Life and SPIA Market Update

SEAC

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Overview of presentation

- Life market
  - Sales results and key issues
  - Interest rate levels
  - AG 38 developments
  - Product issues
  - Regulatory topics
- SPIA market
  - Key drivers of competitiveness/profitability

Life Market

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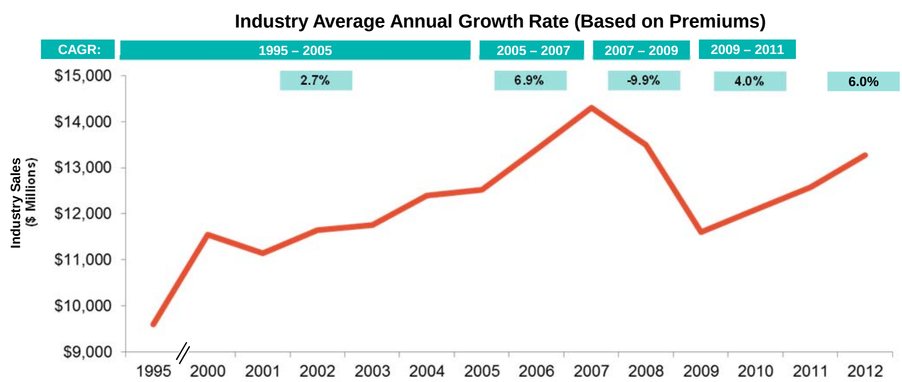
SALES RESULTS & KEY ISSUES

After a significant decline in 2007-2009, life insurance sales have increased steadily (but not spectacularly)

- Increases generally 4% a year since 2009, jumping up to 6% last year
  - Sales growth by premium have consistently outpaced sales growth by face amount/number of policies (not shown), indicating that sales growth is coming from premium oriented policies



Source: LIMRA International Market Trends, TW analysis. Based on first-year (weighted) premium; 100% of planned ongoing premium plus 10% of single premium

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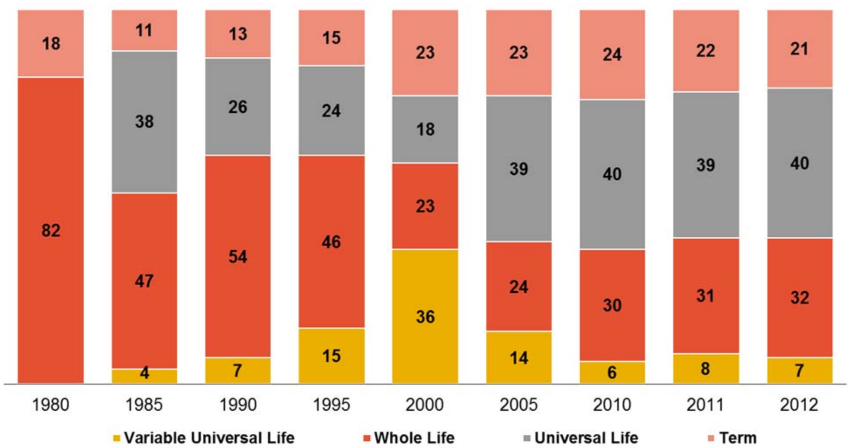
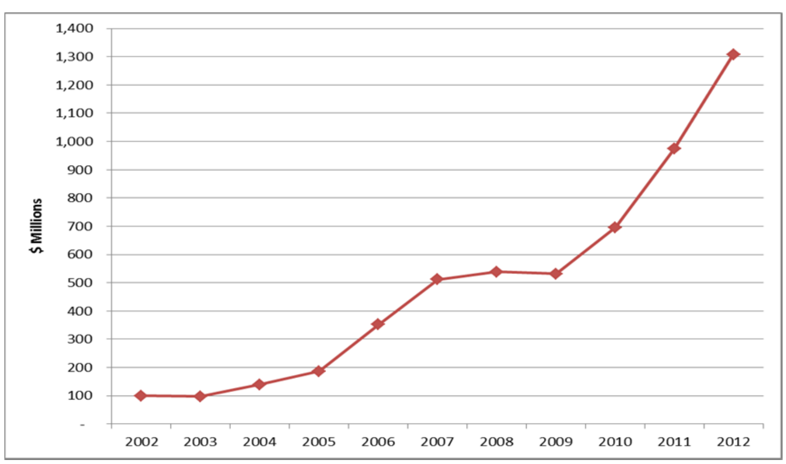
UL products continued to dominate market share of new sales by premium; 2013 YTD results show relatively consistent growth in all product types with VUL an outlier at 13% growth

Market Share of Individual Life Insurance by Product Type (Percent of Total FY Premium)



Source: LIMRA International. Based on first-year premium. UL includes Indexed UL. Results based on policies issued would be significantly different.

