

*The Whole Story
of
Whole Life*

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The Whole Story of Whole Life

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The Whole Story of Whole Life

Executive Summary

Whole life is the most versatile financial instrument ever devised for the protection of families and businesses and the creation and enhancement of wealth. To appreciate the great value of this type of life insurance protection this paper explores how it works, its uses, its benefits and the options you have in structuring a contract to meet your specific needs, and why Guardian is the company of choice.

How Whole Life Insurance Works

Introduction

Whole life is an insurance policy that provides lifetime insurance protection with **significant guarantees** and **tax benefits** for the policyowner. These guarantees can be viewed as either **rates** or **values**. When actuaries design a whole life policy, they begin by determining what rates are going to be guaranteed. Once the guaranteed rates have been set, they are used to determine policy premiums and values. Guaranteed rates and values are based upon conservative assumptions. A mutual life insurance company, such as Guardian, will then adjust the rates and values to current conditions through the mechanism of a non-guaranteed **dividend**. Because life insurance is viewed as good for the benefit and welfare of society, significant **tax benefits** have been given to it that are not found in other financial instruments.

Guaranteed Rates

A whole life policy is built upon a foundation of three guaranteed rates:

- ❑ The guaranteed **mortality** rate – this guarantee comes from the 1980 CSO table, a table of guaranteed mortality rates that are required by insurance regulations.
- ❑ The guaranteed **interest** rate – this rate, for Guardian policies, is 4.0% for the entire life of the policy.
- ❑ The guaranteed **expense** factor – an allocation for expense that is covered in guaranteed values.

