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EXPERT REPORT AND OPINIONS

Irving H. Blumenthal, Jr., individually and on behalf of all similarly situated insureds of New York Life Insurance and Annuity Corporation (NYLIAC),

v.

New York Life Insurance and Annuity Corporation:
Case No.: 5:08-cv-00456-F

Actuarial Review of the Design, Illustrations and Post-Issue Performance of NYLIAC Policy Purchased by Irving H. Blumenthal, Jr.

Prepared By:

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February 2, 2010

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Introduction

I have been asked by counsel Phillip Stano to provide an actuarial review of and expert opinion on the New York Life Insurance and Annuity Company (NYLIAC) life insurance policy purchased by Mr. Irving H. Blumenthal, Jr. Mr. Blumenthal purchased a "Protector" Universal Life Insurance Policy, Policy Form number 62 776 533 (the Policy) from NYLIAC on June 12, 1999.

This report is presented in four sections. The first section provides background on universal life insurance with specific attention to the design of such policies and the competitive and regulatory environment that existed in the late 1990's. The second section presents an analysis of the illustrations provided to Mr. Blumenthal before he purchased coverage from NYLIAC and the illustration that was provided along with the delivery of his policy in June of 1999. The third section addresses how Mr. Blumenthal's policy was administered and illustrated by NYLIAC from policy issue up to the date the coverage lapsed in 2008. Finally, the fourth section provides a review and rebuttal of the report prepared by David M. Sanderford, J.D.

Conclusions

After a review of the Policy, the illustrations provided, the subsequent Policy performance, and the other materials listed in Attachment A below, I came to the following conclusions:

1) The Policy purchased by Mr. Blumenthal performed in a manner that was consistent with the illustrations NYLIAC provided before issue, at policy delivery and while the Policy was in force.

2) The potential for lapse of the Policy was not concealed or misrepresented. Indeed, all of the Policy illustrations and the Policy Annual Summary provided each year the Policy was in force were entirely consistent in indicating the same approximate estimated date when coverage would lapse.

3) The reduction in credited rates on the Policy was not an intentional result of an attempt by NYLIAC to hasten policy lapse, as Mr. Blumenthal's expert suggests, but were consistent with declines in the investment earnings of NYLIAC and the entire insurance industry.

4) The Policy was not negligently designed for the purpose for which it was being sold, but was an appropriately designed death benefit Universal Life product.

5) At the time the Policy was issued, Oklahoma had adopted the NAIC Life Insurance Illustrations Model Regulation (see OKLA. ADMIN. CODE §§ 365:10-3-50 to 365:10-3-62 (1997) ("Oklahoma Regulation")), which requires an annual certification from NYLIAC's illustration actuary. This actuarial

certification supports the conclusions above that the Policy was not negligently designed and its characteristics were properly described and illustrated pursuant to the Oklahoma Regulation.

6) The following comments, analyses and conclusions of Mr. Blumenthal's expert are incorrect:

   a. The Policy was negligently designed for the purpose it was being sold.

   b. New York Life and Marlin (agent) were negligent in failing to disclose all relevant and material facts concerning the Protector universal life insurance product that was recommended.

   c. The decline in the Policy credit rates was not representative of historical interest rates over the same period of time.

   d. NYLIAC knew that it would (even when NYL earnings from operations were increasing) degrade the credited rate to Protector policies.

   e. On a current basis, credited interest comes from the insurer's "Gain from Operations" – which is made up of (a) investment gains, (b) mortality gains, (c) surrender gains, and (d) "loading" gains

   f. Lower credited interest would accelerate the policy's lapse, and Blumenthal would forfeit and remaining cash value at lapse.

   g. That a 15 year level premium $1,000,000 term policy for a 67 year old male (at Mr. Blumenthal's "tobacco" rating) would have been about 40% of the cost of the risky and costly Protector.

Section 1 – Background on Universal Life Insurance

Universal Life Insurance (UL) has been available since the late 1970's. Basically defined:

> Universal life insurance is a flexible-premium, adjustable-death-benefit life insurance policy. UL policies offer flexible, potentially low-cost coverage on a basis that permits transparency. After making an initial premium payment of at least some required minimum, policyowners may thereafter pay whatever amounts and at whatever times they wish, or even skip premium payments as long as the cash value will cover policy charges, subject to company rules and the tax law. Also, policyowners may raise – or lower their policies' death benefits as they deem appropriate with a minimum of difficulty. These are two key elements of UL flexibility.
>
> UL policies offer the potential for low-cost coverage. Most UL polices provide for interest credits based on contemporary rates of interest subject to a specific guaranteed minimum rate. In addition, the current mortality charges associated with the pure insurance element can be low. UL policies expense components are often lower than charged under traditional policy forms, but not always. Together these elements mean that UL policies are capable of affording policyowners low-cost coverage.
>
> UL policies are transparent in their operation. The policyowner is able to see exactly how the policy operates internally. An illustration is provided to prospective purchasers describing how policy elements – premiums, death benefits, interest credits, mortality charges, expenses, cash values – interact. Each year the policyholder receives similar information in the form of an annual report, …[1]

Because the flexibility of UL policies gives the policyholder premium options through time, the insurance company provides the policyholder information – through policy illustrations, the policy form and annual correspondence – showing how the flexibility in premium funding enjoyed by the policyholder affects the duration of coverage. The policyholder then has the responsibility to review the information provided by the insurance company and take advantage of the premium flexibility to extend or reduce how long he or she may want coverage to last.

