

What they don't tell you about Participating Fixed Loans

As the IUL market expands, we've learned that not all IULs are created equal. Loan provisions are a perfect example.

One of the newest features on the market is the participating fixed loan. This is much like a variable rate loan in that loaned funds continue to earn index interest credits. Unlike variable rate loans, however, participating fixed loans charge a fixed rate of interest, instead of a rate that can vary.

While this sounds good in theory, there is a potential cost to this benefit that may not be revealed until much later. Here is an explanation.

Step #1: Understand how indexed credited rates are supported. Assume an IUL product has \$100,000 in the 1-Year Point-to-Point Strategy.

- A.** The company takes that \$100,000 and buys a traditional investment, like corporate bonds, that provide an interest return of, say, 5.2%, in line with the rate on the Moody's Corporate Bond Yield Index.
- B.** Aviva gets quotes from investment banks to purchase a 1-Year Point-to-Point option cap. A 12.25% cap, such as exists on Lifetime Builder, would cost about \$5,200 for the policy in this example.
- C.** The bonds purchased by the company in A. provide a 5.2% rate of interest, or \$5,200, which the company uses to buy the cap option listed in B.

Step #2: The policyholder takes out a \$20,000 policy loan.

- A.** For Variable Rate Loans and Participating Fixed Loans, the loaned funds continue to earn interest credits. However, neither company has access to that \$20,000 to buy the bonds needed to pay for the option cap.
- B.** Instead, the companies use the loan interest charged to the policyholder to buy the option cap on the \$20,000.

Step #3: Here is where Variable Rate Loans and Participating Fixed Loans differ.

Loan type	Variable Rate Loan	Participating Fixed Rate Loan
How Loan Interest Rate is determined	Linked to Moody's Corporate Bond Yield Index	Fixed Rate determined by the company. A typical industry rate is 5.5%
If Moody's Corporate Bond Yield Index remains at 5.2%...	Carrier's loan rate to the policyholder is in line with corporate bonds rates and sufficient enough to pay for the strategy's option cap.	Carrier's fixed loaned rate to the policyholder is in line with corporate bonds rates sufficient enough to pay for the strategy's option cap.
If Moody's Corporate Bond Yield Index rises to 8%...	Carrier's loaned rate to the policyholder will increase to be in line with corporate bond rates and will be sufficient enough to pay for the strategy's option cap.	Carrier's loaned rate is fixed at 5.5% and will not provide enough interest to pay for the strategy's option cap.
The bottom line	The company can have the same interest earnings on all \$100,000 to buy the same cap regardless of how much is loaned out.	The company likely will have to lower the cap rate in order to bridge the gap between the interest earned on non-loaned funds and the interest charged on the \$20,000 loaned funds.

Why does this matter? The illustrated rate used when you sold the policy was developed assuming the cap wouldn't change. A participating fixed loan puts that assumption at risk. What's more, **the potential decline of the cap rate will affect the entire Account Value, not just the loaned funds.**

At Aviva, we know what matters to you and your clients. Our experience and expertise allows us to design products that provide value regardless of interest rate movements.

Aviva USA. The Leader in Indexed Universal Life.

For Agent Use Only. Not for use with the general public.

This information is not intended to be a comprehensive evaluation or comparison of different products. It is intended to provide comparative information on specific aspects of similar products. Competitor information is current and accurate to the best of our knowledge as of October 10, 2011. Product features and rates vary by state and are subject to change.

This comparison isolates features of the product depicted – Loan provisions. Customers should always consider all features and limitations of products they are considering.

Lifetime Builder III [2ECG10] is issued by Aviva Life and Annuity Company, West Des Moines, IA.