Character and Functional Nature of a Cash Value Dependent Policy Style

A "Cash Value Dependent" policy style is one in which the policy costs are taken from the policy cash values. Policy premium is an illustrated hypothecation that represents a strategy of deposits.

These policy styles are known as Universal Life and Variable Universal Life.

The simplicity of this policy style was to provide a cascading effect on capital contributions (premium deposits), which would work like this:

Premium $$$

(-) Minus Premium Loads

Capital Account (+) Interest Earnings

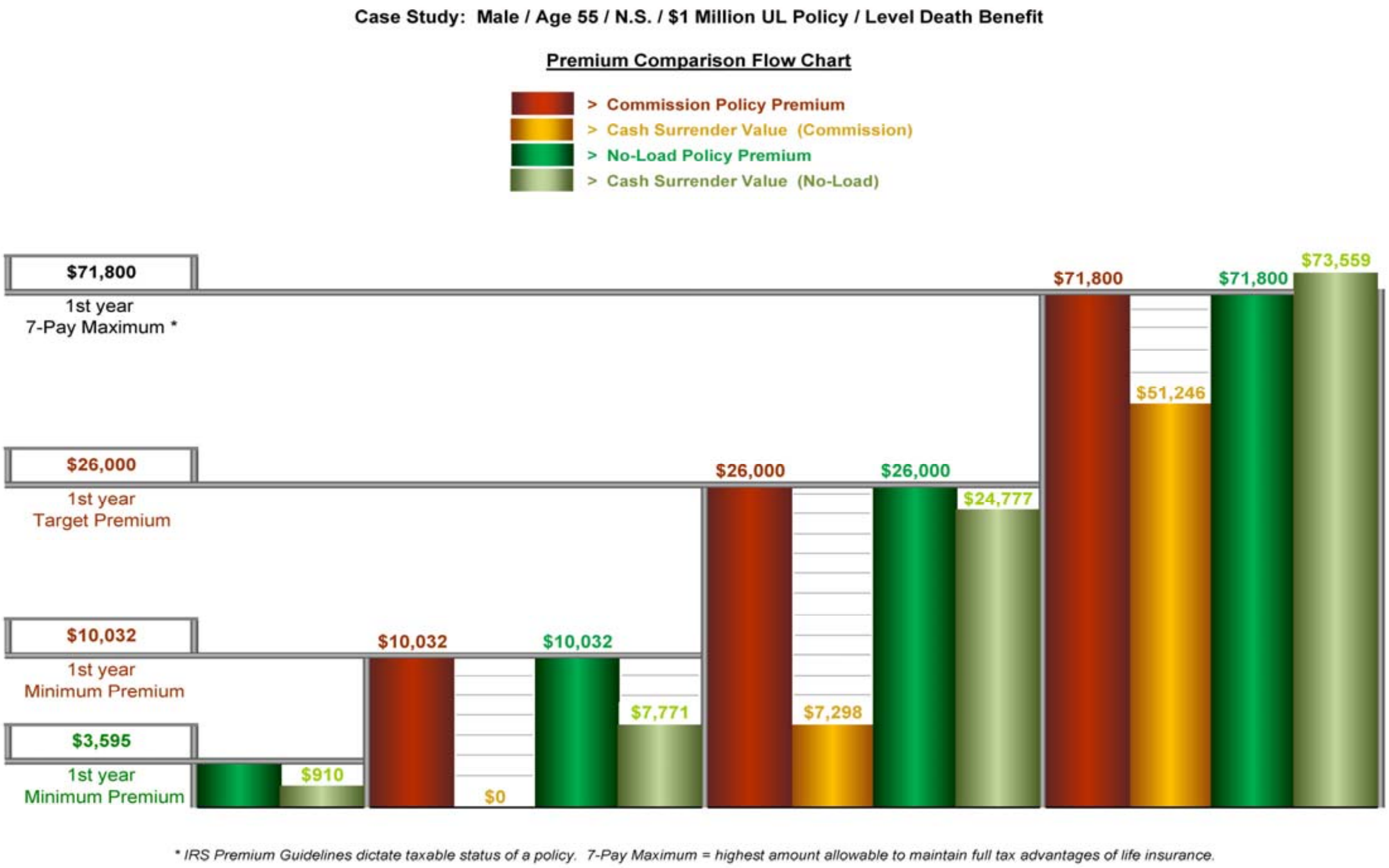
(-) Minus Minimum premium to purchase coverage

Equity (Cash Value)

The original concept and design of this policy style was to provide the consumer with the following advantages:

- Transparency of all economic components
- Pass through of current mortality/pricing assumptions
- Pass through of current market interest rates
- Non-contractual premium requirements
- Policy expenses withdrawn from internal equity (cash value)
- Flexibility to control policy deposits (premiums)
- Flexibility to control and reconstruct death benefits
- High liquidity in policy equity
- Access to policy equity via withdrawals and/or policy loans
- Provide a tax-advantaged alternative to the "Buy Term and Invest the Rest" strategy

This design was transparent and simple: maximum flexibility, control, full-disclosure, high and immediate liquidity with no surrender charges *(see following chart)*.



When it became evident to the insurance industry that the consumers embraced this concept, they had to re-work the original "fee-engagement" model to a "commission" model to make the product attractive to their distribution channel. To do this, an additional component (Target Premium) was added to the above referenced cascading cash flow configuration. The Target Premium is the calculation basis on which all of the maximum commissions are paid.

Look at what happened……

We now have the following adjustment:

Premium $$$

(-) Minus Premium Loads

Target Premium (loads & distribution costs)

Capital Account (+) Interest Earnings

(-) Minus *bundled* premium to purchase coverage

Equity (Cash Value Account)

(-) Minus Surrender Charges

Reduced Equity
(Cash Surrender Value)

The following bar chart illustrates the affect of this Target Premium to the original concept of policy design.

Start by comparing the Minimum Premium, then track the increasing premium deposits as you pour more money into the policy, up to the maximum premium allowed by IRS guidelines (so as not to void all of the tax advantages of the policy)

We are assuming that the client is anticipating how much should be deposited in the first year of this universal life policy.