IUL sales have shown substantial growth in the last decade, including a 35% year of year increase in 2012 sales

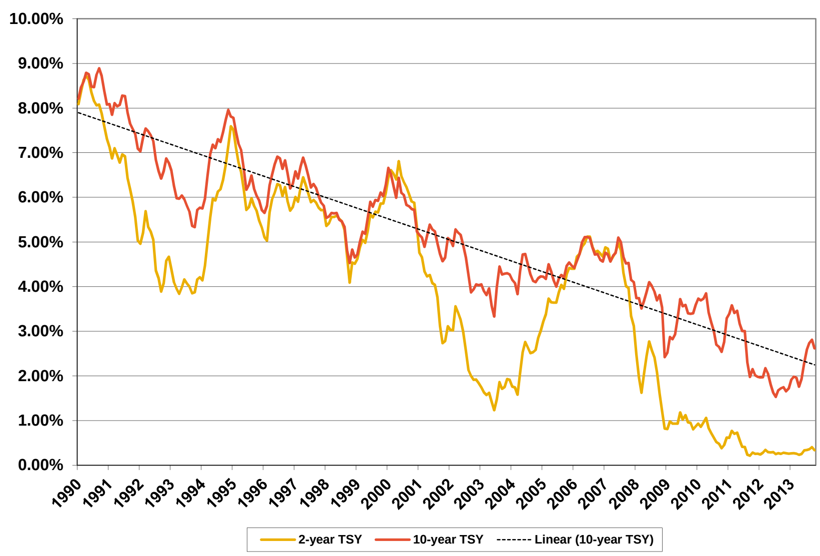


Source: AnnuitySpecs.com's Indexed Sales & Market Report, 4rd Quarter 2012 and previous 4th qtr reports

Key issues

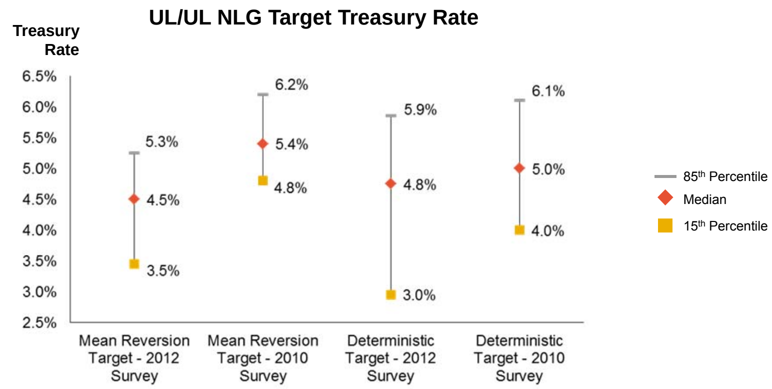
- Although life sales have increased recently, overall sales levels have still not reached pre-GFC levels
  - Institutionally motivated sales have diminished, not offset by increased retail sales
- Americans continue to be underinsured
  - Life coverage is at lowest levels in 50 years
- Traditional distribution approach tilts towards selling to (often older) Americans with financial assets
  - Industry has not found an efficient way to connect with younger, less affluent Americans; alternative approaches (i.e., social media, no bodily fluids) may present opportunities
- Regulatory challenges are ongoing
- Industry is reliant on guarantees
  - Business requires redundant reserve financing
  - Double edged sword with lower interest rate levels

U.S. Treasury rates had generally been trending down for 20+ years; now have moved back up – still relatively low



INTEREST RATE LEVELS

Per the 2012 Towers Watson Pricing Methodology Survey, the median 10-year Treasury rate target used in projecting expected profits for UL and UL NLG is higher than current levels, but is lower than previously assumed

