10 THINGS TO KNOW ABOUT WHOLE LIFE INSURANCE

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Whole life insurance, as the name implies, is a contract designed to provide protection over the insured's entire lifetime. There are many types of whole life policies, but the oldest and still the most common type of whole life policy is ordinary level premium whole life insurance, or simply ordinary life. This form of insurance is also known as "straight life," "traditional whole life," or "continuous premium whole life." If the term "whole life" is used alone, it is generally accepted that the reference is to ordinary level premium whole life as opposed to any other type of lifelong policy.

This type of contract features level or fixed periodic premiums computed on the assumption that the policyowner can retain the policy for the life of the insured. The death benefit remains level throughout the lifetime of the contract. Insurers invented the level premium concept to make the whole life contract affordable for as long as the policyowner decided to keep it.

As an outgrowth and natural byproduct of the fixed and level premium, the whole life contract develops cash values. These values reflect the reserve the insurer needs to accumulate in the early years of the policy's life so that they will have sufficient money (together with interest earned on the reserve) in later years to pay the promised death benefit while keeping premiums level. Absent this reserve, the level premium would be insufficient to pay the increasing mortality costs as the insured ages. The policy contains a fixed and guaranteed schedule of the cash values that the policyowner may borrow for any reason (such as an emergency or opportunity) at any time, or take upon surrendering the contract.

The policyowner agrees to pay a fixed or level premium at regular intervals for the rest of the insured's life (generally only up to age 100, if the insured lives that long, or in some cases, to age 95). In return, the insurance company agrees to pay a fixed death benefit when the insured dies if the policyowner has continued to pay the premiums. Policyowners who discontinue paying premiums and terminate their policies are entitled to the scheduled cash surrender value.

1. Who needs whole life insurance?

In general, some type of life insurance is indicated when a person needs or wants to provide an immediate estate upon his or her death. This need or desire typically stems from one or more of the following reasons:

a. To provide income for dependent family members after the head of household dies until they become self-supporting.

b. To liquidate consumer or business debts or mortgages, or to create a fund that would enable the surviving family members to service the debts.

c. To provide large amounts of cash at death for children's college expenses or other capital needs.

d. To provide cash for federal estate and state inheritance taxes, funeral expenses, and administration costs.

e. To provide funds for the continuation of a business through a "buy-sell" agreement.

f. To indemnify a business for the loss of a key employee.

g. To help recruit, retain, retire, or reward one or more key employees through a salary continuation plan and to finance the company's obligations under that plan to the dependents of a deceased key employee.

h. To fund bequests of capital to children, grandchildren, or others without the erosion often caused by probate costs, inheritance taxes, income taxes, federal estate taxes, transfer fees, or the generation-skipping transfer tax.

i. To fund charitable bequests.

j. To preserve confidentiality of financial affairs. Life insurance proceeds payable to someone other than the deceased's estate are not part of the probate estate and are not a matter of public record. It is not unusual for a beneficiary to be a lover, illegitimate child, or to have some other relationship to the insured that the insured may not want to publicly acknowledge. Likewise, the insured may not want the amount payable to the beneficiary to become a matter of public record.

k. To assure nearly instant access to cash for surviving dependents. Insurers generally pay life insurance proceeds to beneficiaries within days of the claim. Because insurance benefits do not

need to pass through probate court and are not taxable, there is no delay in distributing the assets to the beneficiaries.

l. To direct family assets to family members in a way that minimizes state, local, and federal taxes.

m. Level premium whole life, in particular, is the preferred type of policy when the need is long-term and there is a desire to maintain a relatively fixed annual premium cost. For many families, it is the most “affordable” form of long-term coverage on the principal breadwinners.

n. Level premium whole life may satisfy various business related life insurance needs (e.g., financing vehicles for buy-sell agreements, key person insurance and nonqualified deferred compensation arrangements). It is especially suitable if the objective is also to receive tax sheltered returns and the company has accumulated earnings problems. The cash buildup in life insurance policies held for legitimate business purposes is not counted towards the accumulated earnings limitation.

o. Level premium whole life insurance is often the preferred type of insurance for split dollar arrangements.

p. Level premium whole life is a tax-sheltered way to finance post-retirement health insurance for a selected group of executives or key employees by using life insurance policies on their lives. Cash values are available to the corporation to help meet future cash needs for health insurance premium payments for retirees. When the employee dies, the corporation receives the death proceeds free from federal income tax (except for some potential alternative minimum tax liability). The corporation is reimbursed for part or all of its costs for the post-retirement health insurance. Corporate owned life insurance (COLI) offers certain advantages over other methods for recovering post-retirement health insurance liabilities.

