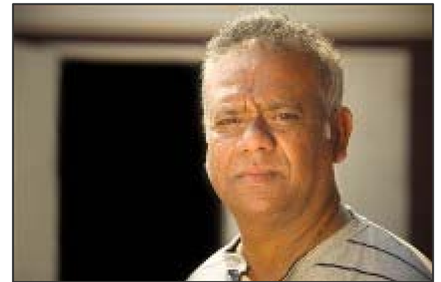
Indexed Products Training Course
(Company Credit Only)

Indexed annuities and indexed life insurance products have become increasingly popular for addressing the financial concerns of consumers who want to achieve more balance between safety of principal and the size of their returns. In this course, you will learn about the indexed products designed specifically to offer the potential for greater returns without sacrificing safety.

The course reviews the basics of both annuities and life insurance, followed by an in-depth look at the features that make indexed products unique.

We recommend you proceed through the course in the order in which the menu items appear. Good luck.



ANNUITY BASICS

Indexed Products

In this course about indexed products, we will be focusing primarily on indexed annuities and indexed life insurance. Indexed annuities are like any other annuity in the basic structure and functioning.

Fixed Annuities

Fixed annuities have evolved into two basic rate-paying methods:

- **Declared rate fixed annuities**…where the rate of interest to be paid is stated and guaranteed for one or more years and typically will have a lesser guaranteed rate, providing a conservative return.
- **Indexed fixed annuities**…where, in addition to a declared interest rate option, the annuity delivers an interest crediting option linked to an outside index that measures the performance of equity markets, providing the potential for greater interest. The most commonly used index is the Standard & Poor's 500® (S&P 500®). You will be learning more about how indexed crediting strategies work later in this course.

Note that both declared rate and indexed fixed annuities have a guaranteed interest rate.

ANNUITY CONTRACT PROVISIONS

Let’s look at provisions for typical fixed annuity contracts—declared rate fixed annuities as well as indexed fixed annuities. Topics in this section include:

- **Common provisions**
- **Indexed crediting strategies**
- **Index strategy performance**

ANNUITY CONTRACT PROVISIONS

Common Provisions

Let's discuss some of the common provisions for both declared rate fixed annuities and indexed fixed annuities.

The **initial interest rate** is established when the annuity is first purchased. It is most commonly guaranteed for one year (in some products it may be guaranteed for longer period).

Insurers sometimes provide for **bonus rates** to be paid under certain circumstances. A **premium bonus** is a special higher interest rate that is paid under circumstances described in the annuity contract.

A common application is for the bonus to apply immediately when the first premium is paid. A 5% bonus rate is common. Adding the bonus to the annuity immediately upon premium payment can have a significant impact on the first year earnings. Here's an example:

- First year's premium of $50,000 is paid in advance.
- Current rate of interest is 4%, but insurer pays a bonus of 5% ($2,500) on the first year's premium.
- Insurer immediately adds $2,500 to the annuity ($50,000 × .05 = $2,500).
- Interest begins to accumulate immediately on $52,500 instead of $50,000.

ANNUITY CONTRACT PROVISIONS

Common Provisions

Annuity Date

Otherwise known as the maturity date of the annuity, the annuity date is the date on which the accumulation of funds stops and the payout begins. If a maturity date on which benefit payments begin is included, the "date" might be a specific age (e.g., 70, 75, 80) or might be based on a period of years (e.g., 10), or might be the later of these two.

Withdrawal/Surrender Charge Waivers

Fees and penalties may apply if an annuity owner decides to withdraw any portion of an annuity or surrender it completely before the expiration of the surrender charge period. However, when certain circumstances arise, the owner or annuitant may be permitted to make withdrawals or surrender the annuity completely without penalty. One type of waiver is a nursing home waiver.

Nursing Home Waivers

When a nursing home waiver is attached to the annuity contract, withdrawal and surrender charges are waived if the individual is confined to a nursing facility. In order for the waiver to be triggered, certain requirements usually must be met, such as the individual must be confined to the nursing home facility for at least 90 consecutive days.

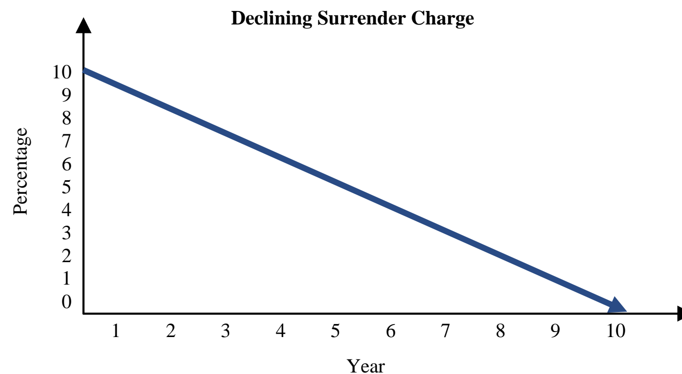
ANNUITY CONTRACT PROVISIONS

Common Provisions

Because money placed in an annuity is generally intended to stay there for the long term, there are penalties for withdrawing money early. The insurer may impose a **withdrawal or surrender charge** during the early years unless a waiver (such as the nursing home waiver) is included in the contract.

The **surrender charge** is generally a percentage of the annuity value that declines over a specified number of years—less than 10 years is common—and is then eliminated. Surrender charges are likely to vary from product to product offered by the same insurance company.

In this illustration, the insurer imposes a 10% surrender charge during the first year, reducing by 1% per year until the 11th year, when it disappears.



ANNUITY CONTRACT PROVISIONS

Common Provisions

However, many insurers permit free **withdrawal privileges** up to a certain percentage of the total in the annuity at specified times, usually once a year. The percentage of the total available for withdrawal generally is about 10% to 15% of the contract's cash value.

If the owner withdraws no more than the permitted amount, and does so during the specified period, there will be no withdrawal or surrender charge.

ANNUITY CONTRACT PROVISIONS

Common Provisions

When an individual is ready to begin receiving funds from the annuity, he or she can choose to take the funds in one lump sum or to have the funds annuitized—paid out in a series of periodic payments. This is **annuitization**—converting the accumulated funds into an income stream, as opposed to taking them all at once.

Annuitization options are also called **settlement options**. The common options include:

- **Life income**…payments as long as the annuitant lives, ceasing only when the annuitant dies no matter how little or how much has been paid
- **Life income with period certain**…payments as long as the annuitant lives and up to the period of time specified if the annuitant dies before all payments are made (e.g., 10 years certain and life would be for at least 10 years and thereafter until the annuitant dies)
- **Joint survivor life**…two annuitants named, payments continue until both have died
- **Period certain**…payments made for a specific period, ceasing whether the annuitant is living or dead (e.g., 10 years certain would be for 10 years and would then end even if the annuitant is still alive)

ANNUITY CONTRACT PROVISIONS

Common Provisions

Upon the death of the owner, annuity **death benefits** generally bypass probate and are paid directly to the beneficiary named by the owner.

When death occurs before payments begin, the beneficiary will receive the greater of the account value and the guaranteed account value on the date of death.

If death occurs after payments have begun, there may also be a death benefit, depending upon the annuity **settlement option** chosen. As you've learned, the owner can choose either to take the annuity in a lump sum or have it annuitized—paid out in a series of payments over time. If the owner has selected a settlement option other than a lifetime guarantee, a death benefit will be available.

