

# An Informative and Transparent Life Insurance Policy Illustration

**An Application of Breadwinners' Insurance Policy Disclosure Approach  
With Additional Explanatory Notes to Facilitate Comprehension**

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Traditional Sales Illustration Used Currently By Agents

Northwestern Mutual Life

\$250,000 90 Life Whole Life Policy  
Male Age 45

Values Shown Below are as illustrated in 1989 to a consumer

A	B	C	D	E	F	G	H	I
End of Year	Insurance*	Dividend*	Annual Premium (Beg Yr)	Cash Value Increase*	CV Growth Less Premium*	Total Premium Outlay	----- Cash Values----- Total*	Guar'nt'ed
1	251,425	408	5,815	408	(5,407)	5,815	408	0
2	253,954	754	5,815	4,726	(1,089)	11,630	5,134	3,955
3	257,582	1,127	5,815	5,269	(546)	17,445	10,403	8,048
4	262,299	1,527	5,815	5,864	49	23,260	16,267	12,285
5	268,128	1,966	5,815	6,512	697	29,075	22,779	16,665
6	275,049	2,431	5,815	7,218	1,403	34,890	29,997	21,198
7	283,098	2,944	5,815	7,980	2,165	40,705	37,977	25,870
8	292,284	3,498	5,815	8,808	2,993	46,520	46,785	30,685
9	302,641	4,104	5,815	9,707	3,892	52,335	56,492	35,635
10	314,221	4,772	5,815	10,693	4,878	58,150	67,185	40,718
11	327,032	5,490	5,815	11,761	5,946	63,965	78,946	45,935
12	340,814	6,139	5,815	91,739	85,924	69,780	91,739	51,288
13	355,567	6,829	5,815	26,709	20,894	75,595	105,655	56,790
14	371,302	7,567	5,815	29,048	23,233	81,410	120,787	62,450
15	388,029	8,357	5,815	31,575	25,760	87,225	137,230	68,275
16	405,783	9,212	5,815	34,309	28,494	93,040	155,096	74,265
17	424,603	10,141	5,815	37,277	31,462	98,855	174,507	80,423
18	444,525	11,147	5,815	40,488	34,673	104,670	195,584	86,745
19	465,597	12,240	5,815	43,956	38,141	110,485	218,463	93,228
20	487,837	13,411	5,815	47,712	41,897	116,300	243,296	99,878

@Age60 405,783 9,212 5,815 34,309 28,494 93,040 155,096 74,265

@Age70 1989 Illustration Data for these ages of insured Not Readily Available in 2009

@Age80 1989 Illustration Data for these ages of insured Not Readily Available in 2009

\* Illustrated values include dividends. Dividends assume no loans; loans can reduce dividends. Illustrated dividends reflect current claim, expense, and investment experience and are not estimates or guarantees of future results. Actual dividends may be larger or smaller than those illustrated.

Health A

Insured: Male, Age 45, Best Health **An Informative and Transparent Illustration** Northwestern Mutual Life

Annual Premium, \$5,815 paid every year until age 90

Illustrated cash values based on 10% return (net inv. expenses) & ill'str't'd costs