Over the last 15 years there have been two key developments in the universal life landscape, which are:

i. The NAIC Life Insurance Illustration Model Regulation; and

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[1] KENNETH BLACK, JR. AND HAROLD D. SKIPPER, JR., LIFE INSURANCE 85 (11th ed. 1987).

ii. Product specialization.

NAIC Life Insurance Illustration Model Regulation

During the high interest rate period in the 1980s the insurance industry heavily marketed and sold what came to be known as "Vanishing Premium" insurance products. These products were generally nothing more than participating (dividend paying) or interest sensitive whole life policies. However, with the high interest rate spike in the economy during the 1980s these fixed premium contracts could be illustrated using assumptions that would lead to the conclusion that the policyholder need only pay a few of the annual required premium payments and then the dividend or interest crediting mechanism of the contract would fund the policy until death or maturity. Unfortunately policyholders sometimes did not understand how these policies worked, or that the "vanishing premium" effect was dependent upon the continuation of unusually high market interest rates. Ultimately interest rates began to decline in the late 1980s and into the 1990s causing a large number of these "vanished" premiums to reappear. Some policyholders alleged that they believed "vanish" was guaranteed and thus were surprised and angered when made aware it was not. The litigation that ensued cost the insurance industry millions of dollars in claims and a considerable hit to the previously lofty reputation it enjoyed among the public.

In response to the consumer protection and regulatory concerns associated with "vanishing" premium products and other alleged sales abuses, the National Association of Insurance Commissioners (NAIC) issued the Life Insurance Model Regulation in 1995[2]. This regulation, now the law in most states, has become the governing legislation that impacts how life insurance policy guaranteed and current values are illustrated to potential and current policyholders. Section 1 of the Model Regulation, which defines its purpose, reads as follows:

> The purpose of this regulation is to provide rules for life insurance policy illustrations that will protect consumers and foster consumer education. The regulation provides illustration formats, prescribes standards to be followed when illustrations are used, and specifies the disclosures that are required in connection with illustrations. The goals of this regulation are to ensure that illustrations do not mislead purchasers of life insurance and to make illustrations more understandable. Insurers will, as far as possible, eliminate the use of footnotes

[2] Many of the reference materials listed in Mr. Sanderford's report relate to the "vanishing" premium problem and are therefore of little relevance here because Mr. Blumenthal's policy was sold after introduction of the regulation that addressed the "vanishing" premium issue. Moreover, Mr. Sanderford fails even to mention the Model Regulation and its incorporation into the insurance law of Oklahoma prior to the transaction at issue in this case.

> and caveats and define terms used in the illustration in language that would be understood by a typical person within the segment of the public to which the illustration is directed.[3]

Thus, the Model Regulation and the Oklahoma Regulation were specifically designed to address inadequacies that had previously sometimes occurred in life insurance illustrations and to prescribe standards that would ensure that illustrations would not be misleading.

In order to enforce this regulation, an insurance company is required to certify annually that its illustrations are in compliance with the regulation. These certifications are signed by a trained actuary who holds a company board appointed position known as the "illustration actuary," whose role is defined as follows:

> The illustration actuary shall certify that the disciplined current scale[4] used in illustrations is in conformity with the Actuarial Standard of Practice for Compliance with the NAIC Model Regulation on Life Insurance Illustrations promulgated by the Actuarial Standards Board,[5] and that the illustrated scales used in insurer-authorized illustrations meet the requirements of this regulation.[6]

The disciplined current scale is a set of assumptions that constitutes a limit on illustrations by requiring, among other things, that they be reasonably based on actual recent historical experience as certified annually by an illustration actuary designated by the insurer. Stated another way, the disciplined current scale is intended to be the most aggressive set of assumptions regarding non-guaranteed elements that can be used in testing the policy illustrations for compliance under the Model Regulation. The assumptions must be reasonably based on the company's recent historical experience, which means that variant assumptions, such as future mortality improvement, cannot be used, even though mortality rates tend to improve over time.

Some of the assumptions that go into the disciplined current scale include:

1. Investment return.
2. Mortality.

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[3] National Association of Insurance Commissioners, *Life Insurance Illustrations Model Regulation* § 1 (adopted 1995); Oklahoma Regulation § 365:10-3-50.

[4] Disciplined Current Scale definition from *Life Insurance Illustrations Model Regulation* § 2D; Oklahoma Regulation § 365:10-3-52.

[5] Also known as Actuarial Standard of Practice (ASOP) No. 24, *Compliance with the NAIC Life Insurance Illustrations Model Regulation*, Actuarial Standards Board (December 1995, revised February 2007).

[6] Section 11B of *Life Insurance Illustrations Model Regulation;* Oklahoma Regulation § 365:10-3-59(b).

3. Annual lapse rates.
4. Expenses, which include commissions, other company expenses, and taxes.

While policies may not be illustrated under a set of non-guaranteed assumptions more favorable than the disciplined current scale, they may be illustrated under what is known as the currently payable scale or the illustrated scale. The currently payable scale is defined as a set of non-guaranteed elements in effect for a policy form as of the preparation date of the illustration or declared to become effective within the next 95 days. The illustrated scale is defined as a set of non-guaranteed elements currently being illustrated that is not more favorable to the policyholder than the lesser of (1) the disciplined current scale; or (2) the current payable scale.