2. What are the advantages of whole life insurance?

1. A fixed and known annual premium. Although, it should be noted that net premiums (fixed premiums minus dividends) for par policies generally will decline over the years.

2. Guaranteed ceiling on mortality and expense charges and guaranteed floor on interest credited to cash values.

3. Cash value interest or earnings accumulate tax-free or tax deferred, depending on whether gains are distributed at death or during lifetime.

4. Ordinary life, through the combination of guaranteed cash values and dividend formulas, frequently pays higher effective interest on cash values than is available from tax-free municipal bonds.

5. Cash values are not subject to the market risk associated with longer term municipal bonds and other longer term fixed income investments.

6. Policyowners can borrow cash values at a low net cost. Although policyowners must pay interest on policy loans, cash values continue to grow and as the insurance company credits at least the minimum guaranteed rate in the policy. Consequently, the actual net borrowing rate is less than the stated policy loan rate.

7. Life insurance proceeds are not part of the probate estate, unless the estate is named as the beneficiary of the policy. Therefore, the beneficiary can receive the proceeds without the expense, delay, or uncertainty caused by administration of the estate.

8. There is no public record of the death benefit amount or to whom it is payable.

9. In most cases, the death benefit proceeds are not subject to federal income taxes.

10. The death benefit proceeds are often fully or partially exempt from state inheritance taxes unless payable to the insured's estate.

11. Policyowners can use life insurance policies as collateral or security for personal loans.

3. What are the disadvantages of whole life insurance?

1. Lifetime distributions of cash values are subject to income tax to the extent attributable to gain in the policy.

2. The premium may be unaffordable for persons of limited financial resources.

3. In the early years, the amount of protection is lower relative to the premium spent than with term insurance. However, later, as term premiums rise while the premiums for ordinary life remain level, the reverse typically will be true.

4. Surrender of the policy within the first five to 10 years may result in considerable loss because surrender values reflect the insurance company's recovery of sales commissions and initial policy expenses.

5. Policyowners generally may not deduct interest paid on policy loans on their tax returns.

6. Cash values accumulating in the contract are subject to inflation. Whole life insurance is by definition a long-term purchase and the guaranteed return on this type of policy provides little inflation protection. However, a partial hedge against inflation is provided by the dividends paid on participating policies which reflect the favorable mortality, investment, and business expense results of the insurer.

7. The overall rate of return on the cash values inside traditional whole life contracts has not always been competitive in a before-tax comparison with alternative investments. However, when safety of principal, contractually guaranteed liquidity, and the cost of term insurance if purchased outside the policy are factored into the analysis, whole life often compares favorably to alternative types of policies as well as nonlife insurance investments on an aftertax basis.**4. What are the tax implications?**

General tax rules

Death benefits are usually free of any federal income tax. In general, death benefits paid under these policies are subject to the same income, estate, gift, and generation-skipping transfer taxation rules as all other types of life insurance policies.

Taxation of living proceeds

Section 72 of the Internal Revenue Code governs the taxation of living proceeds from life insurance policies. Living proceeds are generally any amounts received during the insured's lifetime. For tax purposes, payments are separated into three classes: (1) annuity payments; (2) payments of interest only; and (3) amounts not received as an annuity.

Annuity payments: Annuities include all periodic payments received from the contract in a systematic liquidation of the cash value. This includes both life contingent annuities and fixed

term or fixed amount annuities. The rules of Internal Revenue Code section 72 determine what portion of each payment is treated as a tax-free recovery of investment in the contract and what portion is treated as taxable income or gain. To oversimplify, the rules essentially pro rate the recovery of investment in the contract over the expected payout period. Therefore, each payment is treated partially as recovery of investment and partially as taxable interest until the entire investment in the contract has been recovered. Any further payments are treated entirely as taxable income.

Payments of interest only: Payments consisting of interest only (i.e., they are not part of the systematic liquidation of a principal sum) are not annuity payments and are not taxed under the annuity rules. In general, if living benefits are held by the insurer under an agreement to pay interest, the interest payments are taxable in full when distributed or simply credited to the account.

Amounts not received as an annuity: In general, all living proceeds except for interest and annuity settlements are taxed under the "cost recovery rule." Included in this category are policy dividends, lump-sum cash settlements of cash surrender values, cash withdrawals, and amounts received on partial surrender. These amounts are included in gross income only to the extent they exceed the investment in the contract (as reduced by any prior excludable distributions received from the contract). In other words, nonannuity distributions during life are first treated as a return of the policyowner's investment in the contract (generally premiums paid less dividends received), and then as taxable interest or gain.

