A life insurance resource for individuals and families

Guardian

How Pegging and Substitution can benefit you

Background

- Guardian uses Substitution and Pegging to add an extra degree of stability to its policies.
- Substitution and Pegging apply only to the base policy's non-loaned dividend, not to dividends on Paid-Up Additions.[1]
- Substitution and Pegging apply only during the premium-paying period of the policy (e.g., before year 21 for a 20 Pay Whole Life policy).
- This practice is not guaranteed. Like the dividends themselves, the use of Substitution and Pegging is subject to annual approval by Guardian's Board of Directors.

Substitution

In a declining dividend scale environment, Substitution helps improve policy performance in the early policy years. For example, for policies illustrated and effective in 2021, the base policy non-loaned dividend that will be paid in 2023 and 2024 will not be less than the base policy dividend amount illustrated on the policy date.

Pegging[3]

Pegging allows for a smoother transition from year to year in a declining dividend scale environment. Pegging does not guarantee that the dividend will increase from year to year, but its use does help "soften" the decline in the dividend that would otherwise occur if only the dividend formula were used.

What this means for a policy owner

Guardian calculates its total whole life dividend using the following three components:

- Investment performance;
- Mortality; and
- Expenses.

Since mortality and expenses tend to remain relatively stable, investment performance has been responsible for the majority of dividend fluctuations over the last few years.

Investment performance tends to track broad movements in market interest rates because the majority of Guardian's portfolio is invested in high-quality, fixed-income instruments. While the use of Pegging and Substitution isn't guaranteed, Guardian has used these practices for many years to help mitigate any decreases that might occur in a declining dividend scale environment.

Guardian's current practice is to pay a dividend that is higher than the "formula" dividend amount when certain conditions apply.[2] The practice is called "Substitution" if it applies to the dividend paid on the second and third policy anniversaries and "Pegging" if it applies thereafter.

Example using Pegging and Substitution:

A Life Paid-Up at Age 99 contract was issued with a policy date in September 2019. The 2019 Dividend Interest Rate (DIR) was 5.85%, the 2020, 2021, and 2022 DIRs were each 5.65%, the 2023 DIR was 5.75%, and the 2024 DIR was 5.90%.

What dividend interest rate would Guardian use?

September 2020:
No first-year dividend on base contract

September 2021:
5.85% base policy dividend (using Substitution)

September 2022:
5.85% base policy dividend (using Substitution)

September 2023:
5.75% base policy dividend (using Pegging, if applicable)

September 2024:
5.90% base policy dividend

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[1] Paid-up Additions (PUA) are purchases of additional insurance (death benefit) that have a cash value. These purchases are made with dividends and/or a rider that allows the policyholder to pay an additional premium over and above the base premium. This creates the growth of death benefit and cash values in a participating whole life policy. Adding large amounts of paid-up additions may create a Modified Endowment Contract (MEC). A MEC is a type of life insurance contract that is subject to last-in-first-out (LIFO) ordinary income tax treatment, similar to distributions from an annuity. The distribution may also be subject to a 10% federal tax penalty on the gain portion of the policy if the owner is under age 59½. The death benefit is generally income tax free.

[2] Dividends are not guaranteed. They are declared annually by Guardian's Board of Directors. The total dividend calculation includes mortality experience and expense management as well as investment results.

[3] Beginning with the base policy non-loaned dividend paid on the fourth policy anniversary, Pegging and Substitution are not guaranteed. They are declared annually by Guardian's Board of Directors.

Policy form 21-WL.