Additionally the Model Regulation requires that policies illustrated be "self-supporting" under the disciplined current scale. This means that the revenue, premiums and investment income, less costs, expenses and claims, of the policy must exceed the cash value available to the policyholder. Because most insurance policies have upfront compensation and underwriting costs that exceed first year premium, this test of self-support must be met by policy year 15 (policy year 20 if the contract is a second- to-die design) and every year thereafter. Thus the model imposes a requirement that a policy must ultimately be supported by the revenues directly attributed to that policy.

As a corollary of the self-supported analysis under the Model Regulation, it is further mandated that the policy illustration cannot be "lapse-supported."[7] Lapse-support analysis follows the self-support analysis described above with the exception that the disciplined current scale is revised using the assumption that the lapse rate after the fifth policy year is zero, i.e., that no policies lapse after the fifth policy year. This adjustment in the analysis prevents the insurance company from developing a policy design that requires large numbers of policyholders to lapse in the early policy years to support high, or overly optimistic, policy values to the few remaining policyholders in later policy years.

Thus the Model Regulation has taken away the ability of an insurance company to use in its illustrations overly optimistic assumptions that cannot be proven to be sustainable. This discipline forced upon the industry by the NAIC results in illustrations that have a high degree of integrity.

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[7] Lapse supported policies are designs which typically show exceptional policy values and appear to be an outstanding consumer purchase. Insurers selling lapse supported products implicitly anticipate using the profits from early lapsers to enhance the products' illustrated values. In order for the insurer to avoid substantial financial losses on the sales of such policies, large numbers of issued contracts need to lapse at a point prior to earning those exceptional policy values. If enough policyholders do not lapse, then the insurer either has to revise the policy and not provide those illustrated values or risk falling into an impaired financial condition. The industry regulators rightfully viewed such designs as harmful to policyholders, insurers, and the industry in general and placed specific safeguards to prevent such designs from being illustrated.

The majority of states have adopted the Model Regulation either through legislation or rulemaking by the state insurance department. Oklahoma incorporated the Model Regulation essentially verbatim into its insurance regulations with an effective date of July 1, 1997, OKLA. ADMIN. CODE §§ 365:10-3-50 to 365:10-3-62 (1997).

Compliance with state regulations based on the Model Regulation creates a very strong presumption that the policy illustrations contain proper disclosures, are understandable, and are not misleading. Oklahoma's regulation was in effect when Mr. Blumenthal's policy was illustrated and sold to him in Oklahoma. When it filed the Protector policy form, NYLIAC was required to provide a certification to the Oklahoma Insurance Department by its board appointed illustration actuary that the Protector illustrations satisfy the requirements under the regulation. That certification of compliance with the regulation was signed by NYLIAC's illustration actuary on February 2, 1998.

Product Specialization

For the first fifteen to twenty years that UL was in existence, most insurance companies would have only one or two designs offered to the public at any particular time. Competition naturally led to increased variety and specialization.

This evolution led to two broad categories of UL products in the marketplace. One category of designs was targeted toward low level premium products (also known as death benefit products) and the other category was targeted toward asset-accumulation products (also known as high cash value products). NYLIAC's Protector policy, the policy that Blumenthal purchased, was a death benefit policy; NYLIAC's Accumulator policy was a high cash value policy.

Low level premium, or death benefit, products, as the name suggests, are focused on establishing product design parameters which provide a market competitive premium for the desired death benefit. Since low premiums are the focus of these products, high cash values takes a back seat with this design. The key design elements of a low level premium product are typically low cost of insurance (COI) charges, which might be set at expected mortality plus a small margin, and a policy year based prospective jump in policy crediting rates. This jump in policy crediting rates typically happens at some point between policy years ten and twenty. From the insurance company's perspective this jump in crediting rate is actually a reduction in interest rate spread used to determine the policy crediting rates. For example, if the policy was designed with a 2% interest rate spread, a company earning 7% would be able to credit 5% to the policyholder. At a defined duration, say policy year 16, the company actuary designs the product to require only a 1% interest rate spread, so the 5% credited rate now jumps to 6%. The key to a successful low level premium design is to establish that the present value of future COI charges be as low as possible. By combining lower COI charges with a credited interest rate structure that has been designed to be higher at later policy durations, a company can successfully achieve this goal of having a low present value of future charges.

How does an insurance company profit under a low premium design? Typically higher charges will be embedded in the first few years of the policy, like the higher interest rate spread discussed above. Since lower cash values are typically expected over the longer term of the policy, the interest rate spread will not be generating much revenue for the insurer, so reducing interest rate spread over time typically does not present a financial challenge to the insurance company. A typical design might utilize an interest rate spread of 1.50 - 2.00% prior to a jump in the credited rates, at which time the spread would decline to the 0.25 - 1.00% range, depending on the product design. Also, low cash value means higher amounts at risk (total death benefit minus cash value), so COI charges that have even small loads over the expected mortality can produce sufficient revenue for the insurer. Finally, since COI charges, which are deductions from the cash value for mortality, are kept at lower levels than in other product designs, lower current cash values can actually sustain the policy.

Accumulation designs, as the name suggests, are designed to accumulate cash value within the life insurance policy in part through the payment of higher premiums and in part through higher interest credited rates. The main reason an individual might want to do this within the structure of a life insurance policy is that gains on the policy (i.e., the cash value exceeding premiums paid) is not taxed currently and may never be taxed if the policy is held until death.

