the Segment Term at time of surrender, four years of Index Credit will be lost. This can be seen in illustrations with five-year Segment Terms, where there will be a large account value increase every five years.

Is Interim Interest Credited? - Does the product provide credited interest during the Segment Term? As an example, assume the Segment Term is five years, does interest get credited during the five years before the end of the Segment Term? Typically, EIUL products will credit Interim Interest based on the Growth Floor. As an example, if the Growth Floor is 1%, then 1% is credited during the Segment Term. At the end of the Segment Term, the Index Crediting Rate is determined, and a retroactive credit, net of the interim credit, is applied.

Is Partial Index Interest Credited? - Will the Index Crediting Rate be applied to the fund value at the end of the Segment Term or apply to all funds that were available throughout the Segment Term? As an example, $1,000 of charges may have been deducted on the 11th month of the one-year Segment Term. If a product has Partial Index Interest, then the index account value would receive index credit on the $1,000 charge for the 11 months that the funds were in the account. If there is no Partial Index Interest, then no index credit would be applied to the $1,000 charge since the charge occurred before the end of the Segment Term.

Example: Assume loads are applied every 6 months[1] and the Segment Term is one year.

Value at Beginning of Segment Term = $1,000
Interim Interest Credited = $0 (i.e., 0% Growth Floor)
Policy load = $20 every 6 months
Value at End of Segment Term (but before Index Credit) =

+ $1,000	Beginning Value
+ $0	Interim Interest
– $20	Charge at 6 months
– $20	Charge at 12 months
= $960	Ending Value before Index Credit

Assume Index Credit Rate = 10%

If Partial Index Interest, then Index Credit =

+ $1,000 X (1.1^.5-1) = $48.81	Interest for first 6 months
+ (1,000 – 20) X (1.1^.5-1) = $47.83	Interest for last 6 months
= $96.64	

Ending Segment Value = $960 + $96.64 = $1,056.64

If no Partial Index Interest, then Index Credit = $960 X 10% = $96
Ending Segment Value = $960 + $96 = $1,056.00

While this represents a difference of only $0.64, with compounding the difference can become meaningful over time. As an example, for a male age 55 preferred non-smoker and $2 million death benefit, a premium increase of 3% would be needed to endow with no partial interest as compared to the required premium if partial index interest is credited.

[1] Actual policy accounting is monthly. Use six months for simplicity

What is the Guaranteed Minimum Growth Floor? - Typically the current Growth Floor is guaranteed for life. If not, the current Growth Floor is guaranteed only for the Segment Term and can be changed for future Segments. The Guaranteed Minimum Growth Floor establishes the minimum rate; future Growth Floors cannot fall below this minimum rate.

What is the Guaranteed Minimum Growth Cap? - Typically the current Growth Cap is only guaranteed for the Segment Term and can be changed for future Segments. The Guaranteed Minimum Growth Cap establishes the minimum rate; future Growth Caps cannot fall below this minimum rate.

What is the Guaranteed Minimum Participation Rate? - Note whether the current Participation Rate is guaranteed for life. If not, the current Participation Rate is only guaranteed for the Segment Term. The Guaranteed Minimum Participation Rate establishes the minimum rate; future Participation Rates cannot fall below this minimum rate.

Allocation Restrictions On Funds Applied To An Index Segment - Typically funds are only allowed transfer to an Index Segment on a specified recurring date, such as the 15th of each month. Funds are typically held in the fixed account and receive interest based on the fixed account crediting rate before being transferred to the Index Segment on the specified date.

Restrictions on Transfer/Loans/Withdrawals from the Index Account (possible resulting Lockout) - Typically loans and withdrawals may be taken from an Index Segment at any time, but transfers from the Index Account to the Fixed Account can only occur at the end of the Segment Term. If the deductions from the Index Account are not part of a systematic program, then some products may consider these transfers out as "Non Conforming," which will trigger a period of time in which new funds may not be allocated to the Index Account (i.e., a Lockout Period).

Order of Monthly Policy Charges (Fixed Account Versus Index Account) - Typically charges will first be deducted from the Fixed Account. If there are no funds in the Fixed Account, or if charges exceed the value in the Fixed Account, the remaining charges will be taken from the Index Account.

In Conclusion

While basic EIUL mechanics are relatively straightforward (Growth Rate subject to Participation Rate, Cap, and Floor), there are some complexities that can result in differing performance between Index Strategies, product, and product type (EIUL versus UL versus VUL).