Guaranteed Death Benefit \$ 250,000

In years 1-20, a 5.5% return, less expenses, is guaranteed. See Notes#

A B C = A + B D E F G H I = G + H J = C + I

Years	Base Policy's Guaranteed Maximum Insurance	Add'l Ins. from Paid-up Additions (NOT GUAR.)	Total Illustrated Insurance (NOT Guar'nt'ed)	Maximum Annual Cost	Illustrated Annual Cost (NOT Guar.)	Ill. Ann. Costs Per \$1000 of Insurance	Guaranteed Cash-Value on Date of Issue	Ill. Add'l Cash- Value a.k.a. Total Dividends	Total Cash (Illustrated - NOT Guar.)	Total Paid on Death (total cash + total ins.) NOT Guar.
1	250,000	1,017	251,017	5,815	5,444	21.7	-	408	408	251,425
2	246,045	2,775	248,820	2,066	1,556	6.3	3,955	1,179	5,134	253,954
3	241,952	5,227	247,179	2,142	1,492	6.0	8,048	2,355	10,403	257,582
4	237,715	8,317	246,032	2,218	1,430	5.8	12,285	3,982	16,267	262,299
5	233,335	12,014	245,349	2,304	1,374	5.6	16,665	6,114	22,779	268,128
6	228,802	16,250	245,052	2,387	1,324	5.4	21,198	8,799	29,997	275,049
7	224,130	20,991	245,121	2,492	1,287	5.3	25,870	12,107	37,977	283,098
8	219,315	26,184	245,499	2,600	1,260	5.1	30,685	16,100	46,785	292,284
9	214,365	31,784	246,149	2,723	1,244	5.1	35,635	20,857	56,492	302,641
10	209,282	37,754	247,036	2,855	1,230	5.0	40,718	26,467	67,185	314,221
11	204,065	44,021	248,086	2,993	1,231	5.0	45,935	33,011	78,946	327,032
12	198,712	50,363	249,075	3,136	1,362	5.5	51,288	40,451	91,739	340,814
13	193,210	56,702	249,912	3,274	1,504	6.0	56,790	48,865	105,655	355,567
14	187,550	62,965	250,515	3,411	1,664	6.6	62,450	58,337	120,787	371,302
15	181,725	69,074	250,799	3,549	1,847	7.4	68,275	68,955	137,230	388,029
16	175,735	74,952	250,687	3,697	2,049	8.2	74,265	80,831	155,096	405,783
17	169,577	80,519	250,096	3,850	2,268	9.1	80,423	94,084	174,507	424,603
18	163,255	85,686	248,941	4,015	2,518	10.1	86,745	108,839	195,584	444,525
19	156,772	90,362	247,134	4,192	2,796	11.3	93,228	125,235	218,463	465,597
20	150,122	94,419	244,541	4,372	3,100	12.7	99,878	143,418	243,296	487,837

Derived entirely from information encoded in a Traditional Illustration. This presentation facilitates comprehension by clearly separating the insurance and saving components and by showing the costs in a readily understandable manner of MAX, Illustrated, and Per Unit. This illustration also helps prevent commonplace misrepresentations and misconceptions. Three pages of notes follow. **Page 1 of 4**

Please note that while this illustration has 10 columns of values, in contrast with the widely used 8 columns in a traditional illustration, this presentation can be altered to have fewer columns or be supplemented to contain any column found in the traditional illustration. It should be noted that many of the columns in the traditional illustration are there to facilitate diverting the consumer's attention from the policy's annual costs or furthering a typical misrepresentation.

- Column A is the difference between Guaranteed Death Benefit less Guaranteed Cash-Value
- Column B is the difference between Col. C and Col. A or the At-Risk Amounts provided by the Paid-up Additions
- Column C is the difference between Illustrated Cash-Value less Illustrated Death Benefit
- Column D is derived by reverse-engineering the illustration's Guaranteed Values using its Guaranteed Rate
- Column E is derived by reverse engineering the illustration's Illustrated Values at the illustration's dividend rate - which this insurer reports net of investment management costs.
- Column F is derived by dividing Column E by Column C (and adjusting to report as per \$1,000 of at-risk amount)
- Column G is the Guaranteed Cash-Value
- Column H can be derived two ways. As the difference between I and G, or the sum of all the dividends themselves plus the additional dividends earned on the prior dividends.
- Column I is the Illustrated Cash-Value
- Column J is the Traditional Illustration's Insurance column

**Notes on Illustration (Drafts below are very rough, and I welcome input on such)**

- 1) The Total Annual Costs includes the sum of all costs on this policy, and such costs include, mortality or claim costs, sales costs, premium taxes, administrative and underwriting and costs related to capital (profits or surplus charges) and investment management expenses (unless these investment/capital related costs are itemized separately, or as in this case, the insurer's dividend rate is reported net of investment management expenses).
- 2) Base Policy's Guaranteed Maximum Amount of Insurance - (Explanation on this item can be policy specific, for example) Whole Life policies, such as this policy, are build so that as the policy's cash-value grows, the amount of insurance decreases dollar for dollar.
- 3) Whole life policies can pay dividends. Dividends are NOT Guaranteed. Dividends can be kept/left in the policy to increase both the insurance amount and the cash-value. Increases in the insurance amounts are called paid-up additions (explained further elsewhere)
- 4) Annual costs will never exceed the Maximum Annual Costs. In the later years of a policy, these Maximums are primarily determined by claim costs (which are a function of amount of insurance, the insured's age, and the mortality rates charged by the insurer to such insureds).