While the key design element of an accumulation design should be a higher credited rate, there are other elements that are necessary to create a successful product offering. The next most important element is the structure of the policy loan provision. While accumulation of cash values is important for many individuals, what may be equally important is the ability to spend some of that accumulation during the individual's lifetime. Withdrawals of life insurance cash values in excess of premium paid would normally create a taxable event unless, instead of a withdrawal, a policy loan is done. Policy loans operate like most other loans, in that there is an interest rate that the policyholder is charged for taking the loan. However, the loan is still part of the policy cash value and can continue to receive interest. In most UL designs, the interest rate assessed by the insurance company for taking a policy loan is defined at a 6 - 8% level per annum, but the amount of policy cash value that is backing that loan will be credited at a rate that is 2% less than the policy loan rate[8]. Thus for these policies, taking a policy loan creates a growing amount of debt since the policyholder owes more in interest than he earns on the loaned portion of the cash value. This accumulation of additional debt due to interest is often covered by further policy loans, so that over time a policy might run out of its cash value due to increasing amounts of debt. With an accumulation design product, companies avoid or limit this problem by adjusting the policy loan provision so that the difference between policy loan rates and the credit rate on cash value supporting the policy loan is not 2% but some value between 0% and 0.25%. This reduced spread allows the policyholder to enjoy income from the policy with a reduced risk of policy

[8] For NYLIAC Protector the policy loan rate is 8% and the credited rate on borrowed funds is 2% less than the loan rate or 6%.

lapse, which would occur if the total amount of the policy loan exceeded the policy cash value.

One final element of product design that may differentiate death benefit and accumulation products is insurance agent compensation. For many insurance companies, a goal of aligning agent compensation with targeted policyholder behavior is embedded within their product design. So, for an accumulation design, which generates higher premium payments for the insurer, the agent compensation rate is often higher than what a company might have for its death benefit design product. While there is nothing wrong with aligning agent compensation with the targeted policyholder market, it can lead to situations where an accumulation design might be sold in a death benefit sale situation simply because the agent can generate a higher compensation. In designing Protector and its companion product, Accumulator, NYLIAC opted to take the position that the agent compensation should be structured the same regardless of what product was sold. Since agent compensation is equivalent between both products, this helps assure that the agent will be clearly focused on which design fits the needs of the policyholder.

Based upon the foregoing principles of UL product design, it is very clear that the features disclosed and discussed in NYLIAC's Protector illustrations firmly situate that product's design as entirely appropriate for a death benefit product.

Section 2 –Pre-Issue and Policy Issue Illustrations

The illustrations that Mr. Blumenthal received accurately describe the policy characteristics, economics and operation of the policy.

Initial Illustration

The initial illustration for Mr. Blumenthal was prepared on January 17, 1999 and illustrates a level annual premium of $43,686 dollars for a death benefit of $1 million dollars plus the cash value, assuming that Mr. Blumenthal qualifies as a Standard underwriting risk. Based upon a current credited interest rate of 5.90%, which the illustration shows will jump up 1.25% to 7.15% beginning in policy year 21, the illustration indicates coverage lapsing at some point during the 16th policy year, at a time when Mr. Blumenthal would be 83 years old.

The various definitions and disclosures in the illustration fully satisfy the Model Regulation as well as the Oklahoma Regulation. Also, since this policy was illustrated in 1999 and Oklahoma adopted the Model Regulation in 1997, NYLIAC would have had the illustration actuary prepare a certification indicating compliance with the Model Regulation. Moreover, from that certification and by operation of the Model Regulation as well as the Oklahoma Regulation it can be inferred that the product was not a "lapse-supported" design.

On page 4 of the January 17, 1999 illustration, NYLIAC incorporated a highly descriptive narrative comparing the product design being illustrated, the Protector, and its

other UL product offering, the Accumulator. This narrative makes it clear to potential buyers what kind of policy is being illustrated and provides them with information to determine if the coverage being illustrated meets their goals. The narrative reads as follows:

> This illustration describes the NYLIAC Protector. The Protector is designed to emphasize death protection at a lower cost and may be more appropriate if you are primarily looking for death protection rather than cash value build up. Our other plan, NYLIAC Accumulator, is designed to emphasize the cash value accumulation features of a universal life policy. Under the Accumulator, the policy's cash value builds at a higher current interest rate than under the Protector and it may be more appropriate if you wish to build cash value for use in the future, or to borrow funds. Current costs of insurance, however, are higher under the Accumulator. Ultimately, the product that will work best will depend on a variety of factors, including the amount of coverage you want, the amount of premium you plan to pay and whether you intend to make withdrawals and loans. You should consult your agent to help you understand how both plans work and to select the one that may best accomplish your goals.

It should be noted that in providing this explanatory narrative, NYLIAC was going above and beyond the requirements of the Oklahoma Regulation, as well as common industry practice at the time, to provide the consumer with enhanced information and guidance.

Given that Mr. Blumenthal's initial illustration showed level premium coverage for a limited time period, up until attained age 83, it seems very clear that the illustration properly described the product and informed him that maintenance of coverage after that point would require additional premium.

Illustration Delivered with the Issued Policy

The illustration delivered with the policy on July 20, 1999, and signed by both the agent and the policyholder, Mr. Blumenthal, looks and reads very much like the illustration from January 1999. The major changes are the projected schedule of premium payments and the projected credited interest rates. The interest credited rates increased by 0.25% to 6.15% for policy years 1 - 20 and 7.40% for policy years 21 and later, so the jump in credit rates stayed at 1.25%, which would be expected since it is an integral current assumption in the product design. This increase in credited rates would in effect represent a change in the currently payable scale under the Oklahoma Regulation. The premium payments also increased and are not level by policy duration. The annual premium for the first 5 policy years was set at $53,046 payable on a monthly basis. Beyond the 5th year the annual premium was scheduled to reduce to $48,946 and remain level, which would carry coverage into policy year 17, at which point the illustration indicated coverage would lapse.

