

Episode #186: Will Your IUL Actually Perform? A Case Study Into Past and Potential Future IUL Returns

Video Transcription

Hello, and welcome to another episode of "Money Script Monday." My name is Luke Geller, and today, we're going to look at, will your IUL actually perform? We're going to do a little case study in a past and potential future IUL returns. The reason I want to talk about this is because there's no worse feeling than, and especially today right now, when you're buying so many things online using Amazon, using all these different tools and getting things delivered to you, for you to order something expecting one thing and getting another, right? It's the worst.

As an example, I recently purchased mixing bowls. I needed to buy mixing bowls for the kitchen. Didn't have any, so I went on Amazon. I found some mixing bowls that had 4.8 stars. Awesome, let me buy them. That was about the extent of the research I did. When I got them, I took them out of the package. I was like, "Oh, this package is a little bit small." They were mixing bowls for children. I was extremely disappointed because I was not expecting that.

The reason I say this story is because if you're looking at buying an IUL, or if you're looking into just investing in an IUL, you want to make sure that you are getting what you expect. You don't want to be blindsided by anything. I'm hoping that today we can make you feel a little bit more comfortable with that decision, or at least understanding what this is, and how your IUL will perform in the future. What we're going to talk about, is we're going to talk about index crediting, how your IUL is credited, what's called the Monte Carlo Calculation. The importance of those. Why we want them.

We're going to finally look at an actual policy and its performance versus what was illustrated. Buckle up. Hold on tight. Let's get into it. Index crediting. Every time I talk to someone about an IUL, and tell them, "Hey, this product is great. You have a 0% floor. But you have a cap at about 10%." And they'll say, "Oh, so the insurance carrier just tries to have a low cap and earn a lot in the index, and take all the profits for themselves."

That's not exactly how it works. It would be great for the insurance company if it worked that way, but that's not how it works. I want to kind of talk about that. Let's use this as an example. Let's take a \$1,000 premium. \$1,000 of premium going into the insurance company, what they're going to do with that is they're going to take \$950 of it. They're going to put it in a general portfolio, but not all of it is going into the general portfolio. Some of it is going to the insurance carrier for their profit.

That's where they make their profit. For some costs, for them to recoup their costs as well. That \$950 goes into the general portfolio. They feel very confident, based on their ability, that they know what they'll get in that general portfolio to bring that \$950 back up to \$1,000. That's your floor, your 0% floor. Now you have this \$50 leftover. That allows the insurance carrier to take that \$50 and buy options. The client has the ability, or the client has the option of what they want to do with that \$50.

The client can take that \$50, put it in the general portfolio, and they would get a fixed interest rate for the year. That fixed interest rate is about 4%. What if you wanted to earn a little bit more? You have the option of taking that \$50 and put it into index options. Each insurance carrier is going to have different index options, but your most common one is going to be your S&P 500 index. You'll say, "Hey, I want that \$50 in the S&P 500. What does that give me?" The insurance carrier will say, "Well, we give you a 0% floor, and with \$50, we can get a cap of 9% right now."

That \$50 will then go into options or the insurance carrier will take that \$50, buy options, and be able to offer you a 9% cap in the S&P. They can also take that \$50, and another type of index option is what's called, "A volatility controlled index option." I don't want to get too far into the weeds because that can be a whole nother "Money Script Monday" by itself. It's an index that includes bonds and equities, and the insurance carrier controls and puts money into bonds versus equities based on the volatility in the market.

The more volatile the market, the more your money is going into bonds. The less volatile, the more is going into equities to try and earn that return. That's a quick, brief overview of volatility-controlled index options, but they're extremely common, and they can be very, very capable. Hopefully, that helps you understand a little bit more about how your IUL is credited. One other thing I want to point out is that most of the time it's on an annual point-to-point basis. Let's say you were starting on January 1, 2020, to January 1, 2021, that is one annual point to point, and that is one index segment. That is index crediting.

Let's take a look at what this Monte Carlo Calculation is. What that is, is that takes thousands of those index segments. I just talked about it, January 1, 2020, January 1, 2021, that is one index segment. It takes thousands of those and gives you an idea of how those segments performed over a long period of time.