There are exceptions to this rule, but they are unlikely to arise with level premium policies. The first exception is with respect to policies that initially fail the seven-pay test under the Modified Endowment Contract (MEC) rules. Because level premium policies are designed to have premiums payable for the life of the insured, they are not likely to fail the seven-pay test. The second exception is with respect to policies that originally satisfied the tests to avoid MEC treatment, but that as a result of certain changes in the benefits of the contract, subsequently fail the tests. Once again, the types of changes that would jeopardize favorable MEC status are unlikely to arise with ordinary level premium whole life policies. Problems are more likely to arise with limited pay policies and universal life policies. If any life insurance contract is treated as a MEC, cash distributions are generally taxed under the interest-first rule. Under this rule, distributions are first attributed to interest or gain in the contract and are fully taxable. Only when the interest or gain is exhausted are distributions treated as a nontaxable recovery of investment in the contract.

Loan proceeds: Policy loans under non-MEC life insurance policies are not treated as distributions. If a policy loan is still outstanding when a policy is surrendered, the borrowed amount becomes taxable at the time of surrender to the extent the cash value exceeds the policyowner's investment in the contract. Loans are essentially treated as if the borrowed amount was actually received at the time of surrender and used to pay off the loan.**5. What are the alternatives to whole life insurance?**

There is no substitute for life insurance that provides an immediate estate upon a person's death. All types of life insurance policies can provide tax-free cash upon death. The unique feature of level premium life insurance is its affordability. It provides lifetime coverage at the lowest level annual cost relative to other types of whole life policies. As a byproduct of level premium financing, the policy creates a tax-free or tax deferred cash buildup. Persons desiring a combination of tax preferred cash accumulation and life insurance may want to explore other alternatives:

A combination of a level premium deferred annuity and decreasing term insurance: Cash values accumulate in both annuities and level premium life insurance policies on a tax deferred basis. Therefore, a combination of a level premium deferred annuity and a decreasing term policy can provide levels of tax preferred cash accumulation and death benefits similar to a level premium policy.

There are some important differences, however. The tax rules treat withdrawals, lifetime distributions, or loans from each arrangement differently for tax purposes. Although most ordinary life policies do not permit withdrawals, as such, if a withdrawal of cash values is permitted or the policy is partially surrendered, the amount distributed is taxed under the cost recovery rule. That is, the amounts are included in taxable income only to the extent they exceed the investment in the contract. In contrast, distributions from annuities are taxed under the interest-first rule. In other words, the amounts are fully taxable until owner has recovered all of the excess over the investment in the contract. In addition, nonannuity distributions from an annuity contract before age 59½ may be subject to a 10 percent penalty tax. Furthermore, loans from life insurance policies are not subject to tax; loans from annuities, if permitted, are treated as distributions and taxed under the interest-first rule (i.e., loan proceeds are subject to the regular income tax and may be subject to the 10 percent penalty tax). Finally, loan provisions of deferred annuity contracts are generally more restrictive than those of life insurance policies.

The annuity-term combination will require some additional and increasing premiums over the years for the term coverage. In addition, the mortality charges for term insurance coverage are typically higher than the mortality charges in a level premium policy. Finally, the death proceeds from the insurance policy generally may pass to the beneficiary entirely income and estate tax free, regardless of who is the beneficiary, if the insured has no incidents of ownership in the policy. The gains on the annuity contract still will be income taxable to the beneficiary and will avoid estate taxation only if the annuitant's spouse is the beneficiary and is a United States citizen.

A combination of investments in tax-free municipal bonds and decreasing term insurance: This combination can create a cash accumulation and death benefit similar to a level premium policy. Similar to the cash values in a life insurance policy, bond owners may use municipal bonds as collateral for loans without any adverse income tax consequences. However, interest paid on debt secured by municipal bonds is not deductible, while in some cases the interest paid on life insurance policy loans may be tax deductible. Also, the life insurance death benefits are transferred outside of probate, while municipal bonds are part of the estate. Finally, if the policyowner has no incidents of ownership, the death proceeds are paid estate tax free. The municipal bonds will escape estate tax only if they are left to the spouse and sheltered by the marital deduction

A universal life policy configured as a level premium policy: A universal life policy can be initially configured to resemble a level premium life policy. However, in contrast with "true" level premium life policies, charges for mortality and expenses can change in the universal life policy in such a way that the policyowner could need to pay additional premiums in the future to maintain the death benefit coverage.**6. What fees or other acquisition costs are involved?**

Life insurance companies are free to set premiums according to their own marketing strategies. Almost all states have statutes prohibiting any form of rebating (sharing the commission with the purchaser) by the agent. The premium includes a "loading" to cover such things as commissions to agents, premium taxes payable to the state government, operating expenses of the insurance company such as rent, mortgage payments and salaries, and other company expenses.