The difference in premium levels appears to be tied directly to the Flat Extra Premium that appears on page 2 of the illustration. That amount is listed at $4.10 for 5

years. Since the coverage provided for is $1 million, that flat extra amount computes to be $4.10 x $1 million / 1,000 = $4,100, which is exactly the difference between the annual premium in the first 5 years and the annual premium for years 6 and later. This flat extra premium essentially indicates that, as a result of underwriting, NYLIAC expects individuals who fit Mr. Blumenthal's health and history to exhibit a higher mortality level than the standard insured population, but only for the first 5 policy years. Thereafter mortality is expected to be in line with experience from standard insured risks. The flat extra amount would be expected to be assessed as part of the policy COI charge.

Section 3 – Policy Performance Post Issue

Annual Policy Summary

As required by the Policy, each policy year after the first, NYLIAC provided Mr. Blumenthal with a summary depicting the changes in policy values during the year. The summary always provided an exhibit demonstrating what happened during each month of the year being summarized. Premium payments, COI charges, fees and other charges, and interest earned are shown. In addition to the interest earned, the annual effective rate at which interest is credited monthly is shown.

Along with a monthly retrospective review of policy charges and credits, the summaries always provided projection information that stated the date to which coverage would last, under the following scenarios:

1. Assuming current premium payment levels continued along with the current interest rate being credited and current charges being assessed in the future.
2. Assuming current premium payment levels continued, but policy charges and interest rate credits were assessed at policy guaranteed levels in the future.
3. Same as 1., but assuming premium payments stopped.
4. Same as 2., but assuming premium payments stopped.

The table below summarizes the dates found in each Annual Policy Summary:

	Based on Current Premiums Continuing		Based on Suspending Premium	
Annual Policy Summary Year	Based on Current Credited Rates, Fees, Charges	Based on Guaranteed Interest, Fees, Charges	Based on Current Credited Rates, Fees, Charges	Based on Guaranteed Interest, Fees, Charges
2001	Dec-2016	Feb-2004	Mar-2002	Sep-2001
2002	Nov-2016	Dec-2006	Oct-2004	Apr-2003
2003	Jul-2016	Apr-2008	Oct-2006	Nov-2004
2004	Mar-2016	May-2009	Mar-2008	Mar-2006
2005	Feb-2016	Apr-2010	Jun-2009	Jul-2007
2006	Feb-2016	Feb-2011	Jul-2010	Sep-2008
2007	Feb-2016	Nov-2011	May-2011	Sep-2009

This table clearly demonstrates (second column) that each year NYLIAC consistently informed Mr. Blumenthal that, based upon current assumptions and continued premium payments, coverage would continue until the year 2016, which would translate to either policy year 16 or 17 depending on whether the date was prior to or on or after the month of June (the month the policy became effective). Additionally it should be noted that the projected end date of coverage under the assumption of guaranteed level charges and credits (third and fifth columns) continues to *increase* as the years roll by. This is because each year all the end date projections are based upon starting from the current policy value, which was always higher than the past projected values based on guaranteed projection assumptions of interest credited rates and policy charges. In effect, with each passing year of current assumption growth, Mr. Blumenthal's policy was buying a *better* guarantee.

NYLIAC and Industry Net Yields

Using Best's Insurance Reports and Best's Aggregates & Averages publications I was able to obtain Net Investment Yields for the life insurance industry in general as well as NYLIAC specifically. The table below illustrates those interest rates from 1999 through 2008[9]:

	Net Yield	
Year	Industry*	NYLIAC**
1999	7.25%	7.22%
2000	7.34%	7.50%
2001	7.01%	7.03%
2002	6.55%	6.59%
2003	6.13%	6.12%
2004	5.82%	5.83%
2005	5.78%	5.70%
2006	5.85%	5.70%
2007	5.92%	5.64%
2008	5.57%	5.53%

*Best's Aggregates & Averages
**Best's Insurance Reports

The table above clearly demonstrates that NYLIAC's net yield declined, at a rate consistent with the insurance industry as a whole. This decline in net yield is the driver behind the declining credited rates on Mr. Blumenthal's policy, and not some deliberate action on the part of NYLIAC as suggested by Mr. Blumenthal's expert.

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[9] Data based on BEST'S INSURANCE REPORTS, LIFE-HEALTH, UNITED STATES & CANADA, AM Best Company (2003 and 2009 Editions) and BEST'S AGGREGATES & AVERAGES, LIFE-HEALTH, UNITED STATES & CANADA, AM Best Company (2004 and 2009 Edition).

How does NYLIAC go from the net yield in the table above to the credited rates that were credited Mr. Blumenthal's policy? As discussed in Section 1, the insurance company takes a spread off of the net yields to determine policy credited rates. Furthermore we also know based on all the illustrations provided that beginning in policy year 21 the Protector policy credited rate takes a jump of 1.25% over the credited rate used in policy years 1 – 20. At a minimum that should mean that the credited rate NYLIAC determines is the net yield less 1.25%, which would be NYLIAC's spread for policy years 1 – 20. Actually a spread of 1.25% would leave NYLIAC with a spread of 0% for policy years 21 and later, which would likely cause a problem with compliance with the Model Regulation as well as the Oklahoma Regulation. Based on my experience pricing similar product designs for other life insurance companies I believe that the target spread used to set credited interest rates by NYLIAC during the first 20 policy years is likely to be 2.00%, if not higher. This would leave a spread of at least 0.75% for policy years 21 and later.