If you are looking at an IUL illustration, most of the time they will have a historical look back at the past 25-year average. They'll show, "Hey, January 1 of 2006 to January 1 of 2021 average of 7.8%, right?" That is an average of one segment or one data point.

What this Monte Carlo Calculation does is it takes thousands of those data points. It will take January 1, 2006, to January 1, 2021. And then January 2, 2006, to January 2, 2021, etc., etc., thousands and thousands of times.

Based on the data we did, I'm showing two here, the S&P index and the volatility-controlled index. The reason I want to point this out is just to show you, hey, the S&P can work extremely well. This S&P index had a 9% cap, a 0% floor. Out of those 4,700 different data points, I showed a worst-case scenario, a conservative scenario, and a typical scenario. What that means is, out of 4,700 data points, the worst data point was 4.93%. Ninety percent of those data points are in 5.4%, and 80% of those data points are in about 5.6% or 5.58%.

Not extremely high, but not low, and it beats out that general portfolio that's probably averaging about 4% right now. That is a strong policy or a strong return based on 80% of the time you're going to get most likely around 5.6%. When we look at these volatility-controlled index options, we have a little bit more cushion there. The reason is we don't have a 9% cap. We have some different things in play. It's a little bit cheaper for insurance carriers to buy, so they're not stuck at a 9% cap, and you can't even get somethings that are called participation rates, which increase what you get.

If we look at this, the worst-case scenario was 6.42%. Conservative, 90% of the time, you're getting at least almost 7.5% in your policy, and 80% of the time, you're getting almost 7.9% in your policy. Those are great numbers. For an IUL to work, for a properly structured max-funded IUL to work, all you need is about 5.5%, 6%, and it's going to work extremely well for you.

The reason I wanted to show you these Monte Carlo Calculations is so that when you're looking at an illustration, and you see that 25-year look back, definitely ask, "Well, do you have a Monte Carlo on how these indexes have performed? Or do I just get one data point? Can I see something that shows thousands of different data points?" The more knowledge you have, the more comfortable you are that way you know what you're going to get. That way you feel comfortable knowing what you're getting.

Finally, now that we talked about index crediting, we talked about what Monte Carlo calculations are, let's take a look at an actual IUL policy. This is one that was sold back in 2015, and what we're looking at here is the illustrated value. What you would get if you're looking at an, if someone is talking to you about an IUL, they're going to show you an illustration. This is what this client was shown. The premium amount. The index rate of 7% of what this policy. If this policy earned 7% what it will look like. The accumulation value, or cash value, and then the death benefit.

When we look at that, this policy was illustrated at 7%, which right now would be extremely high. Most policies or most carriers can only illustrate at about 6% due to regulation. Due to regulatory laws. Showing a 7% illustrated rate, let's see how the policy performed. In the first year, it earned a zero. That's not very good. As we go on, 6.5%, 6%, that's not bad. 20%, wow, what a great policy, all right. You're earning 20%. That's huge. This policy was actually in one of these volatility-controlled index options, which allowed for some growth there.

We had another zero-year, so this policy has already had two zero years, two positive years, two zero years, and it ended up with two more positive years and is averaging 8.47%. 8.47% is higher than the typical scenario that we showed here. This just means 80% of all the data points we looked at earned at least 7.87%. The majority of these policies earned higher than that. This is one of those policies.

The reason I wanted and I picked this policy here, and again, it's only one data point. It's only one policy. I could have cherry-picked it. The reason I picked it is because it has multiple zeros. Its recent anniversary was December of 2020, so it just had an anniversary a couple of months ago. It is a solid policy to look at, and see that, hey, even if you have a couple of zeros, it's not going to kill you. You can still earn a great rate of return, and we're bidding what we illustrated by a long shot. Even if we weren't, if it's structured properly, that is a great policy.

In conclusion, what I really wanted to cover, and hopefully, what you were able to get out of this is, when you open up that policy, you're not going to get a bunch of children's bowls as I did from Amazon. I want you to feel more confident. Know what you're getting. Understand what you're getting, or understand what you might be getting, and give you more firepower when you're talking to someone about these policies, so that way you understand them a little bit more. I hope you learned something new, and I will see you next time.