ANNUITY CONTRACT PROVISIONS

Common Provisions

All fixed annuities have a **principal guarantee**, which means the annuity owner is always guaranteed that at least the amount equal to premiums paid in is available to the owner minus any surrender charges that may apply. Stated another way, the fixed annuity's account value will never be less than the premiums paid into the contract.

This is true regardless of how the markets are treating the insurer's general investments upon which interest rates are based.

However, if the owner should surrender the contract before the end of the surrender period, a surrender charge applies. In this case, the principal paid to the owner could conceivably be less than the amount paid in.

ANNUITY CONTRACT PROVISIONS

Indexed Crediting Strategies

Earlier you learned that indexed annuities differ from other fixed annuities because, in addition to a guaranteed interest rate, the annuity interest that will be paid is linked to an outside index that measures the performance of equity markets. This feature, which provides the potential for greater interest crediting than the guaranteed rate, is referred to as an **indexed crediting strategy**.

The index an insurer uses with a specific indexed annuity is referred to as the **tied index**. While the most commonly used index is the Standard & Poor's 500® (S&P 500®), other possibilities include:

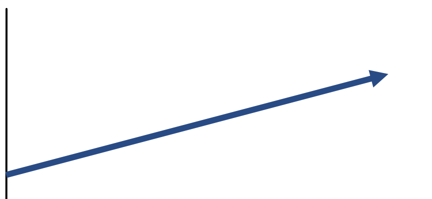
- Dow Jones Industrial Average
- NYSE Composite Index
- Russell 2000® Index
- NASDAQ-100 Index
- S&P 400 Midcap Index

ANNUITY CONTRACT PROVISIONS

Indexed Crediting Strategies

The index can move up or down.

If the index goes up, the accumulation value of the indexed annuity increases.



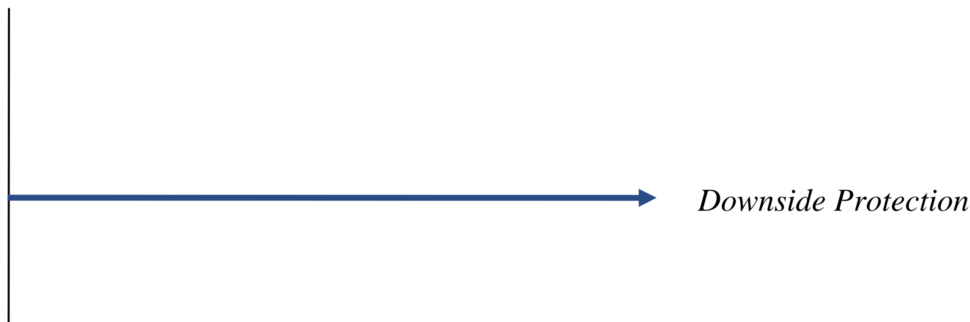
If the index goes down, the accumulation value remains the same because no interest is credited for that period. This is one of the major advantages of indexed annuities—although the value will not increase when the index is down, neither will it decrease.

ANNUITY CONTRACT PROVISIONS

Indexed Crediting Strategies

When it comes to downward fluctuations, the indexed annuity includes a key element. A built-in downside protection provides that the annuity value will never be less than the premiums paid.

In this manner, the indexed annuity offers participation in market upswings with guarantees the owner can count on (similar to a fixed annuity).



ANNUITY CONTRACT PROVISIONS

Indexed Crediting Strategies

It’s important to remember these key facts:

- The tied index is a link or a measuring tool and nothing more.
- An indexed annuity does not represent investment in equity securities.
- The indexed annuity is a fixed annuity that allows account values to increase if the selected index moves upward.
- Account values remain the same if the selected index moves downward.

ANNUITY CONTRACT PROVISIONS

Indexed Crediting Strategies

Indexed annuities are written with certain provisions that can change during the life of an annuity contract. These are often referred to as the contract's **moving parts**. Most insurers attempt to have only one moving part in a single contract. That is, although all three parts could change, the insurer's intention is to keep two stable and only have only one subject to change. The three moving parts are:

- **Participation Rate**
- **Cap or Cap Rate**
- **Spreads/Asset Fees**

The indexed annuity generally does not earn exactly the same interest rate as the gain in the index to which it is linked. Insurers establish a **participation rate**, which is the percentage of the index gain that will be used to compute the interest rate paid.

Although the participation rate can technically range from 1% to 100%, actual rates typically range from as low as 20% up to 100%.

ANNUITY CONTRACT PROVISIONS

Indexed Crediting Strategies

Suppose the index gain is 10% during the index term, and the annuity's **participation rate** is 70%. The gain credited to the indexed annuity in this case will be 7%, which is the result of the following formula:

Participation Rate × % of Index Increase = Credited %

70% × 10% = 7%

Insurers sometimes guarantee that the indexed annuity participation rate will never be less than a specified minimum or more than a specified maximum. When the participation rate is one of the moving parts, it may change from time to time.

Insurers might include a **cap rate** or maximum rate of interest that can be earned. Typical cap rates of various insurers now average 3% - 4%, but can run as low as 1.5% or as high as 6%.

An indexed annuity with a cap rate of 4% will never pay more than 4% of the gain in the index to which it is linked. For example, if the cap rate is 4%, only 4% will be credited even if the index gain is 6%.

As is the case with participation rates, an insurer might guarantee minimum cap rates.

ANNUITY CONTRACT PROVISIONS

Indexed Crediting Strategies

Not all indexed annuities have a **cap**, and a cap frequently is not used when a participation rate is applied. However, because a specific annuity could, in fact, use both a participation rate and a cap rate, you must be aware of how, together, the two rates significantly affect the interest rate actually credited. For example:

Assume a participation rate of 90% and a cap rate of 5%. When it is time to credit the interest to the indexed annuity, the index gain is 7%. The participation rate is applied first; then the cap rate is compared to that result to determine the actual credited rate, like this:

Index Gain × Participation Rate = Rate Credited

7% × 90% = 6.3%

If no cap rate is applicable, the interest credited would be 6.3% for this period.

However, because there is a cap rate of just 5%, the interest paid will be only 5%.

Indexed Crediting Strategies

Many insurers charge a fee that might be referred to variously as the **spread, asset fee, margin or administrative fee**. When such a fee is charged, the interest rate to be credited is calculated by subtracting a specified percentage from the index gain. This might be computed instead of or in addition to the participation rate. Again, the insurer might specify guaranteed minimum and maximum fees.

Here's an example when the participation rate is 100%. With an index gain of 10.5% and a spread of 3%, an insurer subtracts the spread from the gain with the resulting figure being the rate that will be credited to the indexed annuity:

10.5% – 3% = 7.5%

Now also assume that a **participation rate** applies:

Index gain	=	**10.5%**
Spread	=	**3%**
Participation rate	=	**90%**
10.5% - 3%	=	**7.5%**
7.5% × 90%	=	**6.75%**

ANNUITY CONTRACT PROVISIONS

Indexed Crediting Strategies

You have seen the importance of understanding precisely what provisions are made for **crediting interest** to an indexed annuity.

Always know how all of the parts work together to affect the rate that will ultimately be credited to the indexed annuity for each individual client.