Referencing the table of net yields from above, at times when NYLIAC's net yield drops below 6.00% then that credited interest rate that NYLIAC would like to apply, determined by the net yield – 2.00%, is not possible because the contract will not allow the policy credited rate to drop below 4.00%. Since NYLIAC would have liked to have credited a rate below 4.00%, but they were contractually stopped from doing so, this shows that Mr. Blumenthal has received a real economic benefit under Protector's guaranteed interest rate structure in a declining interest rate environment that has been totally unappreciated by Mr. Blumenthal and his expert, Mr. Sanderford.

In Force Illustration

In November of 2006 an in force illustration was provided to Mr. Blumenthal which demonstrates, based on current, mid-point, and guaranteed assumptions along with the current rate of premium payments, how long coverage would be expected to last. The information, with respect to projected coverage end date between current and guaranteed assumptions does not appear to be any different than the information provided by past annual policy summaries, discussed above, and so should not have come as a surprise to Mr. Blumenthal.

The tables below provide a comparison of Mr. Blumenthal's at-issue policy illustration with an illustration comprised of the actual values that emerged through the end of the 8th policy year as culled from the annual policy summaries and the in force illustration projection for policy years 9 and later. This demonstration shows, as stated earlier, that the value of the policy guarantee actually *improved* from the policy delivery illustration, while the current projected basis appears relatively consistent between the two, primarily because the continued payment of the additional premium in years 1 - 5 in

the delivery illustration effectively has offset the decline in credited rates, which was tied to the performance of NYLIAC's investment portfolio.[10]

Illustrated Values at Issue												
			Guaranteed Charges Guaranteed Interest Rate of 4%			Non-Guaranteed Mid-Point Charges / Interest			Non-Guaranteed Current Charges / Interest of 6.15%		
Year	Age	Premium Outlay	Cash Value	Cash Surrender Value	Death Benefit	Cash Value	Cash Surrender Value	Death Benefit	Cash Value	Cash Surrender Value	Death Benefit
1	68	53,046	1,831	0	1,001,831	18,716	0	1,018,716	35,802	9,279	1,035,802
2	69	53,046	0	0	999,949	34,440	0	1,034,440	69,732	21,157	1,069,732
3	70	53,046	0	0	994,011	47,451	0	1,047,451	102,786	54,211	1,102,786
4	71	53,046	0	0	989,490	57,554	8,979	1,057,554	135,282	86,707	1,135,282
5	72	48,946	0	0	984,480	62,698	18,981	1,062,698	163,851	120,133	1,163,851
6	73	48,946	0	0	0	63,609	24,749	1,063,609	190,732	151,872	1,190,732
7	74	48,946	0	0	0	59,408	25,406	1,059,408	215,440	181,438	1,215,440
8	75	48,946	0	0	0	48,426	19,281	1,048,426	235,622	206,477	1,235,622
9	76	48,946	0	0	0	29,830	3,114	1,029,830	250,874	224,157	1,250,874
10	77	48,946	0	0	0	0	0	0	260,523	236,235	1,260,523
11	78	48,946	0	0	0	0	0	0	263,236	241,377	1,263,236
12	79	48,946	0	0	0	0	0	0	256,116	236,686	1,256,116
13	80	48,946	0	0	0	0	0	0	233,123	216,121	1,233,123
14	81	48,946	0	0	0	0	0	0	193,520	178,948	1,193,520
15	82	48,946	0	0	0	0	0	0	136,524	124,380	1,136,524
16	83	48,946	0	0	0	0	0	0	75,012	65,297	1,075,012
17	84	48,946	0	0	0	0	0	0	0	0	0

Actual Values from Annual Statements (Years 1-8 Shaded Data) / Illustrated Values from Reprojection												
			Guaranteed Charges Guaranteed Interest Rate of 4%			Non-Guaranteed Mid-Point Charges / Interest			Non-Guaranteed Current Charges / Interest of 4.00%		
Year	Age	Premium Outlay	Cash Value	Cash Surrender Value	Death Benefit	Cash Value	Cash Surrender Value	Death Benefit	Cash Value	Cash Surrender Value	Death Benefit
1	68	53,046	31,386	4,863	1,031,386	31,386	4,863	1,031,386	31,386	4,863	1,031,386
2	69	53,046	64,914	16,339	1,064,914	64,914	16,339	1,064,914	64,914	16,339	1,064,914
3	70	53,046	97,340	48,765	1,097,340	97,340	48,765	1,097,340	97,340	48,765	1,097,340
4	71	53,046	128,477	79,902	1,128,477	128,477	79,902	1,128,477	128,477	79,902	1,128,477
5	72	53,046	154,434	110,717	1,154,434	154,434	110,717	1,154,434	154,434	110,717	1,154,434
6	73	53,046	181,450	142,590	1,181,450	181,450	142,590	1,181,450	181,450	142,590	1,181,450
7	74	53,046	205,573	171,570	1,205,573	205,573	171,570	1,205,573	205,573	171,570	1,205,573
8	75	53,046	224,654	195,509	1,224,654	224,654	195,509	1,224,654	224,654	195,509	1,224,654
9	76	53,046	173,399	146,683	1,173,399	205,736	179,020	1,205,736	238,070	211,354	1,238,070
10	77	53,046	133,587	109,300	1,133,587	189,740	165,453	1,189,740	245,884	221,596	1,245,884
11	78	53,046	83,741	61,882	1,083,741	165,162	143,303	1,165,162	246,563	224,705	1,246,563
12	79	53,046	23,453	4,023	1,023,453	130,434	111,004	1,130,434	237,380	217,950	1,237,380
13	80	53,046	0	0	0	82,273	65,271	1,082,273	212,564	195,563	1,212,564
14	81	53,046	0	0	0	19,951	5,378	1,019,951	171,728	157,156	1,171,728
15	82	53,046	0	0	0	0	0	0	114,465	102,321	1,114,465
16	83	53,046	0	0	0	0	0	0	53,912	44,197	1,053,912
17	84	53,046	0	0	0	0	0	0	0	0	0