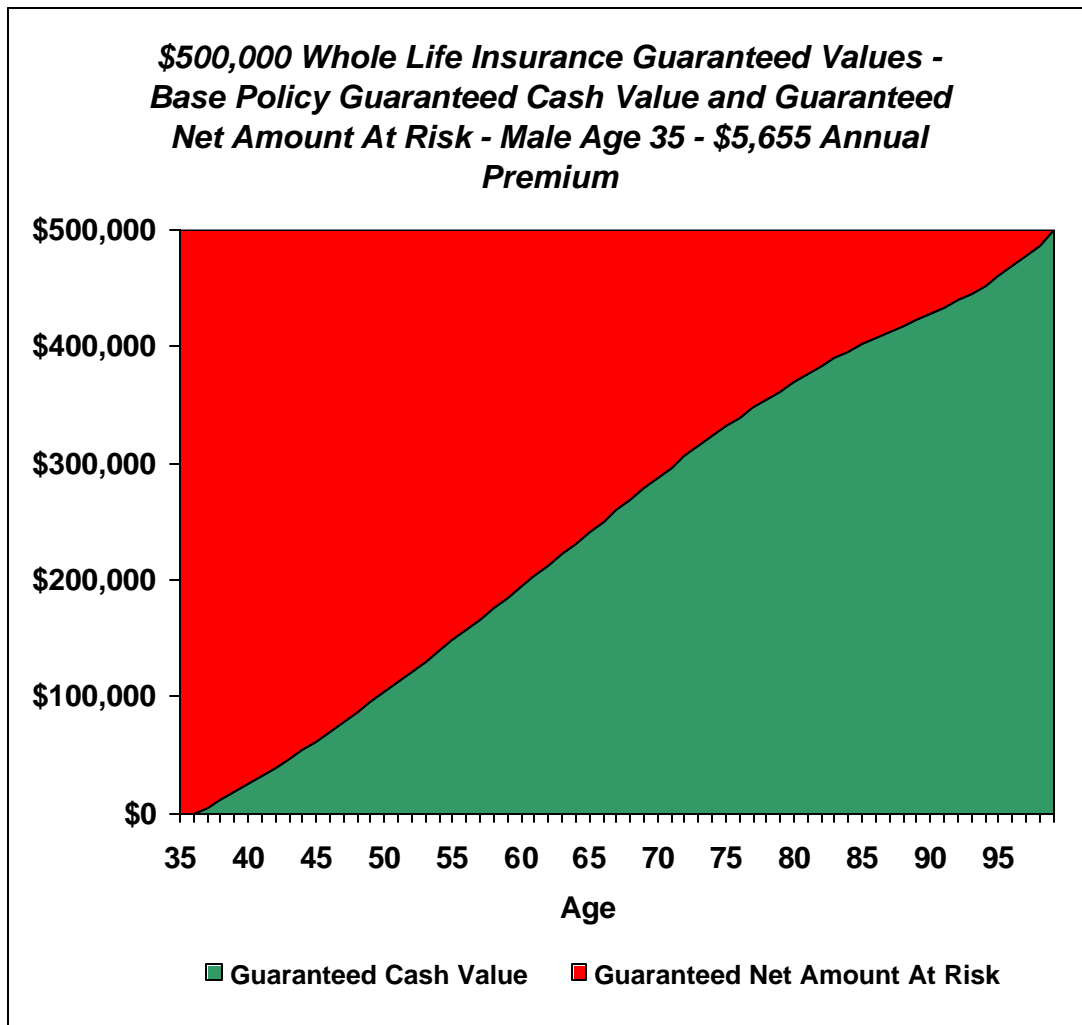
Guaranteed Values

The three guarantee rates are combined in an actuarial formula that results in three guaranteed values: the **premium**, the **death benefit** and the **cash value**. These three guaranteed features set whole life policies apart from all other types of financial instruments. Whole life insurance has a:

- ❑ Guaranteed **Level Premium** – The annual premium is contractually guaranteed to never change.
- ❑ Guaranteed **Death Benefit** – The level death benefit is contractually guaranteed never to go down.
- ❑ Guaranteed **Cash Value** – The contractually guaranteed cash value grows each year until it is equal to the face amount of the policy at a specified age, usually age 100.

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The graph below illustrates the guaranteed values of a whole life insurance policy without any dividend values. The Guaranteed Death Benefit of \$500,000 is a combination of Guaranteed Cash Value and Guaranteed Net Amount At Risk¹. Year by year the Guaranteed Cash Value increases until it is equal to the face amount of the policy at age 100.



¹ Net Amount At Risk is the difference between the policy death benefit and the cash value.

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Dividends

Whole Life offers the ability to provide value *in excess of its guarantees* through dividends. Dividends are paid to the policyholders if declared by the Board of Directors. When dividends are declared they have three components:

- ❑ The insurance company's investment *rate of return in excess of the guaranteed return* promised in the policy,
- ❑ Mortality *experience which is better than that which is guaranteed* in the policy, and
- ❑ Expenses of policy administration which are *less than the cost guaranteed* in the policy.

The graph on the next page illustrates how a whole life policy can grow in value with paid-up-additional insurance purchased with dividends.