ANNUITY CONTRACT PROVISIONS

Indexed Crediting Strategies

The **indexing strategy or method** refers to the approach the insurer uses to measure the amount of change in an index. Large differences can result from choosing one approach over another. Indexing strategies include:

- **Fixed interest**
- **Point-to-point**
- **Monthly averaging**
- **High-water mark**
- **Annual reset (also called ratcheting)**
- **Combination strategies**

ANNUITY CONTRACT PROVISIONS

Indexed Crediting Strategies

You are about to learn a great deal about the strategies commonly used with indexed annuities to determine how interest will be credited. An indexed annuity might have several different strategies applicable to several different accounts.

One such account is a **fixed interest** account. Certain annuity buyers might want to put at least part of their premiums into a fixed interest account where they know they are guaranteed to earn interest, even though it might be a relatively low rate.

Using the **point-to-point** method, interest is based on the difference between the index value at the beginning and end of the index term—that is, between two specific points. The beginning point is when the term begins, so the value of the index at that point is the first value to consider. The ending point is when the period ends, and the value at that point is used to determine the crediting amount. Here's an example using a one-year period, representing an **annual point-to-point**.

Index value at beginning	700
Index value at end	860

To calculate the **crediting rate**:

860 – 700 = 160 ÷ 700 = 22.85%

Indexed Crediting Strategies

Don't forget there are **other considerations** in determining the final rate to be credited. A participation or cap rate is likely to apply. A spread/asset fee is another possibility. Any of these that are applicable must be factored to determine the actual rate the insurer will credit as interest.

So, for the previous example, let's assume the participation rate is 80% and there is no cap rate or spread to consider. The 80% participation rate is applied to the initial crediting rate of 22.85% to calculate the actual credited rate:

22.85% × 80% = 18.28%

A variation of the annual point-to-point is the **long-term point-to-point**, when the period is longer than just a year. "Long-term" typically means five years or more. Again, the value at the beginning of the period is compared to the value at the end of the period. In this case, let's suppose the period is five years and the values are:

Index value at beginning	700
Index value at end	1090

To calculate the **crediting rate**:

1090 – 700 = 390 ÷ 700 = 55.7%

ANNUITY CONTRACT PROVISIONS

Indexed Crediting Strategies

Monthly averaging is a variation on the point-to-point strategy. In this case, the period is shorter—running from the beginning of the month to the end of the month. At the end of the year, then, the total of these values is averaged. The result is the ending value. The beginning value and ending (averaged) value are then compared just as before. It's important to know what type of averaging, if any, is used. The insurer might instead use daily or weekly averaging. Another variation is monthly averaging spread over a two-year period.

Averaging has both an upside and a downside. If the index value drops suddenly, the annuity owner has some protection. On the other hand, if there is a significant increase in the index value, the owner doesn't participate in it directly. Over the long term, then, the owner might have had the potential for earn greater interest if not for the averaging.

ANNUITY CONTRACT PROVISIONS

Indexed Crediting Strategies

Ignoring any participation or cap rates, here's an example of **monthly averaging**:

Value 1st month	$ 635
Value 2nd month	645
Value 3rd month	649
Value 4th month	655
Value 5th month	660
Value 6th month	668
Value 7th month	677
Value 8th month	690
Value 9th month	701
Value 10th month	713
Value 11th month	740
Value 12th month	+ 746
	$8179

8179 ÷ 12 = 682
682 – 635 = 47
47 ÷ 635 = 7.4%

ANNUITY CONTRACT PROVISIONS

Indexed Crediting Strategies

The **high-water mark** approach credits interest at the end of the term. The interest is based on the difference between the index value at the start of the term and the highest value at various points (such as policy anniversaries) during the term. Interest is then added at the end of the term. Again ignoring any additional limits that may apply, here is an example.

Index value at beginning	700
Index value at end	1090
Highest index value during term	1100

To calculate the **crediting rate**:

1100 – 700 = 400 ÷ 700 = 57%

Under this approach, the beginning value for the next term will be the high water mark rather than the ending value for the previous term.

ANNUITY CONTRACT PROVISIONS

Indexed Crediting Strategies

Remember, once this rate is determined…

1100 – 700 = 400 ÷ 700 = 57%

…any additional elements that are part of the particular annuity contract must also be applied. These could include a participation rate, a cap rate and a spread or asset fee. Assuming only a participation rate of 90%, the result is:

57% × 90% = 51.3%

ANNUITY CONTRACT PROVISIONS

Indexed Crediting Strategies

Another crediting strategy, the **annual reset**, compares the index value at the beginning of the contract year with its value at the end of the contract year. This is done every year the contract is in force. Any gain is immediately credited.

After the interest is determined and credited, the beginning index value for the next contract year is reset to equal the ending value of the contract year just ended. In one of our previous examples, the beginning value was 700 and the ending value was 1090. Using the annual reset, the beginning value for the subsequent contract year will be 1090.

This strategy, also known as **ratcheting**, is of course subject to participation and cap rates and fees.

ANNUITY CONTRACT PROVISIONS

Indexed Crediting Strategies

Combining Methods
An insurer is likely to use a variety of indexing strategies in combination in a single annuity. To do so, a number of different accounts are used. For example, the same indexed annuity might have three accounts with three different indexing methods:

1. **Fixed interest**
2. **Monthly averaging**
3. **Annual reset**

Another might have these two:

1. **Fixed interest**
2. **Point-to-point**

The possible combinations are many. The contract itself will explain what strategies are used and how they operate. Be sure you know what is included in the indexed annuities you will offer.

ANNUITY CONTRACT PROVISIONS

Indexed Crediting Strategies

Consumer Choice for Allocations

Although the insurer initially selects the various crediting strategies to be offered with an indexed annuity, the purchaser has the option to allocate the premiums to one or more of the strategies that best fit his or her objectives.

For example, using examples from the previous page, a certain consumer might choose to allocate values like this:

Fixed interest	**10%**
Averaging account	**40%**
Annual reset account	**50%**

Typically, the consumer also has the option to reallocate the accumulated funds from one account to another at certain times—usually on the contract anniversary date. Minimum transfer amounts normally apply, and there is also generally a minimum on the amount that must remain in the account from which funds are transferred to another account.

The individual from the previous example could choose to increase the fixed interest account to 20%, taking 10% from the averaging account for that purpose, and moving another 10% from the averaging account to the annual reset account. The result is:

Fixed interest	**20%**
Averaging account	**20%**
Annual reset account	**60%**

ANNUITY CONTRACT PROVISIONS

Index Strategy Performance

Why Participation Rates Are Less Than 100%
An obvious question with respect to the working of indexed annuities is, "Why might the participation rate be less than 100%?" First, by using a lower participation rate, the insurer is able to recoup certain expenses, such as:

- Costs to issue a policy
- Marketing costs
- Taxes
- Business overhead

And…paying less than 100% also allows the insurer to make a profit.

Index Strategy Performance

Why Participation Rates Are Less Than 100%

Another very important reason that participation rates are sometimes less than 100% has to do with managing the guarantees that are included in the annuity contract. Guarantees that provide for principal protection and payment of a minimum interest rate represent costs to the insurer.

In addition, the insurer must be able to guarantee the payout if the annuity is eventually annuitized and the owner expects payments for life.