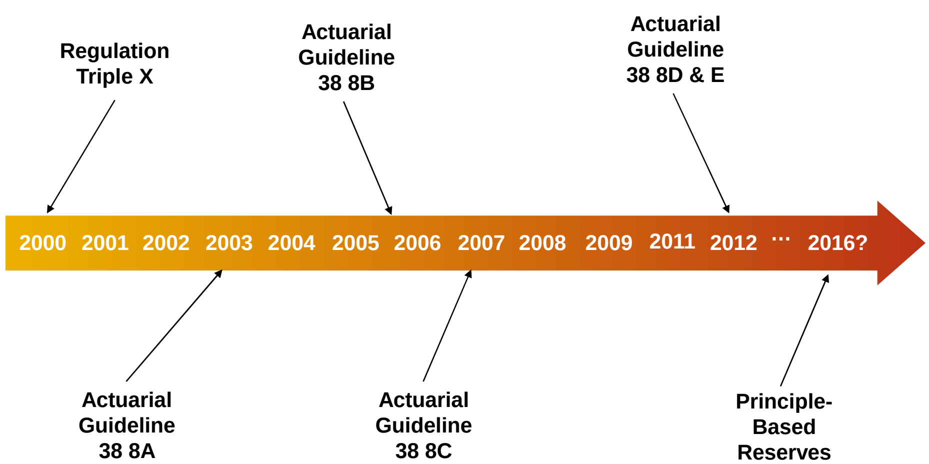


"Mean reversion target" is used for stochastic projections, while the "Deterministic target" is the ultimate rate used for single, deterministic projections. Compared to 2010's Survey, the median mean reversion target has decreased by 0.9% and the median deterministic target has decreased by 0.25%.

The average grading period to achieve the ultimate rate for single, deterministic projection is 12 years (ranging from five to 30 years) based on 80% of respondents; 20% of respondents use a level rate throughout the projection.

AG 38 DEVELOPMENTS

Reserve requirements for UL NLG products have changed over time, and have generally been increasing



In 2012 the NAIC adopted another revision to AG 38 to, once again, address perceived loopholes resulting from certain product designs

- The trend toward multi-fund shadow fund designs and the emergence of Term UL in 2009 drew regulatory scrutiny on reserve requirements
- Specifically, the focus of the scrutiny was on the methodology used to determine the minimum gross premiums in Step 1 of AG 38
  - Which set of rates and charges should or were intended to apply for this determination?
- In 2011 the NAIC formed a commissioner level joint working group to address the issues surrounding AG 38
- The proposal developed by the working group and adopted by the NAIC employs a bifurcated approach:

Section 8D which applies to certain policies issued prior to 1/1/2013	Section 8E which applies to new policies issued on or after 1/1/2013

The revisions to AG 38 posed challenges for UL NLG writers

- Section 8D
  - Required companies to get up to speed quickly on VM-20 assumption setting
  - Required companies to interpret and apply constraints to investment earnings
  - Significant additional modeling, calculations and documentation needed to meet year-end reporting requirements
  - It was anticipated that additional reserves would be required
    - In general, has not materialized
- Section 8E
  - Carriers needed to re-design and re-price products that were negatively impacted by Section 8E in very short timeframe
    - Led to somewhat of a bifurcation of market (next slide)
  - Increased need for reserve financing

An important development is that NY is opting out of the revision to AG 38. This leaves its future uncertain.

PRODUCT ISSUES

AG 38 8E has already had an impact on NLG premium rates and composition of competitors

Top 20 Single Life Non-Indexed UL NLG Premiums
Male Best Nonsmoker 65, $1 Million Face Amount

Statistic	Jan-08	Jan-09	Jan-10	Jan-11	Jan-12	Jan-13
25th Percentile	19,042	18,693	18,796	18,863	18,985	19,116
Median	19,189	18,892	19,184	19,098	19,523	20,151
75th Percentile	19,496	19,024	19,725	19,753	20,120	24,893
Mean	19,219	18,730	19,307	19,348	19,679	22,624
% change	**Jan-08**	**Jan-09**	**Jan-10**	**Jan-11**	**Jan-12**	**Jan-13**
25th Percentile	-1.0%	-1.8%	0.6%	0.4%	0.6%	0.7%
Median	-1.2%	-1.5%	1.5%	-0.5%	2.2%	3.2%
75th Percentile	-1.6%	-2.4%	3.7%	0.1%	1.9%	23.7%
Mean	-1.5%	-2.5%	3.1%	0.2%	1.7%	15.0%

Source: Blease Research's Full Disclosure Reports, Towers Watson analysis

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PRODUCT ISSUES

The term market remains very competitive as there have been some targeted price decreases