A few companies offer "no-load" or "low-load" life insurance policies. These policies are not really no-load, because certain expenses are unavoidable (e.g., the premium tax), but rather pay either no sales commission or a very low sales commission. Consequently, the cash value buildup tends to be larger in the early years. Although commissions are lower, these companies typically

must spend somewhat more money on alternative methods of marketing and may therefore incur generally higher administrative expenses than companies that pay commissions to agents.

The bulk of an insurance company's expenses for a policy are incurred when the policy is issued. It may take the company five years or longer to recover all of its front-end costs. The state premium tax is an ongoing expense that averages about 2 percent of each premium payment. With most cash value policies the aggregate commission paid to the selling agent is approximately equal to the first year premium on the policy. About half (often 55 percent) is payable in the year of sale and the other half is paid on a renewal basis over a period of three to nine years.

Most ordinary level premium life insurance policies have no explicit surrender charges. However, most participating policies will pay a terminal dividend. The terminal dividend is typically higher the longer the policy has remained in force. In essence, this is a form of surrender charge because the company is essentially holding back dividends it could otherwise pay currently and rewarding those policyholders who maintain their policy longer with a greater terminal dividend. **7. How do I select the best type of whole life insurance?**

Selecting the best cash value life insurance policy is a difficult task involving a number of complicated concepts and analyses. However, because the level of dividend payments on participating ordinary level premium life insurance is a critical element of the overall cost of the protection, one primary area of focus should be how the company determines the dividends it pays.

How to evaluate the dividends paid on par policies

Step 1: Compare the current rate credited to policy cash values and the length of the guarantees. All else being equal, policies with higher current rates and longer guarantee periods will be better than those with lower current rates and shorter guarantees.

Step 2: Check to see how the company will determine the rate credited to policy cash values after the guarantee period. Policies that determine the rate based on a specific money rate or bond index leave the company with little room to manipulate the amount credited in an adverse way.

Step 3: Look at the current mortality and expense factors and compare them with the guaranteed maximum mortality and expense factors. The mortality factors currently used should be competitive. If the difference between the current mortality rates and the maximum rates is small,

the company has little room to use higher mortality charges as a means of reducing the effective rate credited to cash values.

Step 4: Look for a bailout provision that reduces or eliminates surrender charges if investment performance does not meet reasonable guidelines.

Step 5: Check the policy loan provision to see if the company uses an “offset” provision to credit borrowed amounts with a lower rate than nonborrowed amounts. If the insured anticipates borrowing from the policy, a company that does not use the offset method is preferable. If borrowing is not anticipated, a company that uses the offset method may be more desirable because the company, in theory, should be able to credit higher interest to policies without borrowing than they otherwise would be able to credit without the offset provision.

Step 6: Check the financial soundness of the company. In the past, some insurance companies attempted to increase their portfolio yield by investing a substantial portion of their assets in relatively high yield but also high risk “junk” bonds. As a result of adverse market conditions and increased defaults on these bonds, some of these companies experienced serious financial stress and reduced portfolio yields.**8. How do I read the ledger statement of an ordinary life policy?**

The ledger statement or policy illustration in the figure below is for a traditional, ordinary level premium whole life policy that is configured to operate like a 20-pay life policy. This is accomplished by using dividends as projected to buy paid-up additions until the 20th policy year. After year 20, dividends are used first to pay the annual premium with any remainder applied to the purchase of paid-up additions. A true 20-pay life policy would have higher annual premiums that would terminate after 20 years with no need to apply dividends to pay premiums. Each of the numbers in the ledger corresponds to the notes below.

1. The length of time in years that the gross premium is to be paid.

2. The plan of life insurance (in this case, it is 20-pay whole life paying dividends as declared).

3. The insurability status (e.g., nonsmoker, smoker (would be standard)) or rated (extra charge because of being a higher risk for medical or occupational reasons). For this life insurance company, “preferred” risk means the insured is a nonsmoker and is not rated.

4. The gender is male, and the issue age is 45.

5. The gross premium (i.e., the premium charged not taking dividends into consideration) not including any additional benefits provided by any riders (e.g., waiver of premium).

6. The initial amount of life insurance that will be payable to the named beneficiary upon the death of the insured.

7. The beginning-of-the-year ledger statement versus the end-of-the-year ledger statement. Dividends, when paid, are not paid until the end of a specific year. If an end-of-the-year ledger statement is used, it would show dividends paid during the first year, which would be inaccurate.