All of these costs and guarantees must be paid regardless of the rise or fall of the index. Therefore, the lower participation rate leaves funds available for the insurer to cover its costs.

So how does this square with the fact that some insurers do pay a 100% participation rate? You can be sure that, in this case, there will be a cap rate and/or a spread/asset fee. There must always be a way for the insurer to keep the promises it makes in the annuity contract.

In a non-indexed annuity, these costs are covered by the returns the insurer receives through investments in its general account. Recall that a fixed interest amount applies here. With the indexed annuity, on the other hand, the interest credits depend on the index values—making them less predictable. The uncertainty of indexed interest credits makes it more difficult for the insurer to predict how much will be available to cover costs.

ANNUITY CONTRACT PROVISIONS

Index Strategy Performance

Participation Rate Fluctuation

Another question that arises is why participation rates fluctuate over the life of the annuity contract. This is a function of the market activity. For an indexed annuity, an additional insurer cost is the purchase of call options in the linked index. A call option is the right to purchase a security at a fixed price.

To cover the cost of these options, one of the variable features—the participation rate or the cap rate—will change. This allows the insurer to maintain its ability to fulfill its guarantees.

Investing the Premium

As is the case with any insurance product, part of the premium paid for an indexed annuity goes to pay for certain costs associated with selling and maintaining the contract. The three broad areas that share in the premium are:

- **Expenses or spread**…insurer's operating expenses, expenses to provide the annuity, agent compensation/commissions, profits
- **Contract guarantees**…costs to guarantee rates, principal, annuitization options
- **Equity index participation**…a portion of the premium earmarked to purchase options that will provide the potential for a greater return through the linked index

Index Strategy Performance

Midterm Withdrawals and Interest Credits

You learned that there can be a surrender charge for making withdrawals before the annuity matures if the owner withdraws too much or does so sometime other than during the period specified by the insurer.

However, there is another drawback to making withdrawals before the contract matures. Depending on the specific policy, the actual interest credited might be less than if the annuity had reached maturity, thus reducing the accumulated value.

With an indexed annuity, certain types pay interest only at the end of the term. As a result, if withdrawals are made before that, the accumulation value drawing interest will be less. In other indexed annuities, the rate paid might not be linked to the index at all if any withdrawals have occurred.

Index Strategy Performance

With respect to minimum interest rates, there are two terms you must not confuse—the minimum nonforteiture interest rate and the minimum annual credited interest rate.

The **minimum nonforfeiture interest rate** is the rate used in determining minimum nonforfeiture amounts that apply for a paid-up annuity, for a cash surrender, or to provide death benefits. Determining this amount requires following guidelines found in state laws and regulations and based on the revised Standard Nonforfeiture Law for Individual Deferred Annuities.

At one time, the nonforfeiture rate was static. The revised law permits the rate to be reset based on steps provided in the law. This is a fairly complicated process, so it will not be covered here. The point for you to remember is that the minimum nonforfeiture interest rate functions to help determine the annuity's nonforfeiture values.

Distinct from the nonforfeiture rate is the **minimum annual credited interest rate**. This is the guaranteed rate the insurer will pay on any money not allocated to an indexed strategy during an interest crediting period. You should be aware of how the minimum rate is applied for the indexed annuities you sell.

Index Strategy Performance

Historical Perspective & Realities

It is plain to see that how indexed annuities operate in the real world depends on a myriad of factors, so many of which are subject to ongoing change. For this reason, it is very important to be careful about what you say to prospective purchasers, and to address the realities of owning an indexed annuity.

Hypothetical models—both historical and projected—are useful, of course, but must be accompanied by caveats that historical performance doesn't guarantee future performance, and that projections are just that…projections.

Actual interest credited to indexed annuities is often different from projections. This is the result of market activity, withdrawals the owner may make, and the potentially changing parts of an indexed annuity. Remember, insurers have the option to make changes in participation and cap rates, and that option is exercised regularly.

Although **renewal interest rates** are seldom emphasized or even of great interest to a purchaser at the time the annuity is sold, these rates can obviously have a significant impact on the future performance of the annuity. It is not unusual for the renewal rate to be substantially lower than the initial interest rate. Be sure the client knows that the initial rate is guaranteed only for the period specified in the contract.

FIXED INDEXED LIFE PRODUCTS

Fixed Products

Before we specifically discuss *indexed* life insurance, let's briefly review the various types of life insurance products available. Non-investment, or non-variable, types of life insurance products, or **fixed products**, include:

- **Whole life insurance**
- **Universal life insurance**
- **Indexed life insurance**

FIXED INDEXED LIFE PRODUCTS

Whole Life

Whole life policies are purchased with periodic premiums that are generally level—that is, the same amount is paid each time a premium is due for the entire lifetime. In the early years of a whole life policy, the level premium substantially exceeds the amount required to pay the current cost of insurance protection. On the other hand, in the later years, as the individual grows older, the level premium falls far short of the amount needed.

No matter how it's paid for, the coverage can continue, however, because the excess premium charged in the early years of the whole life policy permits the policy to build a *cash value accumulation*. This cash value is one of the distinguishing features of whole life insurance.

A whole life insurance policy is made up of two elements:

1. **Pure insurance protection**
2. **Cash value accumulation**

The cash value portion of the whole life policy gradually increases over the lifetime of the policy, until it eventually equals the face amount of the policy, generally when the insured reaches age 100. The portion of the policy not represented by the cash value accumulation is the pure insurance protection portion of the policy.

FIXED INDEXED LIFE PRODUCTS

Whole Life

The **face amount** of a whole life policy always equals the pure insurance protection plus the cash value accumulation:

Face Amount = Cash Value Accumulation + Pure Insurance Protection

When the whole life policy is kept in force, the cash value grows on a tax-deferred basis. The cash value is available to the policyowner in the form of loans or, if the policy is surrendered, the insurer pays the surrender value to the owner. Alternately, if the individual wants to keep the coverage in force, the cash value can be used to provide a lower level of permanent coverage or to buy term insurance. In any event, the cash value belongs to the policyowner in the manner specified in the contract.

Interest sensitive whole life insurance ties the interest rates paid on cash values to the insurance company's investment experience. By basing the interest rate to be paid on current interest rates, the insurer provides the potential for greater growth than is expected with the minimum guaranteed rate. The rate will never go below the minimum guarantee, but when the current rate the insurer is earning on its investments is greater than the minimum, the policy shares in the increase.

FIXED INDEXED LIFE PRODUCTS

Universal Life

Perhaps one of the most widely known types of interest sensitive life insurance is **universal life insurance**, which is technically a flexible premium, adjustable life policy.

The term universal life aptly describes the broad adaptability of the policy to a wide range of changing financial needs over a policyowner's entire lifetime. It also suggests its flexibility and versatility—its universality—in personal planning for financial security.

Universal life differs in several ways from traditional whole life insurance. Consider:

- Premium payments are not fixed and can be increased or decreased at any time within certain limits, or sometimes skipped entirely. Premium payment can be discontinued as long as the cash value is sufficient to cover expense charges and insurance costs for the following month.
- The amount of insurance protection is not fixed; it can be adjusted up or down as needs change, subject to any evidence of insurability required by the insurer.
- Partial withdrawals can be made from the cash value. Policy loans are another option.