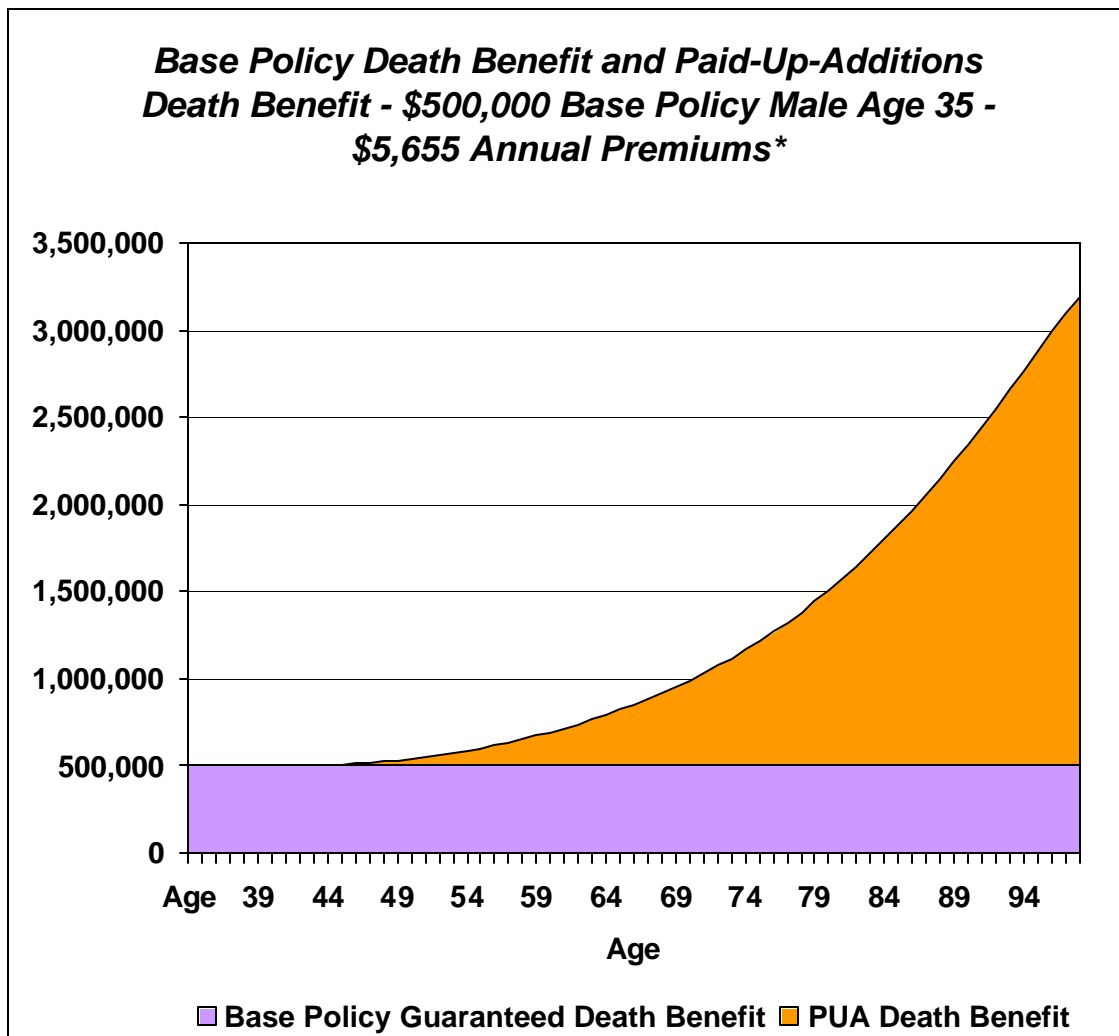
Dividend Options

Policyowners may choose from among a variety of dividend options in order to customize their coverage to meet their specific needs. The dividend option may be changed year by year to address the changing lifetime needs of the policyowner.

- ❑ By far the most widely selected dividend option is to apply dividends to purchase Paid-Up-Additions (PUA). A Paid-Up-Addition is guaranteed permanent paid-up participating life insurance. *This option provides the policyholder with a growing cash value and death benefit that is guaranteed once purchased.* Under this option, each year as dividends are declared, more and more PUAs are purchased which in turn earn their own dividends. Over time, the accumulation of PUAs will offset the effects of inflation by providing a greater level of death benefit protection and accumulated cash values.
- ❑ Dividends may be paid in cash to the policyowner.
- ❑ Dividends may be used to reduce the premium.
- ❑ Additional term insurance may be purchased with dividends.
- ❑ Dividends may be allowed to accumulate with interest.
- ❑ Dividends may be used to pay back an existing loan on a policy.

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The graph below illustrates how the death benefit of a whole life policy can grow in value with Paid-Up-Additional Insurance purchased by dividends.



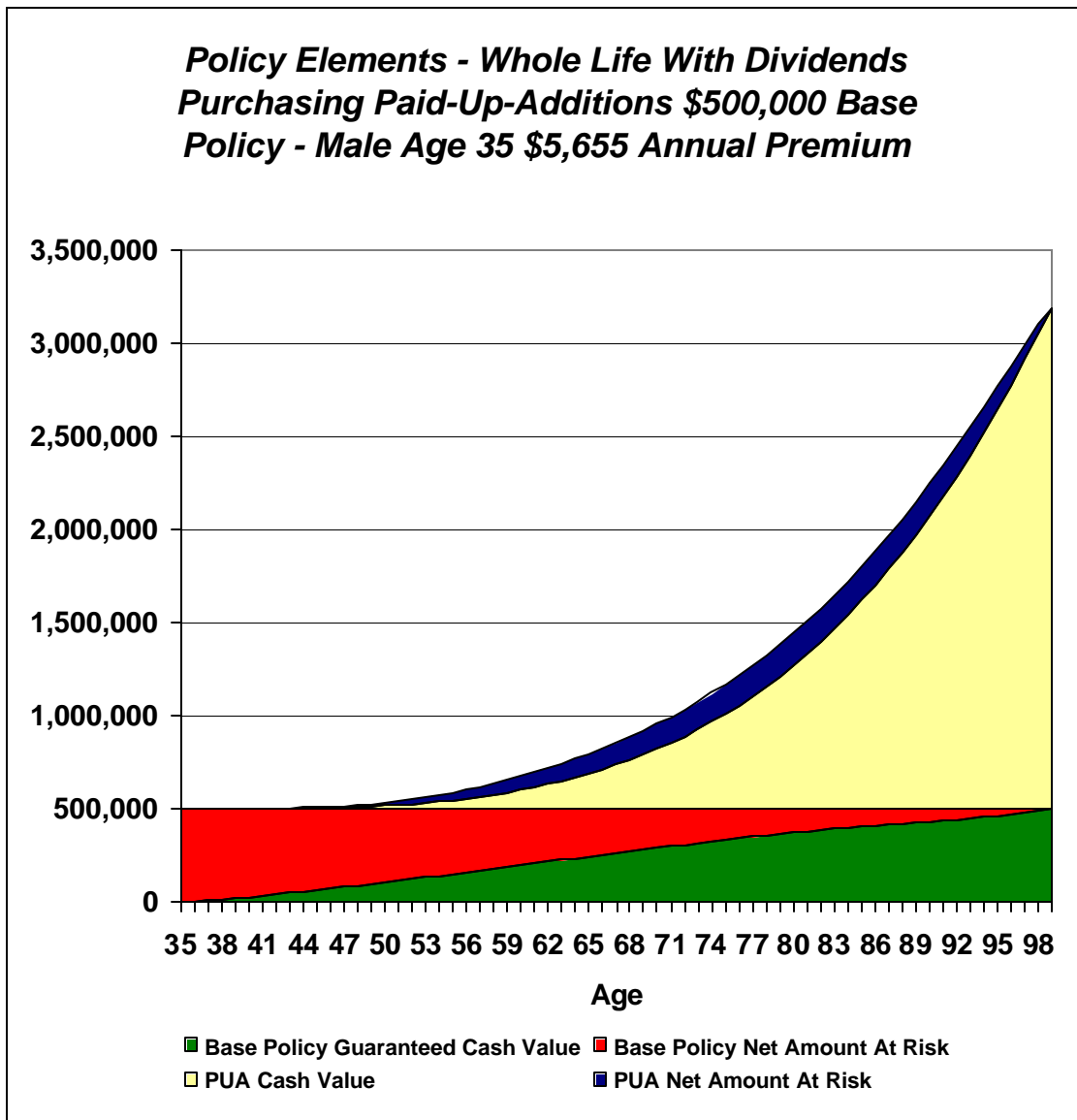
**Based on the 2005 Dividend Scale. Dividends are not guaranteed and may vary from year to year. Guardian has paid dividends to its policyholders every year since 1868.*