8. The amount of premium to be paid each year.

9. The cash amount of premium to be paid each year. In this case it is $2,001 for the first 20 years, and $0 thereafter.

10. The cumulative guaranteed amount of reserve (i.e., the guaranteed cash value) that has accumulated for each year.

11. The cumulative total amount of reserve (i.e., the guaranteed cash value), including the nonguaranteed cash value of the additional paid-up life insurance purchased each year, starting at the beginning of year two, with the yearly declared paid dividend.

12. The yearly amount of increase in the total reserve (i.e., the guaranteed cash value and the nonguaranteed cash value of the additional paid-up insurance purchased each year).

13. The yearly difference between the gross premium of $2,001 and the yearly guaranteed cash value increase and the yearly increase of the nonguaranteed cash value of the additional paid-up life insurance purchased by the yearly declared paid dividend. A minus sign (–) means the combined yearly increase is less than the gross premium of $2,001. The figures do not reflect the time value of money.

14. The amount of additional paid-up life insurance purchased by the declared paid dividend.

15. The yearly total death benefit including the projected additional paid-up life insurance purchased through the projected dividends. From year 16 on, the projected terminal dividend is included.

16. The life expectancy of a 45-year-old male is 29.1 years (age 74) based on life expectancies for males of all races from Vital Statistics of the United States, for the year 1980.

17. A statement indicating that dividends are used to purchase paid-up insurance. The gross premium of $2,001 is paid during the first 20 years. Thereafter, dividends are used to reduce the gross premium of $2,001 and, if necessary, a portion of the paid-up insurance is surrendered to pay the balance of the gross premium. Looking at column 8 in year 21 reveals that this is unnecessary. The projected dividend in year 21 is $3,984, more than the gross premium of $2,001. A minus sign (-) in this column indicates that the projected dividends exceed the gross premium. Finally, from year 21 on, the dividend in excess of the gross premium is used to purchase additional paid-up life insurance. If desired, the death benefit could be frozen at $180,071 (year 20), and the dividend amount in excess of the gross premium could then be paid in cash.

18. The summary page values for this insurance company's ledger statement are different from the values shown on the nonsummary pages for two reasons. First, the yearly declared dividend is assumed to be paid at the end of the year. Second, the terminal dividend is included. The insurance company assumes for the summary page that the policy is surrendered for the years shown.

19. The cumulative amount of guaranteed cash value for the years shown.

20. The cumulative amount of total cash value for the years shown including the nonguaranteed cash value of additional paid-up insurance purchased through the dividends.

21. Each figure represents $2,001 times the number of years shown.

22. The difference between columns 21 and 20. Although mathematically correct, it does not take into consideration the time value of money.

23. The amount of paid-up life insurance for the years shown that can be purchased by the guaranteed cash value. Once purchased, no additional premiums are required and the insurance company pays a paid-up dividend per $1,000 of paid-up insurance.

24. The amount of paid-up life insurance for the years shown that can be purchased by the total cash value.

25. The terminal dividend may be payable after the policy has been in force 15 years or longer.

26. The interest adjusted index.

27. The premium information for various payment options (i.e., annual (once a year), semiannual (twice a year), quarterly (four times a year), and preauthorized monthly payment through checking account (PAC)). The cost is higher if paid more frequently than annually. This is because of the expenses incurred to send a premium notice more than once a year and the time value of money (the insurance company does not have the use of your money all at once). The company is implicitly charging 10.34 percent interest for semiannual payments, 10.88 percent for quarterly payments, and 8.37 percent for monthly payments of the premiums.

28. A statement that dividends in any form are not guaranteed.

29. A statement that a loan against the reserve (i.e., cash value) will affect dividends.

30. A statement that the guaranteed fixed contractual interest rate charged for loans against the reserve is 8 percent payable in arrears, meaning that interest is due one year from the date of the loan.