20 Year Level Term - Top 20 premiums
Male Best Nonsmoker 45, $500,000 Face Amount

Statistic	Mar-11	Jun-11	Sep-11	Mar-12	Aug-12	Sep-12	Mar-13
25th Percentile	616	617	615	615	620	620	619
Median	622	620	620	620	622	620	620
75th Percentile	645	623	626	630	630	630	625
Mean	636	624	628	623	622	623	621
% Change							
25th Percentile		0.1	-0.3	0.0	0.8	0.0	-0.2
Median		-0.2	0.0	0.0	0.2	-0.2	0.0
75th Percentile		-3.4	0.5	0.6	0.0	0.0	-0.8
Mean		-1.9	0.7	-0.8	-0.1	0.1	-0.3

Source: CompuLife, Towers Watson analysis

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PRODUCT ISSUES

Appeal of IUL

- Policyholder attractions
  - Greater upside potential than typical UL currently crediting 2.00% - 4.50%
  - Cap rates in neighborhood of 10%+, leveraging off of portfolio yields
  - High current illustrated index credits, based on historical averages (e.g., 8%)
  - Attractive minimum credited rates – either cumulative or annual (e.g., many in the 2%-3% range)
  - Less risk than VUL due to underlying guarantee floor
  - Performs well in “choppy” equity markets
- Can work for either accumulation or protection focused sales
  - Historically an accumulation sale, but long-term no-lapse guarantee (“NLG”) feature allows it to compete for the protection sale as well
- Had been more limited competitors than traditional UL, but growing quickly

REGULATORY TOPICS

Regulatory issues

- Valuation Manual is now going through the state legislative approval process, before becoming operative
- Valuation Manual will become operative on January 1st following the first July 1 in which both of the following occur:
  - Adoption by 42 states (out of 56 jurisdictions, or 75%); known as the supermajority
  - Adoption by enough states that represent at least 75% of industry direct premiums in 2008
- The close NAIC vote could foreshadow issues or delays with adoption. In particular, due to the state premium test, rejection by only one or two other large states (in addition to NY and CA) could halt the process
- The earliest operative date is probably January 1, 2016
- However, companies may continue to use existing reserve requirements for up to three years following the operative date

SPIA Market

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Key drivers of SPIA pricing

- Investment yield
- Mortality
- Profit targets
- Capital + reserves
- Expenses

Based on a recent survey we undertook, we found that companies generally fall into one of three categories on their investment approach

- The three categories are as follows:
  - Commercial Mortgage – Companies with a significantly higher concentration of commercial mortgages, generally about twice the average allocation
  - Alternative Assets – Companies with significantly higher concentrations of alternative assets (asset backed securities, structured assets, equity and emerging market bonds) and often higher MBS/CMBS allocations
  - Investment Grade Bonds – Companies with a higher concentration of Investment grade bonds and below average allocations to commercial mortgages and alternative assets
- The table below illustrates the average allocation for each group of companies

Asset Class	"Com Mortgage"	"Alternative"	"Inv Grade Bond"	Total
Public IG Bonds	45.0%	38.9%	73.1%	51.3%
Private IG Bonds	17.4	14.8	9.0	14.2
High Yield	3.5	5.7	2.9	4.0
Com. Mortgages	26.8	9.6	12.2	17.7
MBS/CMBS	3.6	10.8	2.8	5.4
Alternative	2.9	15.3	0	5.6
Other	0.8	5.0	0	1.8
Total	**100.0**	**100.0**	**100.0**	**100.0**

- Those companies in the first two categories generally had higher levels of assumed net spreads

There are several components of companies' SPIA mortality assumption

- Base table/HMI
  - Annuity 2000 (Basic) is most common, bring up to today with HMI
  - Multiples (≠100%) can be employed
  - Would calibrate to experience (as available)
- Selection factors
  - Somewhat surprisingly, most companies do not reflect selection on life contingent business
- FMI
  - Typical (but not universal) to reflect, often for lifetime of projections
  - Variety of scales used: G2, G, AA, internal

A few observations on Annuity 2012

- Based on experience of 2000-2004
  - Brought up to 2012 with HMI
- An amalgamation of experience was reflected, limited by typical SPIA issue ages (e.g., 60-80)
  - Various companies (16)
  - Immediate annuities + annuitization + settlement options
  - Life only + life with certain
  - Qualified + non-qualified
  - All durations
  - Various size bands
- Use of generational FMI (G2) for FMI

Annuity 2012 will be required for valuation purposes in future, but companies may decide to use modified versions for pricing