
Network Microdesigns Corporation
Lifebase[®] Advisory Group Meeting
May 6, 2010

Regulatory and Product Developments

Principles Based Reserves/Capital Adequacy

- Complete change in how reserves and minimum capital requirements are determined
 - Based upon actuarial forecasts—best estimates with some margin
 - under a variety of interest rate scenarios (up to 1,000, for some blocks)
 - some blocks may be exempt from this test
 - reserve is larger of these forecasts, or cash surrender value
 - Reserves set to cover at least 70% of the forecasts
 - Minimum capital set to cover at least 90% of the forecasts
 - Will also be formula-based minimums (ACLI is drafting)
 - Reserve rules will initially apply only to new business after effective date
 - Minimum capital rules will apply to all business



Principles Based Reserves/Capital Adequacy

- Whether it will raise or lower requirements will depend upon each company's experience
- Both reserve and capital adequacy rules close to final passage
 - Expect at June, 2010 NAIC meeting
 - Then must get passage by the states
 - After then, NAIC can change the rules without further state action
 - Valuation Manual
- Planning and setup work will likely take more than a year
 - Start work in 2011



Actuarial Guideline 45

- Applies to Products with Interim Endowment Benefit
 - Return of Premium Term
- Effective January 1, 2010 for All Insurers
 - was a 2009 grandfather clause
- Makes classic ROP Term almost impossible to implement
 - Considerable Nonforfeiture Compliance Issues
- Simple Alternative
 - 20 or 30 year endowment plan
 - No policy fee
 - Endow for only the base premiums paid
 - pick one mode—an amount per \$1,000
 - Actuarial Guideline 45 doesn't apply



Annuity Suitability

- NAIC Annuity Suitability Regulation Updated
 - March, 2010 meeting
- New additions
 - Companies must establish compliance programs to consider
 - intended use of the annuity
 - client's existing assets
 - Producers must receive specific annuity training
 - one-time, four credit training course approved by insurance department
 - how contract provisions affect clients
 - use of appropriate sales practices and disclosures
 - within 6 months of regulation effective date
 - New standards must be consistent with Financial Industry Regulatory Authority (FINRA)
 - mostly have to do with variable annuities
- Many states now requiring disclosure forms



Annuity Suitability

- When are fixed annuities suitable?
 - National Association of Fixed Annuities (NAFA) recommendations
- Obtain relevant information from prospect
 - Personal and family, including dependent support requirements
 - Income sources
 - Existing insurance
 - Liquid net worth
- Consider the information
 - Time horizon for the benefit need
 - Other benefit sources (Social Security, Pension...)
 - Existing health issues
 - Other liquidity needs
- Full disclosure
 - liquidity and surrender charges
 - projected taxation and tax benefit
 - after-tax illustrations
 - annuity advantages
 - guarantees
 - Social Security exemption (on interest earnings)
 - no Probate issues



Obama Tax and Budget Proposals

- Anticipated tax rate increases
 - 2010 Roth Conversions Attractive
 - Health Care Reform Tax
 - on high earners
 - 3.8% on investment income (including annuities)
- Estate Tax
 - may return in 2011
 - efforts to get something passed
 - proposed 2009 levels
 - \$3.5 million exemption
 - 45% top rate
 - if nothing done, revert to \$1.0 million exemption and 55%
- Corporate-Owned Life Insurance
 - indirectly tax inside buildup



Obama Tax and Budget Proposals

- Significant Retirement Annuity Incentives
 - encourage transformation of savings to guaranteed annuity income
 - permit partial annuitization of nonqualified annuity
 - reduce barriers to 401(k) annuitization
- Life Settlements
 - taxation on sale of life insurance policy



State and Federal Activity

- State Insurance Filings
 - Mandatory Electronic Filings in most states now
 - Interstate Compact
 - 34 states have joined
 - 4 more in process (NY, IL, NJ, FL)
 - streamlines filings, but rules are strict
 - can be rather expensive
- Federal Insurance Charter
 - Work continues, but no clear timeline yet
 - Nothing likely until after 2010 elections



Investment Market

- Treasury rates continue to decline
 - especially at short end
 - 5 year 2.42%, 10 year 3.66%, 30 year 4.52%
- Corporate bond spreads have narrowed
 - AAA (average annual default 0.03%)
 - 5 year 2.84%, 10 year 3.66%, 20 year 4.91%
 - AA (average annual default 0.04%)
 - 5 year 3.01%, 10 year 4.41%, 20 year 5.30%
 - A (average annual default 0.11%)
 - 5 year 3.33%, 10 year 4.72%, 20 year 5.85%



Investment Market

- Credited Rates Continue to Decline
- Fixed Annuities
 - FPDA average 3.5% (down from 3.6% over past 6 months)
 - SPDA overall average 3.3% (down from 3.6% over past 6 months)
 - 5 year guarantee average 3.45% (down from 3.75% over past 6 months)
- Universal Life
 - overall average 4.6% (down from 4.65% over past 6 months)



Investment Market

- Income Annuities
 - Comparative Annuity Reports Survey
 - April, 2010 Rates

Payout Years	Discount Rate	
	Average	High
5	0.83%	2.28%
10	2.54%	3.56%
15	3.36%	4.08%
20	3.83%	4.63%
25	4.00%	4.34%
30	4.19%	4.56%