In the next Due Care Bulletin

An evaluation of EIUL and the different Index Strategies. Historical results and Monte Carlo simulations will be applied to provide insight on the relative performance of different products and Index Strategies.

Equity Index UL Primer Appendix

Key Index Strategy Terminology

Index Account	Contains funds where the crediting rate is based in part on the earnings of an equity index, subject to a guaranteed minimum floor.
Index	The Index upon which the Index Account crediting rate is based (example: S&P 500).
Segment	Created each time a transfer is made to the Index Account. Each Segment has its own Growth Cap, Growth Floor, Participation Rate and Segment Term.
Segment Term	Defines the time period a Segment stays inforce (e.g., one year or five years). Typically funds from an expired Segment will get rolled over into a new Segment with its associated Segment Term.
Index Credit	The crediting rate applied to the Index Account (typically equal to the Growth Rate multiplied by the Participation Rate, subject to the Growth Cap and Growth Floor, as defined below).
Growth Rate	Equal to the growth in market value of the Index.
Participation Rate	Factor applied to the Growth Rate (e.g., 80%).
Growth Cap	Amount Index Credit can not exceed (e.g., 12%).
Growth Floor	Amount Index Credit must be greater than or equal to (e.g., 0%).
Interest Crediting Period	Defines how often Index Credit is applied to the Index Account (e.g., once per year). Usually the Interest Crediting Period will equal the Segment Term.

Point to Point Index Strategy

Defines the growth in market value of the Index as the market value at the end of the Segment Term, divided by the market value at the end of the preceding Segment Term, less one.

Example #1 (Point to Point Index Credit)
Assumptions:
Index: S&P 500 without Dividends
Segment Term: 1 Year
Growth Rate Methodology: Point to Point
Participation Rate: 80%
Growth Cap: 12%
Growth Floor: 0%
Funds Allocated to Index Account on 1/1/07
S&P 500 Value on 1/1/07: 100
S&P 500 Value on 1/1/08: 110

Growth Rate = 110 / 100 – 1 = 10%
Index Credit = Growth Rate X Participation Rate and subject to Cap and Floor
=Max{Min(10% X 80% = 8%, 12%), 0%} = 8%

What if the 1/1/08 S&P 500 Value = 120?
Growth Rate = 120 / 100 – 1 = 20%
Index Credit = Max{Min(20% X 80% = 16%, 12%), 0%} = 12% (note that the Cap is applied)

What if the 1/1/08 S&P 500 Value = 90?
Growth Rate = 90 / 100 – 1 = -10%
Index Credit = Max{Min(-10% X 80% = -8%, 12%), 0%} = 0% (note that the Floor is applied)

Key Index Strategy Terminology

Point to Average Index Strategy

Defines the growth in the market value of the Index as the simple average of the market value of the last X months (typically the last 12) of the Segment Term, divided by the market value at the end of the preceding Segment Term, less one.

Example #2 (Point to Average Index Credit)
Assumptions:
Index: S&P 500 without Dividends
Segment Term: 5 Years
Growth Rate Methodology: Point to Average (last 12 months)
Participation Rate: 100%
Growth Cap: 76.2% (i.e., 12% annual growth rate)
Growth Floor: 5.1% (i.e., 1% annual growth rate)
Funds Allocated to Index Account on 1/1/07 with fund value equal to 100

Fund Values Last 12 Months of Segment Term

Date	Fund Value	Date	Fund Value
2/1/2011	150	8/1/2011	156
3/1/2011	151	9/1/2011	157
4/1/2011	152	10/1/2011	158
5/1/2011	153	11/1/2011	159
6/1/2011	154	12/1/2011	160
7/1/2011	155	1/1/2012	161

Growth Rate = Average Fund Value Last 12 Months / Fund Value When Segment Established

(150+151+152+153+154+155+156+157+158+159+160+161)/12=155.5
155.5/100-1=55.5%

Index Credit = Max{Min(55.5% X 100% = 55.5%, 76.2%), 5.1%} = 55.5% (i.e., 9.2% annual growth rate)

Note the Index Credit with Point to Point would be 161/100-1=61%, which represents a 10% annual growth rate.

If the market value of the Index tends to increase in the last year of the Segment Term, then the Point to Point Index Strategy will provide a higher Index Credit (assuming the Cap, Floor, and Participation Rate are the same for both strategies). If the market value of the Index tends to decrease in the last year of the Segment Term, then the Point to Average Index Strategy will outperform the Point to Point Index Strategy (assuming other mechanics of the Index Crediting formula are the same for both strategies).