FIXED INDEXED LIFE PRODUCTS

Universal Life

Universal life insurance policies offer two distinct death benefit options:

- A level death benefit, known as Option A
- An increasing death benefit, known as Option B

Under **Option A**, the death benefit equals the initial face amount, which includes the cash value of the policy. Thus, as the cash value increases, the pure protection decreases, just as with traditional whole life. The result is a level death benefit, at least in the early years.

Still, to retain its legal identity as life insurance, the policy must provide a minimum amount of pure protection at all times. This minimum is often referred to as a corridor. As a result, Option A provides that as the cash value approaches the face amount, the death benefit will automatically increase to maintain the required corridor. This could occur earlier in the life of the contract if premium payments are near statutory maximums and/or interest rates have been relatively high.

Under **Option B**, the death benefit is equal to the face amount plus the cash value. The face amount remains level while the cash value increases.

The policyowner is permitted to change from one death benefit option to another at any time. If the change is from level Option A to increasing Option B, evidence of insurability is required because of the greater potential risk the insurer assumes. No such requirement applies if the change is from Option B to Option A.

FIXED INDEXED LIFE PRODUCTS

Indexed Life

Indexed life insurance, which follows many of the same general principles as indexed annuities, can be provided as any interest sensitive life insurance product. The most commonly used product is universal life insurance. The basic principles that are similar between indexed life and indexed annuities are these:

- Purchasers have the option to allocate premiums to a fixed interest account.
- For the index crediting strategy options, the interest rates paid are linked to an outside index, such as the S&P 500® or one of the others mentioned previously.
- The crediting strategy features that are similar include:
  - The **terminology** is essentially the same with respect to defining the unique features of indexed products—participation rates, caps, spreads or fees, point-to-point crediting, daily averaging, annual reset, fixed interest, etc.
  - The **mechanics** of crediting interest are also quite similar—participation rates, cap rates and fees are applied, and the insurer's approach to measuring the amount of change in an index produces results in the same way for life insurance as for annuities.
  - The **indices** that may be used as the equity link are also typically the same for both life and annuity products—S&P 500,® Dow Jones Industrials, NYSE Composite, Russell 2000®, NASDAQ-100 and S&P 400 Midcap being among the most common.

FIXED INDEXED LIFE PRODUCTS

Indexed Life

Differences: Periodic vs. Single Premiums

Indexed life insurance also has many significant features that differentiate it from indexed annuities, including the terminology associated with and the treatment of the periodic premiums typically paid.

When a premium is paid, it goes first to a fixed rate strategy (which might also be called a declared interest rate strategy) from which any required policy charges and fees are deducted. These include the amount to pay for the insurance plus administrative and policy fees. The remainder, then, can be sent to the desired fixed rate and indexed crediting strategies. (For a new policy, there must typically be a specific amount accumulated in the fixed account before the excess may be directed to one of the indexed strategies.)

The amount directed to the indexed strategy is called a **segment** or **bucket**. Once the fixed rate segment has enough value to pay policy charges and the cost of insurance for the required period, the excess is directed to the fixed rate or indexed strategies selected. A segment is typically created monthly, quarterly or more frequently depending on company practice.

Indexed Life

Segments (Buckets) & Timing of Allocation

A new segment is created each time a portion of a premium is directed to a certain strategy. Each segment is subject to its own participation rate and cap rate, depending on what caps the insurer is applying at that time.

Each segment remains where it is until the end of the segment term, at which time it could be transferred to a different strategy if permitted. For example, the strategy might be a one-year or five-year strategy, which means the segment term is one or five years. During the specified term, the minimum guarantee applies and no transfers may be made until the end of the segment term.

Indexed Life

Timing of Credits

Various methods are used by insurers for calculating and crediting interest on indexed life products. Although a segment term may last, for example, five years, interest might be calculated (and credited) annually on every segment anniversary.

For example, for calculating interest for a typical one-year point-to-point strategy, the beginning value for the measurement would be the index value as of the date the segment is created. The index value on the segment anniversary date (12 months later) would then be compared to the beginning value to determine the index earnings for that 12-month period. After any applicable participation rate, cap, etc., are applied, the resulting number represents the interest that is credited to that segment of the account value. In this example, that calculation and the resulting interest credit would occur on each segment anniversary through the end of the five-year term.

The annual point-to-point crediting method is commonly used for indexed life insurance policies. Here's an example:

Index value at beginning	**1204**
Index value at end	**1252**

To calculate the crediting rate:

1252 – 1204 = 48
48 ÷ 1252 = 3.83%

FIXED INDEXED LIFE PRODUCTS

Indexed Life

Timing of Credits

Each strategy clearly defines the timing of the indexed crediting. Each premium has the potential to become an additional segment with its own interest crediting period.

Whatever timing the policy stipulates, at the end of that term, the change in the index is recorded and the amount to be credited is calculated. If the change in the index represents a gain, the participation rate and cap rate are applied, determining the amount to be credited to the particular segment. The participation rate for indexed life insurance is usually 100%, unlike the annuity contracts we've discussed. Remember the word "usually." You will find indexed policies with lower participation rates.

But suppose the index measurement produces a loss instead of a gain. Insurers guarantee the credit will never be less than 0%—in other words, there will never be a negative applied to the segment.

Indexed Life

Timing of Credits—An Example

The other modifications that may be made are also applied in the same way for indexed life insurance as for indexed annuities. Remember, we said that the participation rate is generally 100% for indexed life. Let's assume that is the case, then use the same example we just discussed and apply the participation rate and the cap rate, which in this case is 3%.

$$3.83\% \times 100\% = 3.83\%$$

The fact that the participation rate is 100% appears to be a positive feature of this indexed life policy; however, in this case the cap rate is 3%, so 3% is the maximum gain the policyowner will enjoy—not 3.83%.

You should know that with indexed life insurance, the cap rate is sometimes referred to as the growth cap. The minimum of 0% is called the growth floor.

Indexed Life

Monthly Deductions

Indexed life insurance is subject to policy charges just as other policies are. Most such policies are indexed universal life, so in this respect operate the same as non-indexed universal life. One such charge is the **premium load**.

A premium load combines a premium expense charge and any premium tax required. This is expressed as a percentage of each premium, typically ranging from 3% to 9%. The specific percentage differs from insurer to insurer and an insurer might charge different loads for different policies.

Another monthly deduction is for the **cost of insurance**. This is generally expressed as a dollar amount per thousand dollars of coverage. This is where the insured person's age, gender, and other underwriting data are considered to arrive at a fair rate.

Cost of insurance also includes the cost of any riders attached to the policy that require a separate premium or charge.

FIXED INDEXED LIFE PRODUCTS

Indexed Life

Monthly Deductions

Some insurers might have a separate **expense charge** that is different from the premium load charges, covering administrative costs.

This is typically a flat dollar amount per month, such as $5 or $10. The amount is likely to increase after a specified number of years. For example, the fee might be $5 per month for the first five years, then $10 per month after that.

Indexed Life

Alternatives to Handling Monthly Deductions
The various policy charges are automatically deducted from the existing cash values. This occurs whether or not premiums are currently being paid. Remember, one of the features of any universal life policy is the ability to skip premiums. However, there must be enough money in the cash value to cover the cost of insurance and other charges. If not, the cash value will eventually be exhausted and the policy will lapse. To avoid such a situation, the policyowner could pay the monthly costs separately from the premium payments or pay an additional amount along with the minimum premium.