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The graph below illustrates the four elements of a whole life policy;

- ❑ The base policy guaranteed cash value,
- ❑ The base policy net amount at risk,
- ❑ The paid-up-addition cash value, and
- ❑ The paid-up-addition net amount at risk.

These four elements constitute the total death benefit of a whole life policy.



**Based on the 2005 Dividend Scale. Dividends are not guaranteed and may vary from year to year. Guardian has paid dividends to its policyholders every year since 1868.*

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Taxation Protection

The contribution that life insurance makes to the welfare of society by providing protection for surviving family members has resulted in it being vested with the following significant tax benefits:

- ❑ ***Income tax free death benefits.***
- ❑ ***Tax-deferred build up of cash values*** inside of the life policy.
- ❑ ***Access to policy values on a tax favored basis.***
 - The cash values of life insurance policies may generally be accessed on a tax-favored basis by the withdrawal of dividends or through policy loans.
 - Withdrawal of dividends from a life insurance policy is permitted on a First-In First-Out Basis (FIFO). This means that the first dividends paid out to the policyowner are considered a return of cost basis¹.
 - All of a policy's cash value may be borrowed from a policy without the triggering of income tax on any gain that has been borrowed from the policy.

Uses for Whole Life

Whole life insurance provides a means by which families and businesses may enjoy the benefit of their human life value when it is threatened by loss.

- ❑ **Human Life Value Protection** – Property values whether they exist in the context of a family or a business are in fact the result of human effort. Human life value is clearly seen in a family whenever income is earned to provide for the economic needs of the family. Human life value is clearly seen in a business where a key person is often identified as a significant contributor to revenue and earnings.

Whole life insurance provides a means by which an individual may insure their human life value.

Solomon Huebner defines Human Life Value as

the capitalized monetary worth of the earning capacity resulting from the economic forces that are incorporated within our being: namely, our character and health, our education, training, and experience, our personality and industry, our creative power, and our driving force to realize the economic images of the mind.²

Most people see the importance of insuring the value of property such as their home or car for its replacement value and are able to do so with their casualty insurance. The human

¹ Cost Basis is the investment that is made in a life insurance policy. The formula for cost basis is the aggregate amount of premium paid on a base contract and permanent benefits under the contract, or other consideration paid for the contract *minus* the aggregate amount received under the contract, to the extent such amount was excluded from gross income.

² S.S. Huebner, *The Economics of Life Insurance*, page 5, (Executive Asset Mgmt. 3rd ed. 1996) (1927)

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life value of an individual, which is by far the most valuable asset of a family or business, is also insurable for its replacement value on a permanent basis with whole life insurance. Whole life insurance provides an affordable effective way of permanently indemnifying a family or business against the loss of its most valuable asset.

