SOCIETY OF ACTUARIES

Article from

Risks & Rewards

August 2017

Issue 70

Indexed Universal Life Snapshot

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This article expresses the views of the author and not those of Securian Financial Group, Inc.

WHY YOU SHOULD BE AWARE?

Indexed Universal life (IUL) emerged onto the scene in the late 2000s and has achieved an outstanding level of acceptance among life insurance buyers. The growth of IUL has been impressive over the last decade under a variety of metrics. In market share of total sales IUL has grown from 3.85 percent[1] in 2007 to 21.6 percent[1] of all sales in 2016. The compound annual growth rate of sales from 2007 to 2016 is 20.17 percent.[1] The growth associated with IUL has not been confined to sales either; the number of carriers that sell IUL has doubled from 16[1] in 2007 to 32[1] in 2016. Whole life is the only other product type that has shown similar sales growth over the same time pe+riod.

WHAT IS IUL AND HOW DOES IT WORK?

IUL is a flexible premium universal life contract that credits interest to the account value based on an external index or indices of market performance over a period of time. Most IUL contracts have several index options available along with fixed crediting option to allow their clients flexibility to allocate the accumulation value within the contract. Within the industry there is a plethora of index options to choose from (and I could spend the whole article delving into the differences). I will make reference to the different options out there, but in an effort to keep the explanation simple I will be referencing the most common index structure, as defined in Actuarial Guideline 49 as the benchmark index.

Indexed Accounts generally all have these parameters:

The underlying index or combination of indices
The external index or indices for which the growth is measured. The most popular index is the S&P 500 price index.

Floor
The minimum index growth rate used for calculating a credit. The most common floors range from 0 percent to 1 percent.

Cap
The maximum index growth rate used for calculating a credit. Some index options in the industry offer an unlimited cap, but the majority of the index options offer a cap in the 6 percent to 14 percent range with the most common cap currently in the 10 percent to 12 percent range.

Participation Rate
This is the portion of the index growth rate that gets used in the index crediting calculation. The most common is 100 percent, but can range from 25 percent to 200 percent.

Calculation method
Method for which one determines the basis to apply the calculated index growth rate. The most common is Point to Point, but others include daily averaging, monthly averaging and performance triggered.

Time period
Period of time in which the index growth is calculated. Most common is one year, but it can range up to five years.

The index growth calculation generally works one of two ways:

Maximum (Minimum (Index Growth rate, Cap), Floor) * Participation Rate

Maximum (Minimum (Index Growth rate * Participation Rate, Cap), Floor)

For illustrative purposes if the index parameters were a floor of 1 percent, a cap of 12 percent, and a participation rate of 110 percent and the index growth rate was 15 percent, 10 percent and -10 percent in three time periods. The index returns respectively under those scenarios would be 13.2 percent, 11 percent, and 1.1 percent for the first calculation method and 12 percent, 11 percent, and 1 percent for the second method.

WHAT IS DRIVING THE SALES OF IUL?

This is a great question and one that has sparked much debate in the industry. Is it the product design, the market cycle, illustrations or agency rules (that is, who can sell the product) that is the driving factor for the increase in IUL sales? Let us look at these point by point.

The universal life chassis provides flexibility in:

- Varying levels and time horizon for which the client pays premiums.
- Multiple death benefit options and face amount combinations.

- Multiple index options that allow the client to select the risk/reward profile that they desire.
- Ever expanding list of riders covering anything from early values to chronic illness benefits.
- Flexibility to change in the future if needed.

All of these factors make it very easy to customize an IUL sale to the client's specific needs. These features are all important, but what I hear the most positivity about is the floor. Prospective clients are more than willing to forgo returns in excess of the cap if they can avoid the scenario where they lose 10 percent of their value over the course of the year because of a market downturn. Consider we have had one of the longest market expansions in history. Yet through the prolonged expansion people still remember how much value they lost in the 2000 and 2008 market downturns. The downside protection provided by the floor in an IUL policy is the top valued feature by clients and agents. On a side note, one would have thought the market cycle we are in would have spurred more growth in variable life sales. While variable sales have been flat or decreased over the current market cycle, IUL has seen gains.

Prior to 2015 there was inconsistency in the industry around how to illustrate IUL, even when the index parameters are the same. One company might have used the last 25-year compound average growth rate (CAGR) while the next might have used the 30-year CAGR to determine their max illustrated rate. One could argue that there were indices introduced inside of IUL specifically because they back cast well. This practice was appropriately criticized because the past performances of these indices was highly unlikely to repeat. Due to these issues, the industry needed some commonality and best practices for how IUL contracts were illustrated. In 2015/2016 Actuarial Guideline 49 was implemented which brought with it a consistent method for setting the maximum illustrated rate and illustration requirements. With the introduction of AG49 there was some belief in the industry that it would drastically curtail the growth of IUL, but that hasn't come to fruition.

A contributing factor to IUL growth is the fact that the industry treats IUL as a non-registered product. This means that advisors do not have to be licensed with the SEC to sell securities or affiliated with a broker-dealer to sell IUL. This greatly increases the pool of advisors that will show interest in IUL. These advisors are able to sell a product that participates in some of the upside of the market, with none of the downside.

> IUL is here to stay. It will continue to be a disruptive and compelling force in the life insurance industry for years to come.

WHAT IS NEXT?

What lies ahead for IUL is a question that the industry is wrestling with. After AG49 was introduced there was lull in IUL development as carriers were determining how best to move forward under the new parameters. Already in 2017 we have seen several new entrants into the market with their products "optimized" to conform with AG49. Will agents buy into these product changes, will it lead to new regulation, will the market contract for an extended period of time, will interest rates ever increase making fixed products more attractive? The answers to these questions will play out over time, but my prediction is that IUL is here to stay. It will continue be a disruptive and compelling force in the life insurance industry for years to come. ■

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ENDNOTE

1 U.S. Retail Individual Life Insurance Sales Participant Report Fourth Quarter Year-to-Date 2007 & 2016