Impact on Indexed Interest Credits when Deducted from Indexed Crediting Strategies
One reason to have additional funds covering the monthly deductions is to be sure the maximum amount of interest is credited. It’s easy to see that when the monthly charges are deducted, the cash value is reduced so interest is paid on that reduced amount.

It’s important to remember that insurers differ in terms of the account where the monthly deductions come from, and how interest, if any, is credited to those funds prior to their being deducted from the policy.

Indexed Life

Underlying Guarantees

It is important to understand the **contractual terminology** of indexed life insurance so you can explain it to clients. This is especially valuable when examining the guarantees that underlie the policy. Always notice which items are described as "current" and which are described as "guarantees." For example, the current cost of insurance charge might be X number of dollars per thousand per month, but it's not guaranteed to remain at that level unless the provision includes wording such as "for the life of the policy."

Indexed products may include a provision specifying a **guaranteed minimum interest rate**. Some insurers offer an annual minimum guaranteed interest rate. This is the strongest guarantee an insurer can make. Because this guarantee costs more, insurers typically use lower caps and/or participation rates to pay the cost of the annual guarantee.

Other insurers offer a minimum guarantee applicable over the segment term. Still others offer a minimum guarantee that applies only upon policy termination—this is the weakest guarantee.

FIXED INDEXED LIFE PRODUCTS

Indexed Life

Like other insurance products, indexed life provides **liquidity** in various ways. One way is to surrender the policy for its cash surrender value—which means the insurance will cease. And, surrendering the policy can trigger surrender charges.

Cash surrender value means the total accumulations minus surrender charges and minus any indebtedness (such as the amount of a policy loan and any interest due on it).

A **surrender charge** is a specified amount that will be assessed against the cash value if the policy is surrendered during the surrender charge period, also specified in the policy. Surrender charges vary. They are typically based on factors such as issue age, gender, face amount, risk class and policy duration. Expressed as per $1,000 of the policy's face amount, surrender charges ordinarily decrease gradually over the surrender period.

The **surrender charge period**—the period during which a charge will be assessed—can vary greatly. It's not uncommon for the policy to have a surrender charge period of up to 20 years.

FIXED INDEXED LIFE PRODUCTS

Indexed Life

Indexed life insurance policies include **transfer provisions** that permit the policyowner to transfer funds from one strategy to another at certain times. The point at which a transfer can be made is typically when a particular segment term ends.

For example, suppose the policy has a five-year indexed strategy. At the end of the five years, the policyowner may redirect the value of that account to another—or to more than one different account if preferred. If it's a one-year strategy, transfers may occur after one year when the segment term ends. The policyowner may also have the freedom to select what percentages of the segment will be directed to each new strategy.

On the other hand, *new* premiums can be directed to different strategies at any time. But, you cannot generally reallocate money within a segment until the end of the segment term.

Indexed Life

In most cases, **withdrawals** from the cash value are allowed after the policy has been in force for at least a year. It's typical for a charge to be made for each withdrawal. About $25 is a common administrative charge for withdrawals.

The death benefit and cash value will be reduced by the amount of the withdrawal. And, if withdrawals from the indexed strategies are made before interest is credited, no indexed earnings will be credited to the withdrawn amount.

Indexed Life

Another way to gain access to indexed life insurance values is through a **policy loan**. Most insurers offer loans with either a fixed rate or a variable rate. A few companies offer both. Which type is most advantageous depends on the particular client and the current economic climate.

A **fixed rate loan** from an insurance policy involves an interest rate that is usually lower than loan rates in the marketplace. Currently, the range is from about 3% to 5%, but the actual percentage or range will be specified in the policy.

Some insurers offer a so-called **preferred loan** after the policy has been in force for a certain number of years. These loans result in a net interest rate of zero because they credit interest to the borrowed funds matching the interest rate charged on policy loans.

Assuming the policy is not classified as a modified endowment contract (MEC), **policy loans** are not taxed as current income. Policy loans unpaid at the insured person's death will reduce the death benefit amount by the amount of the loan and any interest due.

With a fixed rate loan, loaned values will typically be credited with a low guaranteed interest rate of about 2%.

FIXED INDEXED LIFE PRODUCTS

Indexed Life

A number of **riders** are available with indexed life insurance policies.

One common rider is the **accelerated death benefit rider**, which allows a stipulated percentage of the death benefit up to a specified dollar amount to be accessed if the insured has a terminal illness—typically one where life expectancy is 12 months or less.

Many insurers make this rider available with the indexed life policy at no additional cost.

Policyowner Understanding of Indexed Life Policy Performance

A life insurance **illustration** is used to show a client how the policy an agent is proposing might potentially perform. It is only a *projection* and is definitely *not* a guarantee that the policy will perform in the manner shown in the illustration.

To help assure that illustrations are properly prepared and that they are properly explained to clients, the National Association of Insurance Commissioners (NAIC) has developed a **Life Insurance Illustration Model Regulation**. This Model has been generally adopted by the states. Both insurers and agents have **responsibilities** with respect to preparing and using illustrations as described in the Model.

When an illustration is used with a policy, it must show a guideline rate to be illustrated for the **indexed crediting strategies** shown in the illustration. Insurers may use **alternative approaches** to developing the guideline rate.

Some insurance companies use an illustrated rate that does not vary by strategy and is not based on historical data, but which has been determined by some other means. There are no industry standards today for developing the guideline rate. For this reason, two different insurers might illustrate the same strategy using different rate caps and eventually credit exactly the same interest. Agents must consider such differences when comparing company illustrations to ensure they are comparing illustrations on the same bases.

FIXED INDEXED LIFE PRODUCTS

Policyowner Understanding of Indexed Life Policy Performance

On the indexed life policy illustration, a **disclaimer** must be included stating essentially:

Historical index performance does not represent future performance of the S&P 500 Index (or other index used), nor past or future indexed interest

In addition to pointing out the disclaimer, it is an agent's responsibility to make clear that the **actual interest credited** to the policy will differ from the illustrated rate. It may be higher or lower, based on the actual index movement.

Policyowner Understanding of Indexed Life Policy Performance

Before continuing, let's be sure certain terminology is clear by reviewing these terms. These definitions are based in part on the National Association of Insurance Commissioners Life Insurance Illustration Model Regulation.

Guaranteed elements are the premiums, benefits, values, credits and charges under a policy of life insurance that are guaranteed and determined at issue.

Non-guaranteed elements are the premiums, benefits, values, credits and charges under a policy of life insurance that are not guaranteed or not determined at issue, and which are subject to change.

Policyowner Understanding of Indexed Life Policy Performance

Life insurance policy illustrations must include a **range of possible results** including guaranteed values, mid-point values, and current assumptions. These results are typically shown for five, 10 and 20 years, and possibly other periods. Showing the range provides a more realistic view of how the policy can be expected to perform.

Guaranteed values are the elements we defined on the previous screen that are established at policy issue and will not change during the policy term.

Mid-point values are values shown on the illustration that result from averaging the current assumption rate and the guaranteed rate as well as policy charges that are at the midpoint between the guaranteed values and the current assumptions.