There are many benefits that a family may enjoy from the production of income such as the purchase of a home, rearing and education of children and the enjoyment of life. The indemnification of the breadwinners in a family will ensure that these benefits will continue to the survivors in the event of death.

- **Family Protection** – The death benefits of life insurance can assure the economic continuity of a family at a time when it is faced with the greatest of all possible traumas, the death of a beloved father, mother, husband or wife. Whole life insurance can also assure financial stability through the funding of:
 - Mortgage protection,
 - Education funding, and
 - Income needs.

- **Business Protection** – Businesses face special insurance funding needs in order to provide a business continuity plan that will protect the owners in the event of death. Whole life insurance is ideally suited to provide the capital needed to adequately buy the interest of a deceased owner and indemnify the business against the loss of the services, expertise and skill of a key man. Life insurance is ideally suited to address three major areas of business planning:
 - The funding of buy-sell agreements and stock redemption plans,
 - Funding of supplemental retirement programs, and
 - Key man indemnification.

- **Estate Planning** – Planning for the orderly transfer of property at death can minimize taxes and provide for heirs in a way that will reflect an individual’s desires. Whole life insurance plays a key role in providing for loved ones by offering:
 - Adequate liquidity to pay estate and inheritance taxes,
 - Assets to generate income for a surviving spouse and children,
 - Estate equalization amongst heirs, and
 - Funding for special needs children.

- **Asset Maximization** – One of the unique benefits of whole life insurance is the way that it enhances the value of other assets in your estate. The presence of guaranteed whole life insurance gives the owner the ability to use estate assets in ways that would not be possible if the insurance did not exist. Whole life is the “permission slip” that may enable you to maximize retirement income and your personal net worth. For example:

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- **The Power to Consume** – The presence of whole life insurance in your estate will allow other assets to produce greater income by providing access to the principal as well as interest as a source of income. Life insurance gives the owner the power to consume assets that would otherwise have to be managed in an ultra-conservative fashion in order to preserve the principal and the income stream it produces.
- **Pension Maximization** – Most retirees will select a joint and 50% survivor annuity as the retirement income option on their pension plan. The cost of selecting this option is a lower retirement income, as much as 15%, followed by an income to the surviving spouse of 50% of the lowered retirement income. The presence of permanent whole life insurance may enable a retiree to take a much higher retirement income in the form of a single life annuity because the insurance benefits will be available to a surviving spouse as a future source of income.
- **Charitable Remainder Trust** – The cost of successfully building a business or managing a personal investment portfolio is often measured by the enormous capital gains tax that must be paid when a business owner looks to sell a business interest or portfolio holdings in order to fund retirement income. Often financial success brings with it a desire to express benevolence towards those charitable causes that are of particular interest. With a charitable remainder trust, these two seemingly diverse needs and desires can meet in a plan that provides:
 - A lifetime income for a benevolent donor,
 - A substantial bequest to a charity of choice,
 - Avoidance of the capital gains tax, and
 - Significant income tax deductions.

The existence of permanent whole life insurance in the estate of a donor makes it possible to achieve the desired charitable intent with all the collateral benefits while providing an intact transfer of estate assets to heirs.

The Benefits of Whole Life Insurance

- **The Protection of an Instant Permanent Estate** – Instantly with the payment of the first premium, Guardian sets aside the entire death benefit for your family. Whole life insurance provides a guaranteed death benefit for the entire life of the insured.
- **Disability Protection** – Life insurance is uniquely different from all forms of savings and investment vehicles such as bank accounts, IRAs, 401(k) accounts, mutual funds, and brokerage accounts because it can continue to grow even if you are disabled. Disability usually brings with it the strain of reduced income, increased expenses and dissolution of existing savings and investment. The Waiver of Premium Rider guarantees that if disabled, you will not lose the umbrella of financial protection provided by a whole life insurance policy. The policy will continue to provide death benefit protection, the cash values will continue to grow and dividends will continue to be paid just as they would if you had not been disabled.