Therefore, contrary to concerns raised in Mr. Sanderford's report, Mr. Blumenthal should have observed real value under the longer guarantees pointed out by the in force illustration and satisfaction that the in force illustration was consistent in demonstrating a point of policy lapse consistent with the illustration provided at policy issue and with every annual policy summary he received.

[10] Mr. Blumenthal should have also realized that if he needed coverage to last more or less than what was in the illustration, that all he would need to do is adjust his premium funding levels.

Section 4 – Report and Analysis of David M. Sanderford, J.D.

In his report Mr. Sanderford reached the following conclusions:

1. The Policy was negligently designed for the purpose it was being sold.

This conclusion is incorrect because, as is clearly shown from the analysis above, the NYLIAC policy was properly designed as a death benefit product, and that is precisely what Mr. Blumenthal was illustrated. Additionally, based on the fact that the Protector policy form complies with the Model Regulation and the Oklahoma Regulation, it can be concluded that the Protector policy was illustrated in a way that contained proper disclosures, was understandable, and was not misleading.

2. New York Life and Marlin (agent) were negligent in failing to disclose all relevant and material facts concerning the Protector universal life insurance product that was recommended.

This conclusion is incorrect for a number of reasons. First of all in Section 1 it was shown that the Protector product illustrated to Mr. Blumenthal falls under the Model Regulation and the Oklahoma Regulation, therefore it can be concluded that the illustration contained proper disclosures, was understandable, and was not misleading. Secondly in Section 2 it was pointed out that the level of disclosures contained in the Protector illustration went above and beyond the requirements of the Model Regulation and the Oklahoma Regulation. Finally in Section 3 the disclosures contained in the Annual Policy Summary and the inforce illustration provided were clear and consistent as to when coverage would end assuming Mr. Blumenthal continued to pay his planned premiums.

3. The decline in the Policy credit rates was not representative of historical interest rates over the same period of time.

This conclusion is incorrect because, as was shown under the table in Section 3 illustrating the net yields of both the insurance industry in general and NYLIAC specifically, net yields over the time period Mr. Blumenthal's policy was in force were consistently declining every year after the millennium. It is that decline in net yields that led to the decline in credited rates.

4. NYLIAC knew that it would (even when NYL earnings from operations were increasing) degrade the credited rate to Protector policies.

This conclusion is incorrect for the same reason as number 2 above. NYLIAC decreased the credited rate for no other reason than its returns were declining. NYLIAC certainly did not purposely cause its returns to decline. The entire life insurance

industry's returns were declining over the same period and NYLIAC was experiencing just what the industry as a whole was experiencing.

5. On a current basis, credited interest comes from the insurer's "Gain from Operations" – which is made up of (a) investment gains, (b) mortality gains, (c) surrender gains, and (d) "loading" gains.

This conclusion is incorrect because as stated earlier the determination of credited interest is actually based on the net yields of the underlying investments. It seems Mr. Sanderford has taken a very common formula for assessing the statutory profitability and attempted to infer that investment gains are directly related to the establishment of credited interest. Actually, credited interest impacts the level of statutory reserves that the company holds for its policies, and under the "Gain from Operations" formula the level of statutory reserves impacts each of the 4 labeled gain components. Therefore Mr. Sanderford's inference makes no sense at all.

6. Lower credited interest would accelerate the policy's lapse, and Blumenthal would forfeit and remaining cash value at lapse.

This conclusion is incorrect because the Protector policy was already crediting its minimum interest rate of 4.00%. NYLIAC simply cannot go lower, which seems to further indicate Mr. Sanderford does not understand how policy crediting interest rates are established.

7. That a 15 year level premium $1,000,000 term policy for a 67 year old male (at Mr. Blumenthal's "tobacco" rating) would have been about 40% of the cost of the risky and costly Protector.

This conclusion is incorrect because Mr. Sanderford made it without presenting any evidence that a company would sell a 15 year level premium term to a 67 year old male tobacco user at such a price. I sampled current, 2010, 15 year level premium term policies for a 67 year old male tobacco user and did not find one that was at 40% of the $53,046 premium level that Mr. Blumenthal paid on Protector (40% x $53,046 = $21,218.40). The table below illustrates the first five companies and the premium levels that I found simply using the website "IntelliQuote":

Company	Premium Guarantee	A.M. Best Rating	Monthly Premium	Annual Premium
Prudential	15	A+	$3,069	$36,828
Transamerica	15	A	$3,174	$38,088
American General	15	A	$3,212	$38,544
ING	15	A	$3,350	$40,200
Genworth Financial	15	A	$4,149	$49,788

As the table shows, not one policy from these highly rated insurance carriers comes in at 40% of the premium level Mr. Blumenthal paid on Protector, and this comes nearly 11 years after Mr. Blumenthal's original policy was issued. I would expect, given underlying favorable mortality trends over the past decade, that the term policies issued in 1999 were at least equal to, if not higher than, what I have illustrated in the table above. Additionally Mr. Sanderford's argument completely ignores the flexibility of continuing the Protector policy beyond the illustrated period. Mr. Sanderford also ignores that a typical 15 year term insurance policy would either terminate at the end of the 15th year or continue on an annual increasing premium scale that is considerably higher than the level premium charge during the first 15 years. Whereas the Protector policy would allow Mr. Blumenthal to put in additional premium funding at any time, in order to fund the policy in line with his needs and a lower level than the continuation of a typical 15 year level term policy.