Current assumptions refer to the figures on the illustration showing the anticipated premium payments and the rates being paid currently by the insurer. Current rates are also referred to as assumed rates or illustrated rates.

FIXED INDEXED LIFE PRODUCTS

Policyowner Understanding of Indexed Life Policy Performance

The NAIC Life Insurance Model Regulation requires that when **non-guaranteed elements** are shown on an illustration, they must be clearly identified as such, and guaranteed values must be shown as well. Information about non-guaranteed elements must include a reference to where the individual can find information about the guaranteed elements.

The model also requires that any "illustration of non-guaranteed elements must be accompanied by a statement indicating that:

a) The benefits and values are not guaranteed;
b) The assumptions on which they are based are subject to change by the insurer; and
c) Actual results may be more or less favorable."

The illustration must also include the following statement or one that is substantially similar:

> "This illustration assumes that the currently illustrated nonguaranteed elements will continue unchanged for all years shown. This is not likely to occur, and actual results may be more or less favorable than those shown."

Policyowner Understanding of Indexed Life Policy Performance

An **in-force illustration** refers to an illustration that is prepared after the policy has been in force for at least a year.

Agents should encourage policyowners to request such an illustration in order to examine the insurer's projections of current and future benefits and values based on current conditions. These are typically available once per policy year, but may be made available by some insurers more frequently.

FIXED INDEXED LIFE PRODUCTS

Policyowner Understanding of Indexed Life Policy Performance

Life insurance policies that use illustrations require the insurer to provide policyowners with **annual reports** of the status of their particular policies. An indexed universal life policy report typically must include at least this **key information**:

- The beginning and end date of the current report period;
- The policy value at the end of the previous report period and at the end of the current report period;
- The total amounts that have been credited or debited to the policy value during the current report period, identifying each by type (e.g., interest, mortality, expense and riders);
- The current death benefit at the end of the current report period on each life covered by the policy;
- The net cash surrender value of the policy as of the end of the current report period;
- The amount of outstanding loans, if any, as of the end of the current report period; and either
    - For fixed premium policies: If, assuming guaranteed interest, mortality and expense loads and continued scheduled premium payments, the policy's net cash surrender value is such that it would not maintain insurance in force until the end of the next reporting period, a notice to this effect shall be included in the report; or
    - For flexible premium policies: If, assuming guaranteed interest, mortality and expense loads, the policy's net cash surrender value will not maintain insurance in force until the end of the next reporting period unless further premium payments are made, a notice to this effect shall be included in the report.

In addition, indexed policy reports include information about all of the individual segments currently in place for the particular policy, and how the above information applies to each segment.

FIXED INDEXED LIFE PRODUCTS

Policyowner Understanding of Indexed Life Policy Performance

The **annual statements** are provided once each year on the policy's anniversary date. For this reason, any given report will show only the earnings credited to the various segments during that policy year.

Policies such as indexed policies that have a number of variable elements should be monitored on a regular basis to determine if the policy is performing as desired. Because non-guaranteed elements can change, agents must be aware of the **importance of annual follow-up** with the policyowner.

Delivery of the annual statement is a prime opportunity for agents to follow up and be certain the policyowner understands the significance of the report.

FIXED INDEXED LIFE PRODUCTS

Policyowner Understanding of Indexed Life Policy Performance

The agent must be able to help the policyowner read and understand how an indexed life insurance policy performs through the **full contract disclosures** required by law. Here are some of the key points.

The contract must fully disclose (and agents must be able to explain) the application of **excess interest credits**…how the performance of each index is calculated and how the insurer's participation rate and cap rate affect the index gain that is added to each segment.

Depending on the type of policy, the amount of the **death benefit** may or may not be guaranteed. The policy must be clear about the circumstances under which a guaranteed death benefit amount will be paid. Of course, there must always be a death benefit in order for the policy to retain its insurance character. As you know, depending on the death benefit option selected, there is the potential, but not a guarantee, for the death benefit to increase.

Policyowners must be made aware of the **liquidity** options available to them through policy loans and surrender of the policy. They must also know the consequences, positive and negative, of such measures.

Some disclosures are included with the illustration. As a result, when an illustration is used, a **signed illustration** must be obtained. Both the policyowner and the agent must sign the illustration summary/signature page.

SUITABILITY & MARKETING PRACTICES

NAIC Suitability in Annuity Transactions Model Regulation

The NAIC Suitability in Annuity Transactions Model sets forth some specific and detailed **duties of insurers and insurance producers** with regard to the sale of annuities, including these:

- An agent who recommends that a consumer purchase or exchange an annuity resulting in another or a series of insurance transactions must have reason to believe the recommendation is suitable based on information provided by the consumer.
- Before executing the transaction, the insurer or producer must attempt to acquire information about the consumer's suitability. Suitability information includes age; income; financial situation and needs, including resources used to fund the annuity; financial experience, objectives and time horizon; intended use of the annuity; existing assets, including investments and life insurance; liquidity needs; liquid net worth; risk tolerance; and tax status.

Sagicor expects producers to complete a suitability assessment on each transaction, annuity or life.

SUITABILITY & MARKETING PRACTICES

Importance of Determining Client Suitability for Annuity Products

Why is it so important for producers to **determine client suitability** for indexed products? Aside from the fact that there is a legal requirement to do so for annuity products, it is vital for producers to **gather information** about their potential clients and **use that information before recommending a purchase** because certain features of indexed products make them more suitable for some clients than for others.

Gathering and thoroughly analyzing the required information can help reduce the chance that legal issues will arise from clients who decide they were not adequately informed before purchasing indexed products.

Importance of Determining Client Suitability for Annuity Products

While it is true that suitability is important in any insurance product transaction, indexed products in general operate somewhat differently from traditional products, and annuity products specifically include some complex features.

Insurers typically provide **guidelines** and **suitability questionnaires** for producer use in making suitability determinations.

A **consumer's financial status** begins with information about both available income and liquid assets.

Income is any money that the individual receives on a regular basis.

Liquid assets are any assets owned by the individual that are readily convertible to cash.

However, just determining the amount of income and assets the potential client has is not enough. How money is currently being used and whether it is adequate to make additional purchases is the key to suitability with respect to finances. Remember, with annuities, surrender charges apply if the owner should need access to the funds in excess of any free withdrawal provision before the surrender charge period expires. In addition, withdrawals can trigger penalties before the owner reaches age 59½.

Importance of Determining Client Suitability for Annuity Products

The consumer's **tax status** is also important during the annuity accumulation period and at payout during the distribution period. During the accumulation period, the higher the tax bracket, the more valuable the tax deferral is.

Another step toward making a suitable recommendation is determining the consumer's **investment objectives**. Along with this consideration is measuring the individual's **risk tolerance**. In some cases, the desired objectives and the tolerance for risk are not compatible.

Another important element is the individual's **time horizon**—that is, how much time does the individual have to accomplish the objectives? For example, if a prospect will need to begin using the money being considered for premium payment within perhaps as soon as 12 months, an annuity is definitely *not* suitable—surrender charges will erode the principal. On the other hand, an individual who hopes to leave account values untouched for 20 years or more might be a candidate for either an annuity or a life insurance policy (depending upon how other suitability characteristics come into play).