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- ❑ **Liability protection** – In many states the benefits of life insurance are protected from the claims of creditors. If your state provides this legal protection, the cash values and death benefit of a whole life policy will be protected from lawsuits that can claim other assets such as bank accounts, mutual funds and brokerage accounts.
- ❑ **Distribution like a will** – Life insurance is distributed like a will in that you specify who and how much of the benefit will be distributed to each beneficiary. Unlike a will, however, life insurance has the added benefit of privacy. Wills once probated become public documents. The beneficiary distribution of life insurance is a private, contractual agreement between the policyowner and insurance company that passes outside of a will and thus provides privacy for the beneficiary.
- ❑ **Tax-free death benefit** – The death benefits of life insurance policies are free from all Federal Income taxes. The enormous value of this benefit must not be underestimated, especially in light of constantly growing government expenditures and taxes.
- ❑ **Tax-deferred growth** –The growth of cash value inside of the life insurance policy is deferred from taxation while the funds remain in the policy. This is yet another wealth protecting benefit for families and businesses provided by whole life insurance.
- ❑ **Tax favorable access to policy cash values through withdrawals of dividends** – During the insured's life, cash values can be accessed under favorable FIFO (First-In-First-Out) tax rules. This means that dividend withdrawals are tax free up to the amount paid cumulatively premium.
- ❑ **Tax favorable access to policy cash values through policy loans** – During the insured's life, loans taken against a life insurance policy will not trigger a taxable event even though the policy may have a large gain in excess of premiums paid.
- ❑ **Self-funding** – You have the option of having the policy pay for itself over time by applying dividends to pay premiums. This feature may be invoked or changed at any time to meet the changing circumstances of your life.
- ❑ **Ability to invest cash value in growth securities** – Policy values are always available via a policy loan and may be used for a variety of reasons including investment in growth securities.
- ❑ **Ability to pay itself back from anticipated earnings** – Once a policy loan has been taken, the annual dividend can be used to help pay back a policy loan.
- ❑ **You can make direct loans to yourself for any reason** – Cash values can be accessed on a demand basis via a policy loan at any time and for any reason without the application and approval process that is required for consumer or business loans. Whole life insurance can then free a policyholder from reliance upon commercial lenders and high interest rates.

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- ❑ **Flexible loan repayment terms** – Life insurance policy loans are flexible to the extent that *they do not need to be paid back unless you decide to pay them back*. Once a loan is taken out on a policy it can be paid back at the option and discretion of the policyowner. When a policy loan is paid back, there will be a commensurate increase in the death benefit of the policy which may be reborrowed at a future date or paid out to the beneficiary.
- ❑ **Death benefit increase** – When dividends are used to purchase paid-up-additions, death benefits will grow, helping offset the eroding effects of inflation. Once a dividend has purchased paid-up-additions, the additional death benefit and cash value of the paid-up-additional insurance is guaranteed.

Types of Whole Life Insurance

There are several types of whole life insurance which are designed to provide flexibility and options in the structuring of an insurance program:

- ❑ **Level Premium Whole Life** – This is the most popular type of whole life insurance and it offers a guaranteed level premium to age 96 or 100. The level premium structure makes the policy ideally designed to provide affordable lifetime insurance coverage. The guaranteed level premium structure gives the policyowner peace of mind, because regardless of what happens in a volatile world, the premium will not change.
- ❑ **Limited Payment Whole Life** – This type of policy has a fixed level premium like a *Fixed Premium Whole Life* policy but the premium is only payable for a fixed period of time. The most popular plans are *Life Paid-Up at Age 65* and *20 Payment Life*. The advantage of these limited payment policies is that they are guaranteed to be paid-up at the end of the payment period. Thus they allow valuable insurance coverage to continue for the insured's entire life without any payment required at later ages and throughout retirement.
- ❑ **Graded Premium Whole Life** – This type of policy starts out with a low initial premium which increases incrementally for a period of years. This type of policy is well suited for those who have a growing income and a desire to purchase valuable permanent coverage with an affordable premium.

Whole Life Insurance Gives You Options

Whole life insurance as offered by Guardian has many riders that may be added to a policy in order to customize the coverage for your specific needs. Some of the more popular riders are:

- ❑ **Waiver of Premium** – protects you in the event of disability by paying the premium. Because the premium will be paid, cash values will continue to build, dividends will continue to be paid and the financial security afforded by a whole life policy will permanently stand as a sentinel protecting you and your family.

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- ❑ **Enhanced Accelerated Benefit Rider** – allows you to accelerate the benefits of a whole life policy for chronic and terminal illnesses. In the event that you become chronically ill, a portion of a policy's death benefits may be accelerated during your lifetime if you are permanently unable to perform two out of six Activities of Daily Living (ADL's) or if you become permanently cognitively impaired.
- ❑ **Guaranteed Purchase Option (GIO)** – gives the owner the right to purchase additional insurance on the insured's life without evidence of insurability. There are up to eight option dates on the anniversaries nearest the insured's 25th, 28th, 31st, 34th, 37th, 40th, 43rd, and 46th birthdays and/or upon marriage, the birth or adoption of a child. The GIO option becomes all the more valuable in the event of disability.