Investment Market

- Valuation and Nonforfeiture Rates
 - Ordinary Life
 - currently 4.00% reserves , 5.00% cash values
 - not projected to change in 2011
 - Single Premium Deferred Annuity Reserves
 - without MVA-5.00% in 2009; estimate to decrease to 4.50% in 2010
 - with MVA-5.50% in 2009; estimate to decrease to 4.75% in 2010
 - Flexible Premium Deferred Annuity Reserves
 - 5.00% in 2009; estimate to decrease to 4.50% in 2010
 - Single Premium Immediate Annuities
 - 6.00% in 2009; estimate to decrease to 5.25% in 2010



Investment Market

- Profit Objectives Generally Reduced
 - after-tax return on invested surplus
 - 12% for many years
 - now often recognizes current investment yields
 - long term U.S. Treasury yield, plus risk spread (2.50%-3.00%)
 - 7.50% to 9.00%, after tax, not uncommon



Life Insurance Market

- 2009 Sales Down 10%
- Seeing some increase in permanent life sales
 - long term guarantees getting good press
- Term wars mostly over
 - some have increased rates
 - most have dropped return of premium
 - many have dropped 30 year term



Life Insurance Underwriting

- More emphasis on straight-through processing
 - database underwriting
 - some rely only upon databases (MIB, ScriptCheck, MVR)
 - electronic application/home office transmission
 - less reliance on doctors
 - new blood marker may eliminate EKG requirements
 - NT-proBNP
 - more reliance on teleinterview
 - some evidence that more accurate responses
 - especially smoking question
- Increase in Simplified Issue sales
 - “instant issue”



Annuity/LTC Combination

- Tax-favored treatment effective January, 2010
 - Payments for LTC not taxed
- Upon commencement of Long Term Care
 - Monthly withdrawals from annuity
 - Annuity will run out in 24 months
- Can purchase extensions
 - usually another 24 or 48 months
 - paid by interest expense fee, varying by issue age
 - from 40 bps to 180 bps, ages 45 to 75
- Must be underwritten
 - at issue and at time of claim



Retirement Income Market

- Rapidly Emerging
 - as yet, largely untapped
 - 77 million Baby Boomers, reaching age 65 starting in 2011
 - GBC valuation inventories
 - \$2.2 billion deferred annuity account value
 - 80% age 60 and over
 - 57% age 70 and over



Retirement Income Market

- Educate Regarding Life Expectancy
 - one in four 65 year old couples will both live to age 97
 - 50% chance of outliving your life expectancy
- Stress the Positives, as Opposed to the Lost ‘Bet’
 - “Retirement Security”
 - Industry is pushing for tax favorability
 - may receive it with Obama initiative
 - October, 2009 Time Magazine Article
- Good market for tax qualified plans
 - Add annuitization as regular option
 - Principal Group’s Golden Retirement plan
 - Approach can work for with current annuity products
 - adjustable settlement option
 - improving picture regarding “partial annuitization”

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Retirement Income Market

Sample Partial Annuitization Illustration

Illustration of Increasing Annual Retirement Income from conversion of 20.00% of Account Value every 5 years from ages 65 through 80 and 90.00% at age 85

End of Year	Age	Guaranteed Values at 1.8%			Nonguaranteed Values at 4.00%		
		Account Value	Surrender Value	Annual Income*	Account Value	Surrender Value	Annual Income*
1	56	\$254,500	\$234,140	\$0	\$260,000	\$239,200	\$0
9	64	293,542	293,542	0	355,828	355,828	0
10	65	239,060	239,060	3,446	296,049	296,049	5,354
14	69	256,743	256,743	3,446	346,335	346,335	5,354
15	70	209,092	209,092	7,044	288,151	288,151	11,390
19	74	224,558	224,558	7,044	337,096	337,096	11,390
20	75	182,880	182,880	10,897	280,464	280,464	18,374
25	80	148,937	148,937	14,833	233,346	233,346	25,466
30	85	15,162	15,162	33,518	24,268	24,268	58,878
35	90	15,435	15,435	33,518	25,239	25,239	58,878
40	95	15,713	15,713	33,518	26,248	26,248	58,878
45	100	15,995	15,995	33,518	27,298	27,298	58,878

*--Single life annuity--income is guaranteed as long as John Doe is alive. Payable monthly. Nonguaranteed income is based upon current annuity purchase rates. Income is shown before any income tax.

Regulatory and Product Developments



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Retirement Income Market

- Need to provide for flexible planning
 - nonlevel payout patterns
 - periodic lump sum payouts
 - inflation-indexed
 - requires a robust pricing model and quote system
 - interest rates updated weekly
 - each payment discounted separately
- Alternative—for those who are accumulating estate value
 - United Life Product
 - settle deferred annuity with 5 year certain annual payout
 - issue Single Premium Whole Life for first payment
 - add 4 more guaranteed insurability increases to be purchased with remaining payouts
 - underwrite for full amount
 - end of 5 years, tax-effective way to move to an income-tax free life insurance benefit
 - alternative—5 or 10 pay life
 - immediate benefit but longer term cost