31. A statement about the summary page calculations.

LEDGER STATEMENT FOR WHOLE LIFE PAYING DIVIDENDS AS DECLARED

1 20-PAY LIFE ILLUSTRATION

+Plan: Ordinary Life **2**
Class: Preferred Standard **3**
Male Age 45 **4**

5 Basic Annual Premium: $2,001.00

6 Face Amount: $100,000

7 Beg. Pol. Year	**8** Pre-mium Payable*	**9** Cash Pre-mium Pmt.*	**10** Guar. Cash Value	**11** Total Cash Value*	**12** Ann. Incr. in Total Cash Value*	**13** Total Cash Value Incr.(-) Cash Prem.*	**14** Div. Adds Death Benefit*	**15** Total Death Benefit*
1	$ 2,001	$2,001	$ 0	$ 0	$ 0	-$ 2,001	0	$100,000
2	2,001	2,001	1,026	1,058	1,058	-943	113	100,113
3	2,001	2,001	2,938	3,043	1,985	-16	354	100,354
4	2,001	2,001	4,890	5,130	2,087	86	780	100,780
5	2,001	2,001	6,881	7,347	2,217	216	1,460	101,460
6	2,001	2,001	8,909	9,724	2,377	376	2,456	102,456
7	2,001	2,001	10,971	12,289	2,565	564	3,830	103,830
8	2,001	2,001	13,069	15,085	2,796	795	5,646	105,646
9	2,001	2,001	15,202	18,150	3,065	1,064	7,965	107,965
10	2,001	2,001	17,366	21,526	3,376	1,375	10,848	110,848
11	2,001	2,001	19,432	25,135	3,609	1,608	14,362	114,362
12	2,001	2,001	21,520	29,152	4,017	2,016	18,573	118,573
13	2,001	2,001	23,626	33,632	4,480	2,479	23,544	123,544
14	2,001	2,001	25,746	38,531	4,899	2,898	29,109	129,109
15	2,001	2,001	27,878	43,890	5,359	3,358	35,297	135,297
16	2,001	2,001	30,016	49,735	5,845	3,844	42,119	142,467
17	2,001	2,001	32,160	56,220	6,485	4,484	49,829	150,519
18	2,001	2,001	34,304	63,404	7,184	5,183	58,476	159,553
19	2,001	2,001	36,445	71,235	7,831	5,830	67,884	169,393
20	2,001	2,001	38,580	79,762	8,527	6,526	78,085	180,071
21	-3,984	0	40,702	87,033	7,271	7,271	85,431	187,939
22	-4,544	0	42,805	94,954	7,921	7,921	93,586	196,232
23	-5,178	0	44,882	103,597	8,643	8,643	102,638	205,420
24	-5,878	0	46,925	113,028	9,431	9,431	112,655	215,572
25	-6,655	0	48,929	123,322	10,294	10,294	123,723	226,773
26	-7,510	0	50,892	134,563	11,241	11,241	135,923	239,103
27	-8,445	0	52,820	146,848	12,285	12,285	149,336	252,644
28	-9,458	0	54,718	160,272	13,424	13,424	164,033	267,466
29 **16**	-10,551	0	56,596	174,946	14,674	14,674	180,088	283,645
30	-11,723	0	58,458	190,978	16,032	16,032	197,564	301,243
31	-12,993	0	60,303	208,489	17,511	17,511	216,551	320,351
32	-14,389	0	62,124	227,616	19,127	19,127	237,172	341,092
33	-15,963	0	63,912	248,530	20,914	20,914	259,620	363,658
34	-17,699	0	65,651	271,379	22,849	22,849	284,057	388,211
35	-19,613	0	67,331	296,317	24,938	24,938	310,667	414,934

Beg. Pol. Year	Premium Payable*	Cash Premium Pmt.*	Guar. Cash Value	Total Cash Value*	Ann. Incr. in Total Cash Value*	Total Cash Value Incr.(-) Cash Prem.*	Div. Adds Death Benefit*	Total Death Benefit*
36	-21,690	0	68,947	323,488	27,171	27,171	339,605	443,982
37	-23,913	0	70,499	353,028	29,540	29,540	371,007	475,489
38	-26,277	0	71,989	385,977	32,049	32,049	404,998	509,580
39	-28,780	0	73,426	419,802	34,725	34,725	441,699	546,378
40	-31,441	0	74,818	457,379	37,577	37,577	481,251	586,024

17 *Dividends are used to purchase paid-up insurance in years 1 through 20. Thereafter, dividends are used to reduce premiums, and if necessary, a portion of the paid-up insurance is surrendered to pay the balance of the premium.