An insured who is disabled and has their premium waived under the Waiver of Premium rider may exercise the GIO rider on the option dates and Guardian will pay the premium on the new policy as well as on any existing policy(ies) that have the Waiver of Premium rider.

- ❑ **Enhanced Paid-Up-Additions Rider**– gives the owner the right to purchase paid-up participating insurance on the owner's life. The real benefit of this rider is that it gives premium flexibility so that you may add varying amounts of premium to a whole life policy. The greater the premium paid into a policy the greater will be the protection afforded by the policy, the greater will be the guaranteed cash value, and the greater will be the tax deferred accumulation of cash values and dividends.
- ❑ **Renewable Term Rider** – purchases ten-year renewable and convertible level term insurance.
- ❑ **Accidental Death Benefit** – can be added to a policy to provide an additional death benefit in the event death occurs by accidental bodily injury. The benefit will be doubled if the injury is sustained while a passenger in a public conveyance.

Why Guardian?

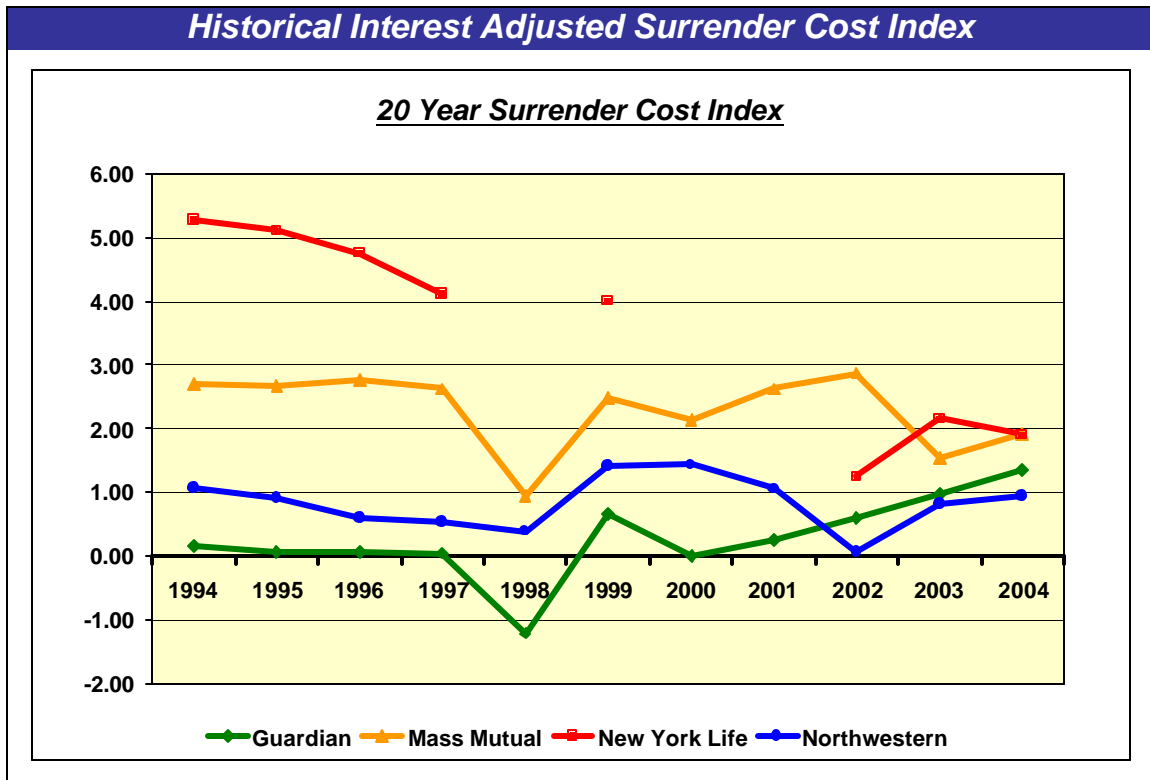
- ❑ **Quality Company** – Guardian is recognized by all the major rating agencies as a company that provides superior financial strength. The table below shows Guardian's ratings from each of the five major rating agencies. The numbers to the right of the rating shows the rank of the rating out of the total number of possible ratings for each rating agency.