- 5) Regarding policy's annual costs: 1) They increase as the insured ages because older individuals die at a higher rate than younger ones. 2) Given this policy's declining amount of insurance, the Total Annual Cost are less than they would have been had the amt of insurance stayed constant.
- 6) The Annual Costs Per Thousand Dollars of Insurance (or At-Risk Amount) is the basic unit price of life insurance; it is naturally useful for comparison shopping, just like any other unit price. Given the long term nature of a life insurance policy, it is useful to evaluate a policy's costs over a period of years, and the conventional way to do such is to calculate the present value of a policy's future annual costs.
- 7) This policy builds up cash-values. When annual costs are less than the annual premium paid, the balance of the annual premium is added to the existing cash-value. The insurer guarantees that the existing cash-value will earn 5.5% in the first 20 years and 4% annually thereafter. Please be aware that if annual costs exceed the annual premium, some of the earnings on the cash-value can be applied so that the net returns on the cash-value in the yr could be less than 4%.
- 8) Additional Cash-Value, that is cash-value being greater than the minimum guaranteed year-end values, or greater than the specific annual increase in guaranteed cash value, arises when costs are not as great as the maximum, and/or when the earnings on the cash-value are greater than the minimum guaranteed earnings. These amounts are part of what comprises a dividend.
- 9) Guaranteed Cash-Values on Date of Issue - It is important to understand that a Whole Life policy's cash-value never decreases unless the policyholder borrows, surrenders or withdraws some cash-value. In the above chart, the total cash-value in any year becomes a guaranteed value from that date forward.
- 10) Annual Premium is fixed, guaranteed to remain level, and due every year until the insured is age 90. The fact that it is guaranteed does not mean that the annual costs do not change, as you'll note they clearly change. The level premium is just the result of the mathematical formula where based on maximum possible costs and minimum guaranteed increases in cash-value from investment results, the actuaries of the company solved the formula to determine the amount that has to be paid annually to maintain the coverage.

**Two examples to help understand the calculation of guaranteed cash-values and the calculation of the historical performance**

<u>Accounting of Yearly Changes in Guaranteed Cash Value</u>		<u>Accounting of Yearly Changes in Illustrated Cash Value</u>	
Year 4's Year-End Guaranteed Cash Value	12,285	Year 4's Year-End Illustrated Cash Value	16,267
+ Premium Paid	\$0	+ Premium Paid	\$0
- Guaranteed Maximum Cost	-2,304	- illustrated Cost	-1,374
= Beginning of Year Net Cash-Value	9,981	= Beginning of Year Net Cash-Value	14,893
Guaranteed Earnings Rate Confirmed	67.0%	Illustrated Earnings Rate Confirmed	52.9%
= Year-End Guaranteed Cash Value	16,665	= Year-End Guaranteed Cash Value	22,779

Calculation of Dividends

Dividends, as we all know, arise when Actual Costs are < Guar. Max. Costs and Actual Investment Earnings are > Min. Guar. Earnings  
 Or Formulaically

Guaranteed Max Cost (both Mortality and Expenses) 2,304  
 - Actual Costs -1,374  
 = Expense Contribution to Dividend 930

Actual Investment Earnings 7,886  
 - Guaranteed Minimum Earnings (6,684)  
 - Guaranteed Min. Earnings on Paid-Up Additions (159)  
 = " = Investment Contribution to Dividend" 1,043

Calculated Total Dividend 1,973 (930+1043)  
 Actual Illustrated Dividend (from 1989 illustration) 1,966

De minimis \$7 Difference arises from insurer's illustration providing incomplete info on Paid-Up Additions' Max. Costs and/or Minimum Rate