Importance of Determining Client Suitability for Annuity Products

The individual's **age** is another relevant piece of information, including whether the prospective client is in the **pre-retirement** or **post-retirement** stage of life.

Rather than a specific number of years, think of pre-retirement as some period before the individual intends to retire from his or her employment, and therefore has several income-earning years remaining. Post-retirement refers to the number of years an individual might live without earning income.

The issue of age can be especially pertinent with respect to the surrender charge period in an annuity. An older person might be more likely to die than to survive this period. In this case, the annuity is certainly not a good idea for an older individual who will need the funds for income sooner than the end of the period. In addition, some contracts do not waive surrender charges even if the individual dies, so the charge would be deducted before the proceeds pass along to any beneficiaries.

With this type of information analyzed along with other suitability data such as investment objectives and risk tolerance, it's possible to determine what products are and are not suitable for a particular client.

SUITABILITY & MARKETING PRACTICES

Importance of Determining Client Suitability for Annuity Products

The law requires records to be kept with respect to any insurance transaction, and **complete record keeping** is especially pertinent with indexed products, which are subject to many structural factors. In addition, records of questions asked and answered (or answers refused by the applicant) are important in the suitability determination and potentially in defense of the agent's recommendations.

States typically require that information used in making insurance transactions be kept for a specific number of years, perhaps 10, after the transaction was completed. Insurers, general agents, independent agencies and producers must keep records.

Importance of Determining Client Suitability for Annuity Products

Replacement involves the surrender, forfeit, lapse or termination of an old policy and the purchase of a new one. **Exchange** is the tax-free exchange of one annuity contract for another, also known as a 1035 exchange.

A new contract may be beneficial if it offers more investment options at less expense than the consumer's current contract. The new contract might also offer enhanced death or living benefits.

However, some agents have recommended unsuitable replacements or exchanges in the past, so these transactions are now subject to a higher level of scrutiny. Therefore, it is very important for producers to determine client suitability for any replacement or exchange of an annuity or life insurance policy.

Importance of Determining Client Suitability for Annuity Products

The producer must consider whether the **exchange or replacement** will subject the consumer to:

- a surrender charge,
- the commencement of a new surrender period,
- the loss of existing benefits, or
- increased fees or charges for riders and similar product enhancements.

The producer must weigh any of the above negatives against any real benefit the consumer would gain through product enhancements and improvements in the new annuity contract.

In order to determine client suitability for any **exchange or replacement**, the producer is required to make reasonable efforts to obtain and review the consumer's suitability information.

The producer should also consider whether the consumer has had another annuity exchange or replacement (in particular, another such transaction within the preceding 36 months).

Producers may only recommend a replacement or exchange if, after evaluating the consumer's finances, needs, and risk tolerance, the producer determines such a replacement or exchange is in the consumer's best interests.

SUITABILITY & MARKETING PRACTICES

Needs-Based Selling for Life Insurance

Whether indexed or not, life insurance should never be sold unless the producer has determined there is actually a need for life insurance.

Needs-based selling means that, no matter what financial expectations an individual might have for an indexed life insurance policy, the primary purpose of the policy is to provide life insurance to fill a need. If there is no demonstrable need for life insurance, it is probably not appropriate.

Two important elements of needs-based selling that every producer must examine are:

- **Financial underwriting issues**…does the individual have unmet financial needs that can be satisfied by the purchase of a life insurance policy and does the individual have discretionary income or assets to purchase the policy?
- **Insurable interest**…does the individual purchasing the policy have an insurable interest in the life of the person to be insured? That is, will the individual suffer a loss if the insured person should die prematurely?

Answering these questions will help establish the need for the life insurance protection being recommended and whether or not the policy is suitable for the individual involved.

SPECIAL ISSUES FOR SENIOR CONSUMERS

Product Complexity

As the life expectancies of seniors in the U.S. continue to expand, the **complexity of insurance products** being offered to older consumers has come under close scrutiny by insurance regulators.

While not strictly a concern for older people, there is some evidence that seniors, more than the younger population, need and want a full explanation of any product being considered. They want—and are entitled to—a clear understanding of the advantages and disadvantages before they make a purchasing decision.

SPECIAL ISSUES FOR SENIOR CONSUMERS

Product Complexity

Because insurance products have become quite complex—and indexed products are certainly an example of that complexity—seniors must look to insurance professionals for information. Producers must, therefore, be prepared to explain the many facts included in this training course, and ask the proper questions to be certain prospective purchasers understand.

For example, on the surface, the idea supporting an indexed annuity seems fairly simple: Instead of settling for a conservative declared interest rate, the owner can link to an equity index that has a greater chance of earning at an increased rate. On this basis, there is essentially no downside—no chance of losing principal as would be the case with the actual purchase of equities.

However, you've learned that there is nothing simple about indexed products. They include numerous moving parts and structural elements that can greatly impact the interest crediting for indexed products. Prematurely withdrawing money or surrendering all or part of an indexed annuity or a life insurance policy can trigger substantial penalties.

It is elements such as these that producers must pay special attention to when explaining how products work and in making the required disclosures to consumers.

SPECIAL ISSUES FOR SENIOR CONSUMERS

Buyer Competence

Buyer competence is an issue that is more likely to arise with older senior consumers. People joke about short-term memory loss, but the joke is based on the demonstrated fact that memory appears to suffer as people grow older. However, dramatic memory loss is typically associated with disease such as Alzheimers and dementia, not normal aging. Often, people who recognize they have some memory loss and compensate for it in some way do not necessarily have a disease.

Whether the condition is serious enough to question the buyer's competence is a medical decision, but anyone can probe to make at least a preliminary judgment. Insurance producers must make a concerted effort to do so when they are explaining insurance products to seniors.

If you have any doubt about an individual's ability to understand what you are selling, don't recommend the sale without consulting the insurer.

SPECIAL ISSUES FOR SENIOR CONSUMERS

Ethics & Compliance Issues

Insurers and producers have become accustomed to dealing with both **ethics and compliance issues** with respect to marketing their products. State legislatures and the courts increasingly require certain minimum requirements to be met in relationships such as insurance transactions, where fiduciary responsibilities are significant.

The letter of the law, of course, is not the only consideration. Again, state insurance departments have increasingly recognized the need to deal specifically with the ethical aspects of insurance transactions. Many states now have a separate ethics study requirement for insurance producers.

These issues are important in any transaction. However, insurance producers should be very careful in transactions with older consumers and ensure that their ethics are never questionable. Older people are more vulnerable to being taken advantage of by unethical agents. In most cases, such agents have been found not only to have behaved unethically but also illegally. The penalties can be severe, including large monetary fines and imprisonment.

NOTE TO STUDENT

Take the Final Exam Now

REMEMBER:

1. To fulfill Sagicor's company-mandated training requirement, please complete the exam and your results will be sent to our Agent Training Department. If you have any questions regarding this or any other Sagicor training requirement, please call us at 888-SAGICOR (724-4267).

   WARNING: **PRINT, SIGN & DATE YOUR RESULTS PAGE AT THE CONCLUSION OF THIS EXAM… Your printout will serve as the ONLY proof of completion in the event our automated notification system fails.**

2. Active X and/or Flash add-on may be required. Depending on your browser and security settings, you may see a Security Warning dialogue box. If so, click “Install” or “Allow” to install the appropriate add-on.

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