Guardian Ratings			
Rating Agency	Rating	Rating Rank	Total Possible Ratings
AM Best Company	A+	2	15
Standard & Poor's	AA	3	20
Moody's	Aa2	3	21
Fitch	AA	3	24
Weiss	A	2	16
Ratings are current as of January 1, 2005			

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- ❑ **Mutual Company** – Guardian is proud to be one of the few remaining major mutual insurance companies in the nation. We are owned by our policyholders who share directly in our annual earnings. We have no stockholders expecting dividends, immediate returns or short-term growth. Guardian has no stock and thus no stock options exercisable by senior management that can sap away the financial vitality of the company. Guardian is committed to its status as a mutual life insurance company and is here to provide policyholder insurance needs, now and far into the future.
- ❑ **Solid History** – Founded in 1860, we have paid out dividends to our policyholders *every* year since 1868. As a mutual company we have been able to provide one of the lowest net costs on ordinary life coverage over the past twenty years, while still retaining a solid financial position. The Surrender Cost Index table below demonstrates how Guardian has consistently delivered exceptional value to its policyholders year after year.

The 20 Year Interest-Adjusted Surrender Cost Index is a method of comparing the cost of similar types of life insurance policies. The graph and table below illustrate the historic surrender cost index for the four major mutual life insurance companies in the United States. The index takes into consideration the fact that money spent on premium dollars could have been invested elsewhere and earned a 5% return after tax. As can be seen in the graph Guardian has had the lowest 20 year surrender cost index in eight out to the past eleven years. The lower the Surrender Cost Index the better the buy.



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20 Year Interest Adjusted Surrender Cost Index Data								
Year	Guardian		Mass Mutual		New York Life		Northwestern	
	20 Year Interest Surrender Cost Index	Percent of Policies Issued ¹	20 Year Interest Surrender Cost Index	Percent of Policies Issued ¹	20 Year Interest Surrender Cost Index	Percent of Policies Issued ¹	20 Year Interest Surrender Cost Index	Percent of Policies Issued ¹
Male Age 45 - Best Rate Class - Non-Smoker - \$250,000 Face Amount - Source: Blease Research								
2004	1.34	56.2%	1.91	55.3%	1.90	100.0%	0.93	22.0%
2003	0.97	59.0%	1.53	57.7%	2.15	100.0%	0.81	22.0%
2002	0.59	41.8%	2.87	47.3%	1.24	N/A ²	0.06	1.0%
2001	0.24	39.0%	2.62	45.0%	N/A ²		1.05	24.0%
2000	0.00	45.0%	2.14	46.0%	N/A ²		1.43	21.0%
1999	0.66	34.0%	2.48	80.0%	4.00	N/A ²	1.41	18.0%
Male Age 40 - Best Rate Class - Non-Smoker - \$100,000 Face Amount - Source: Blease Research								
1998	-1.21	27.0%	0.94	13.0%	N/A ²		0.39	16.0%
Male Age 45 - Best Rate Class - Non-Smoker - \$50,000 Face Amount - Source: Best's Historical Survey								
1997	0.04	26.0%	2.62	17.7%	4.11	N/A ³	0.53	21.0%
1996	0.06	30.0%	2.77	8.0%	4.75	73.0%	0.59	17.0%
1995	0.06	18.1%	2.67	8.0%	5.10	N/A ³	0.91	17.0%
1994	0.16	19.5%	2.69	9.0%	5.27	N/A ³	1.07	17.0%

1. The life policies issued as a percent of all policies issued by the company upon which the surrender index cost is based.

2. New York Life did not submit data for the Full Disclosure Dividend History Survey in the 1998, 1999, 2000, 2001 and 2002.

3. New York Life did not submit data to Best's for the Percent of Policies issued upon which the surrender index was based in 1994, 1995, and 1997.

Sources: A.M. Best Historical Survey 1994 -1997. Blease's Full Disclosure Whole Life Report 1998 - 2004.

This material was prepared for the purpose of educating the reader. It should never be used as an argument for the replacement of any life insurance product. Dividends are not guaranteed.

Past performance is not indicative of future results.

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Concluding Note

The protection and wealth-enhancing benefits of whole life insurance make it the most comprehensive financial tool available today. Its great value is enhanced by its flexibility enabling it to be customized for a variety of consumer needs. Premium flexibility is provided by premium and dividend options. The loan feature and the ability to withdraw dividends provides readily available liquid assets. Together, the guaranteed cash value, guaranteed death benefit and guaranteed premium provide a solid foundation for financial protection and the building of wealth in a turbulent and uncertain world.

We would like to acknowledge Robert Castiglione and his company, LEAP Systems, Inc. for their educational contributions to our industry and for promoting many of the topics discussed in this report. Specifically, LEAP's unwavering use of the Human Life Value concept and how the living value provided by the death benefit of a whole life policy can be presented. Guardian agents who elect to use the LEAP system will find much of this material consistent with the LEAP training that they have already received.