Summary # Page 18

	19 Guar. Cash Value	20 Total Cash Value*	21 Cash Premium Payments	22 Total Cash Value Less Prem. Payments	23 Guar. Paid-up Insurance	24 Total Paid-up Insurance*
5 Years	$ 6,881	$ 7,696	$10,005	$ 2,309 -	$17,453	$ 19,519
10 Years	17,366	23,069	20,010	3,059	37,811	50,228
15 Years	27,878	47,945	30,015	17,930	52,791	90,792
20 Years	38,580	89,420	40,020	49,400	64,503	149,504
Age 65	38,580	89,420	40,020	49,400	64,503	149,504

25 Terminal dividend*

Interest-adjusted indexes* based on a 5.00% interest rate, for basic policy only:

26	Life insurance net payment cost index	10 years:	$16.24	20 years:	$ 9.89	Age 65:	$ 9.89
	Life insurance surrender cost index	10 years:	3.09	20 years:	1.95-	Age 65:	1.95-
	Equivalent level annual dividend	10 years:	3.77	20 years:	10.12	Age 65:	10.12

27	Premium information:	Annual	Semiannual	Quarterly	Pac.
	Ordinary Life	$2,001.00	$1,025.70	$520.56	$173.20

Beg. Pol. Year	Premium Payable*	Cash Premium Pmt.*	Guar. Cash Value	Total Cash Value*	Ann. Incr. in Total Cash Value*	Total Cash Value Incr.(-) Cash Prem.*	Div. Adds Death Benefit*	Total Death Benefit*
36	-21,690	0	68,947	323,488	27,171	27,171	339,605	443,982
37	-23,913	0	70,499	353,028	29,540	29,540	371,007	475,489
38	-26,277	0	71,989	385,977	32,049	32,049	404,998	509,580
39	-28,780	0	73,426	419,802	34,725	34,725	441,699	546,378
40	-31,441	0	74,818	457,379	37,577	37,577	481,251	586,024

17 *Dividends are used to purchase paid-up insurance in years 1 through 20. Thereafter, dividends are used to reduce premiums, and if necessary, a portion of the paid-up insurance is surrendered to pay the balance of the premium.

Summary # Page 18

	19 Guar. Cash Value	20 Total Cash Value*	21 Cash Premium Payments	22 Total Cash Value Less Prem. Payments	23 Guar. Paid-up Insurance	24 Total Paid-up Insurance*
5 Years	$ 6,881	$ 7,696	$10,005	$ 2,309 -	$17,453	$ 19,519
10 Years	17,366	23,069	20,010	3,059	37,811	50,228
15 Years	27,878	47,945	30,015	17,930	52,791	90,792
20 Years	38,580	89,420	40,020	49,400	64,503	149,504
Age 65	38,580	89,420	40,020	49,400	64,503	149,504

25 Terminal dividend*

Interest-adjusted indexes* based on a 5.00% interest rate, for basic policy only:

26	Life insurance net payment cost index	10 years: $16.24	20 years: $ 9.89	Age 65: $ 9.89		
	Life insurance surrender cost index	10 years: 3.09	20 years: 1.95-	Age 65: 1.95-		
	Equivalent level annual dividend	10 years: 3.77	20 years: 10.12	Age 65: 10.12		

27	Premium information:	Annual	Semiannual	Quarterly	Pac.
	Ordinary Life	$2,001.00	$1,025.70	$520.56	$173.20

20-PAY LIFE ILLUSTRATION
Explanatory Notes

*Includes dividend values. Dividends are not guaranteed. 28

Illustrated dividends are based on the company's current mortality, expense, and investment experience. Actual dividends may be higher or lower than shown as a result of future changes in the company's experience, especially the interest rates earned on investments. A terminal dividend is payable upon surrender, lapse, or death, after at least 15 policy years, but only if declared by the company at such time, and is included in the total death benefit, in summary values for total cash value and total paid-up insurance, and in the interest-adjusted surrender cost index.

*Illustrated dividends assume no loans on policy. Policy loans will affect dividends. 29

30 +The values shown in the ledger assume an annual mode of premium payment and a fixed policy loan interest rate of 8.00% applied in arrears, except in the case of a partial cash premium payment; then, a change to the automatic monthly premium modes has been assumed. The issuance of any policies or riders is subject to the company's regular underwriting practices. The amounts of coverage and premiums for any policies or riders, if issued, may differ from those illustrated.

#Summary values are calculated as of the end of the year. 31

9. How does the "savings component" of ordinary life work?

One can view ordinary level premium whole life mathematically (but not legally) as a combination of decreasing term insurance and increasing “savings fund.” Although the level premium payment method permits the policyowner to pay the lowest up-front outlay necessary to acquire lifetime coverage, the premiums are still greater than the mortality costs in the early years. Because premiums remain level while mortality costs increase at later ages, the insurer must set premiums in the early years high enough to pre-fund the excess of mortality costs over premiums in the later years. Consequently, ordinary level premium whole life policies build reserves to pay the future excess mortality costs and to serve as the basis for determining the policyowner’s cash surrender values.

