BROKER WORLD

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Is Zero Still Your Hero?

How High Fees and Bonuses Have Adjusted the IUL Landscape

When I first learned of indexed universal life (IUL) products years ago, I was taught that, "Zero is your hero." As you are most likely aware, this product is tied to the stock market but isn't actually "in" the market. Hence, when the market is negative you won't lose cash value to negative market returns. Negative returns result in a simple yet comforting zero index credit to your policy. There is still the cost of insurance and other fees; however, these costs are not deemed significant because competitive products can have low costs and are viewed simply as the cost of doing business. I was taught, "IUL costs and fees are high in the early years but decrease as the policy matures and access to cash is needed most." That statement rings true today, but should be amended to exclude "early years." The new statement should be, "IUL costs and fees can be high, based on your risk tolerance, and can continue to be high every year you own the contract." It should not stop there since, comparing IULs to 401(k)s and mutual funds, the IUL traditionally has had lower costs and fees than investments in the other vehicles. This is no longer the case with the high bonus and high fee IUL products. With today's new generation of IUL products, which include additional costs as high as a six percent asset charge per year, a key selling point (low cost) of IULs no longer applies. This begs the question, is zero still your hero?

With the introduction of AG49 in 2015, illustrations became more uniform in nature. Max uniform caps on illustrated rates were mandated. This uniformity birthed a frenzy of innovation. Illustration wars were tabled, but the battle for highest bonus had begun. With the introduction of high bonuses came an additional layer of fees. The question no longer was, "What is the illustration rate?" It has now become, "How big is the bonus?" The latter question should be followed up with, "What are the fees?" These new bonuses bring an extra expense inside the policy that means we can no longer say, "Zero is our Hero." In most cases, consumers will not do a deep dive into policy costs to see exactly how much these bonuses will cost them over time. The onus is on the advisor to be transparent when talking about fees and be able to thoroughly explain illustrations and the inner workings of an IUL contract. It is easier for advisors to purposely ignore these additional costs than to delve deeper. The advisor should also be able to explain that in some cases fees are taken first, can reduce potential returns, and add up over time.

When discussing fees, illustrations have shown that in a high index credit year high fees are tolerable. Not many clients will complain about double-digit net returns after fees or asset charges, and bonuses or multipliers, are applied. In great index credit years, high fee and high bonus products look phenomenal. The problem occurs when we look at moderate, zero, and negative years. For example, using purely hypothetical numbers, let's take a five percent asset charge and 200 percent multiplier IUL that returns a positive interest credit of two percent. At the end of the year the net result is a minus one charge (-5 + 2(200%) = -1). If the policy earns a zero or negative interest credit the net result is a minus five charge (-5 + 0(200%) = -5). As you can see moderate, zero, and negative interest credits can produce an asset charge assessed to the cash value. Imagine an annual review where you have to tell your client that their policy received an interest credit but still lost money. The high bonus/multiplier high fee IUL product satisfies an aggressive risk tolerance profile. This profile can represent an ideal IUL client, aged between 35 and 55. They must also have a long time horizon and not be concerned with the sequence of returns. For clients over 55 and premium finance cases, this high bonus, high fee IUL may be cost prohibitive.

When comparing fees and expenses of traditional IULs to 401(k)s and mutual funds the cost over time of the IULs could be significantly less. Depending on age however, with high bonus, high fee IULs the inverse is true. Take for example a client over 55. The client is in their early 70's and purchases a high bonus, high fee IUL with a sizeable bucket. Hypothetically, at age 85, the high bonus, high fee IUL can be two to five times higher than alternative investments. When looking at the actual numbers, the fees from the IUL compared to a taxable account are jarring.

Two main selling points of a traditional IUL have been low fees compared to 401(k)s and mutual funds, and protection from negative market returns. With the advent of the high bonus/multiplier, high fee IUL products this is no longer the case. On the risk tolerance scale, someone with a conservative or moderate risk profile can still enjoy the cash accumulation benefits of a traditional IUL. But the way the industry is headed due to increased regulation, the risk profile may change with it. These new high bonus, high fee IUL products are more of a hybrid variable universal life (VUL) type product. In many cases they are "High Risk IULs" and suit a younger and more aggressive clientele. Ideally, IUL products should offer allocation options that cater to a client's risk tolerance. For the saver, they can choose the fixed account, or a low to no fee, or low to no bonus option. For the younger more aggressive client, they can go all in with a high bonus/multiplier, high fee option considering they know the risk involved. The answer to the question presented in the title is not answered with a simple yes or no, the answer depends on your outlook on life. If you are a glass half full person, a positive index credit number will be your new zero, anywhere from plus three to plus six. To receive a zero with a high fee and bonus IUL, the policy would have to return a number slightly higher than the asset fee to not lose money. If you are a glass half empty person, a negative number will be your new zero. If the IUL policy receives an interest credit that is moderate or zero the net result will be a negative number. How comfortable are you with a minus one to minus three net result? When crunching the numbers on the high bonus, high fee IUL products, the concept of "Zero is your hero" needs to be reimagined.