Section 5 – Qualifications and Compensation

Qualifications

My qualifications to review universal life policy illustrations and comment on policy pricing and design issues are based on over 20 years of extensive experience first as an insurance company product actuary and then as consulting actuary working for numerous clients in the design and development of life insurance contracts. I am a fellow of the Society of Actuaries and a member of the American Academy of Actuaries.

A copy of my CV is included as Attachment B.

Compensation

My compensation for the preparation and writing of this report, the preparation for and the giving of a deposition, and the preparation for and giving of testimony is $475 per hour. My compensation is not dependent on the outcome of this case or opinions offered.

Signed:

Michael LeBoeuf, FSA, MAAA
February 2, 2010

Attachment A

List of Materials Reviewed:

Report and Analysis of David M. Sanderford, J.D. With Respect to the Matter of Irving H. Blumenthal, Jr., Individually and on behalf of all similarly situated insured of New York Life Insurance and Annuity Corporation (NYLIAC) v. New York Life Insurance and Annuity, as well as Exhibit D attachments.

New York Life Policy No. 62 776 533 issued to Irving H. Blumenthal, Jr.

Certification of the Illustration Actuary submitted to the Oklahoma Insurance Department, February 4, 1998.

Documents produced by Irving H. Blumenthal, Jr. including illustrations and annual policy summaries from 2001-2007.

Most of the pleadings of the parties to this litigation.

Kenneth Black, Jr. and Harold D. Skipper, Jr., *Life Insurance*, (11th ed. 1987).

National Association of Insurance Commissioners, *Life Insurance Illustrations Model Regulation* (adopted 1995).

Oklahoma Insurance Illustrations Model Regulation, Okla. Admin. Code, Sections 365:10-3-50 through 365:10-3-62

Actuarial Standard of Practice (ASOP) No. 24, *Compliance with the NAIC Life Insurance Illustrations Model Regulation*, Actuarial Standards Board (February 2007).

Best's Insurance Reports, Life-Health, United States & Canada, AM Best Company (2003 and 2009 Editions)

Best's Aggregates & Averages, Life-Health, United States & Canada, AM Best Company (2004 and 2009 Edition).

Attachment B

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Areas of Expertise

Project Experience
- Process Analysis
- Project Scoping/Project Planning
- Client Management
- Project Financial Management
- Project Management
- Strategic Planning

Industry:
- Insurance

Functional:
- Financial Modeling Analysis
- Product Development
- COLI/BOLI Market Analysis
- Expert Witness Services
- Risk Transfer Analysis

Technical:
- APL
- Word
- Excel
- PowerPoint
- AXIS

Michael LeBoeuf, FSA, MAAA, CLU, ChFC

Managing Director

Michael LeBoeuf is a Managing Director in SMART's Actuarial Services practice. Mike has more than 25 years of experience providing actuarial and consulting services for the insurance industry, specializing in product design, development and implementation, with strengths in COLI, individual variable and universal life, and specialty insurance riders that provide long-term death benefit guarantees, critical illness and long-term care benefits.

As a consultant, Mike has participated in and managed a wide range of life insurance consulting projects including: designing, pricing and implementing a variety of individual life insurance and annuity products; developing products and programs to fit COLI/BOLI/Pension markets including private placement offerings; providing expert witness services; performing policyholder risk transfer analysis and providing financial analyses in the area of life settlements and structured settlements.

Project Experience:

Liability Hedge Project
Participated and managed a project allowing several leading life insurers to generate a system for advantageous handling of taxable income supporting the company's hedging program for its variable annuity guarantees.

Expert Witness
Provided expert witness consulting support services for several companies on numerous industry topics including private placement life insurance and annuities, COLI and 412(i).

Product Development
Designed, developed and implemented numerous life insurance products and programs for mid- to large-size life insurance companies targeted at individuals, corporations and pension plans.

Other Accomplishments
Mike is a contributor to SOA section newsletters including *TAXING TIMES,* the newsletter of the Taxation Section and *PRODUCT MATTERS,* the newsletter of the Product Development Section. He also is a frequent speaker on product development issues at the Society of Actuaries' meetings as well as meetings sponsored by the Actuarial Club of the Southwest, the Actuarial Society of New York, the Hartford Actuaries Club, and the Southeastern Actuaries Club.

Prior Experience:

Prior to joining SMART, Mike spent the last 10 years as an actuarial consultant, most recently as a Vice President and Consulting Actuary with Aon Insurance Consulting Services. Prior to his consulting career, he was with Chubb Life America, responsible for life insurance product development and implementation. Mike began his insurance career as an actuarial student at Mass Mutual.

	Education Background: Mike received his Bachelors of Science degree, cum laude in Mathematics from the University of New Hampshire. **Professional Affiliations:** Mike is a Fellow of the Society of Actuaries (FSA), a member of the American Academy of Actuaries (MAAA), a Chartered Life Underwriter (CLU) and a Chartered Financial Consultant (ChFC).