The cash value normally increases each year until it reaches the face value at age 100. The cash value grows more slowly in the early years and more swiftly in the later years because the company typically recovers the expenses associated with the sale of the policy over the early years.

Policyowners may directly access cash values in ordinary life policies in two ways. First, policies permit policyowners to borrow cash values. As long as the policyowner continues to pay premiums, the policy remains in force, but the death benefit is the face amount reduced by any outstanding policy loans and unpaid interest on the policy loans.

Alternatively, policyowners may terminate or surrender their policies and receive the net cash surrender value shown in the policy as of the date of surrender. The net surrender value is the gross cash value shown in the policyminus any identifiable surrender charges, outstanding policy loans, and unpaid interest on policy loans plus any prepaid premiums, dividends accumulated at interest, cash values attributable to paid-up additions, and any additional terminal dividends. In this case, however, the policyowner must give up the insurance protection.

Because policyowners may access virtually the same amount of cash through policy loans as through surrender of the policy, loans are generally the better alternative if the policyowner expects the need for protection to continue.

In some cases, the policies may permit partial surrenders. Some participating policies permit policyowners to surrender paid-up additions without surrendering the base policy. Although it is not a matter of legal right, in practice some companies also will allow partial surrenders of ordinary life policies. In these cases, the insurer reduces the death benefit and premiums in proportion to the reduction in the cash value.

One additional method to access cash values without giving up coverage entirely may be to exchange a policy for another policy with a lower cash value under the exchange rules of IRC Section 1035. **10. Is it better to pay premiums annually, quarterly, or monthly?**

Insurance companies usually quote insurance premiums on an annual basis, but the insurer can convert the annual payment to monthly or quarterly payments, if the policyowner desires. When insurers convert annual premiums to monthly or quarterly payments, they typically charge an implicit interest rate on the payments that are deferred until later in the year. In other words, the insurance company essentially is loaning the policyowner a portion of the annual premium that the policyowner then repays over the term of the year with a "borrowing" rate equal to the implicit rate. If the implicit rate is greater than the policyowner's after-tax opportunity cost of funds (the policyowner's potential after-tax investment rate), he or she should pay the premium annually, if possible. Conversely, if the implicit rate is less than the policyowner's potential after-tax investment rate, the policyowner will be better off deferring payments by electing to pay monthly or quarterly.

If, for cash flow reasons, the policyowner cannot pay the premiums annually, the issue is whether the insurance company's implicit rate is greater than or less than the after tax-rate at which the policyowner could otherwise borrow money to pay the annual premium. If the implicit rate is higher than the policyowner's after-tax borrowing rate, he or she should borrow the money elsewhere and pay the premium annually. Conversely, if the implicit rate is lower than the after-tax borrowing rate, the policyowner should elect to pay premiums quarterly or monthly.

The decision as to which payment plan to elect depends on the insurance company's implicit rate. Determining the implicit rate is relatively straightforward. The ratio of the monthly (or quarterly) premium to the annual premium is called the monthly (or quarterly) conversion factor. Once one knows (or computes) the conversion factor, one can determine the interest rate that the insurance company is implicitly charging for the monthly or quarterly payment plan. For example, if the monthly payment is equal to 1/12 (.083333) of the annual premium, the insurance company is charging 0 percent interest on the premium payment plan.

In virtually all cases, however, the monthly payment is greater than 1/12 (.083333) of the annual premium because of an implicit interest charge. The table below shows the interest rate the insurance company is implicitly charging for various monthly and quarterly conversion factors. For example, assume the premium for a policy is $1,000 if paid annually, or $88.75 if paid monthly. The monthly conversion factor is the ratio of the monthly premium to the annual

premium, $88.75/$1,000, or 0.08875. According to the table, the implicit interest rate for this monthly conversion factor is about 14 percent.

IMPLICIT INTEREST RATES FOR CONVERTING ANNUAL PREMIUMS TO QUARTERLY OR MONTHLY PREMIUMS

Quarterly Conversion Factor*	Monthly Conversion Factor*	Implicit Interest Rate
0.25000	0.083333	0%
0.25094	0.083716	1
0.25187	0.084099	2
0.25281	0.084482	3
0.25374	0.084867	4
0.25468	0.085252	5
0.25561	0.085638	6
0.25654	0.086025	7
0.25747	0.086412	8
0.25840	0.086800	9
0.25933	0.087189	10
0.26119	0.087969	12
0.26304	0.088752	14
0.26397	0.089144	15
0.26489	0.089537	16
0.26674	0.090325	18
0.26858	0.091116	20
0.27317	0.093105	25
0.27774	0.095109	30

*Ratio of monthly or quarterly premium to annual premium.