Key Index Strategy Terminology

Monthly Cap Index Strategy

Defines the growth in the market value of the Index as the sum of the percentage change in monthly values for the Segment Term, subject to a monthly change cap

Example #3 (Monthly Cap Index Credit)
Assumptions:
Index: S&P 500 without Dividends
Segment Term: 1 Year
Growth Rate Methodology: Monthly Cap
Participation Rate: 100%
Growth Cap: 3.3% per month (i.e., 48% annual growth rate)
Growth Floor: 1% annual growth rate
Funds Allocated to Index Account on 1/1/07 with fund value equal to 100

Monthly Fund Value

Date	Fund Value	Monthly Growth Rate	Date	Fund Value	Monthly Growth Rate
2/1/2007	105	105/100-1=5%*	8/1/2007	104	104/105-1=-1.0%
3/1/2007	102	102/105-1=-2.9%	9/1/2007	102	102/104-1=-1.9%
4/1/2007	103	103/102-1=1.0%	10/1/2007	105	105/102-1=2.9%
5/1/2007	104	104/103-1=1.0%	11/1/2007	109	109/105-1=3.8%*
6/1/2007	106	106/104-1=1.9%	12/1/2007	110	110/109-1=0.9%
7/1/2007	105	105/106-1=-0.9%	1/1/2008	110	110/110-1=0.0%

* Will be capped at 3.3%

Index Credit = Sum of monthly growth rates, subject to the monthly 3.3% cap, and subject to the 1% annual growth floor.

+3.3%-2.9%+1.0%+1.0%+1.9%-0.9%-1.0%-1.9%+2.9%**+3.3%**+0.9%+0.0% = 7.7%

Note the 3.3% cap for month #1 and month #10
Note that the 7.7% annual growth rate exceeds the 1% growth floor

Note that the Index Credit with Point to Point would be 110/100-1= 10.0%

Equity Index UL Primer Appendix A (continued)

Key Index Strategy Terminology

Multi Index Strategy

Index Credit is dependent upon not one Index, but multiple Indexes. Typically, index returns are weighted, like 75% of the best return, 25% of the second best return, and 0% of the worst return. Index Credit is then the weighted sum of the individual Index Growth Rates, and subject to a Participation Rate, Growth Cap, and Growth Floor.

Example #4 (Multi Index Credit)
Assumptions:
Index: S&P 500, NASDAQ 100, DJIA all without Dividends
Segment Term: 1Year
Growth Rate Methodology: Multi Index Strategy
Index Weighting: 50% of best growth rate, 30% of second best, 20% of worst
Participation Rate: 60%
Growth Cap: 14% annual
Growth Floor: 0% annual

	S&P 500	NASDAQ 100	DJIA
Value on 1/1	100	100	100
Value on 12/31	120	110	90
Growth Rate	20% (1st)	10% (2nd)	-10% (3rd)

Index Credit = {(50% X 20%) + (30% X 10%) + (20% X -10%)} X 60% = 6.6%
Note the 6.6% falls within the Growth Cap and Growth Floor

Key Index Strategy Terminology

Cumulative Interest Guarantee

Defines the minimum Index Credit over the Segment Term or over the life of the policy. Example: Interest Crediting Period is 1 year with a 0% Growth Floor, but the Segment Term is 5 years with a Cumulative Interest Guarantee of 2% annual over the 5 years. Example: Upon surrender of policy, the cumulative annual Index Credit must be at least 2%

Example #5 (Cumulative Interest Guarantee)
Assumptions:
Index: S&P 500 without Dividends
Segment Term: 5 Years
Interest Crediting Period: 1 Year
Growth Rate Methodology: Point to Point
Participation Rate: 100%
Growth Cap: 12% annual
Growth Floor: 0% annual
Cumulative Interest Guarantee: 10.4% over 5 years (equivalent to 2% annual)

Year	Growth Rate	Annual Index Crediting Rate
1	5.0%	5.0%
2	-10.0%	0.0%*
3	-10.0%	0.0%*
4	0.0%	0.0%
5	3.0%	3.0%
Cumulative Return**		8.2%

* Growth Floor applied
** Equal to (1.05 X 1.0 X 1.0 X 1.0 X 1.03)-1

In this example, the Cumulative Interest Guarantee is applied and will be credited at the end of year 5.

Cumulative Index Credit over 5 years = Max(10.4%, 8.2%) = 10.4%

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