Episode #336 – The Ultimate Guide to IUL Index Options

Hello and welcome to another episode of Money Script Monday. My name is Luke Geller, and today we're going to be talking about the ultimate guide to IUL index options. The reason I want to talk about this is because whether you’re purchasing an IUL for the first time, or you've had one for multiple years and continue to get that annual statement with all these different index options, all these different performance indicators, and you're not really sure exactly how they work or what's going on. Well, it's really important for you to know, at least from a high-level standpoint, exactly what is going on with those index option so you can make the right choice and how you should allocate the investments in your life insurance policy.

First, we're going to look at exactly how indexing works at the carrier level. The carrier receives a $1,000 premium. Now what they're going to do is split that up between 2 buckets. That first bucket, they're going to take $950 of that thousand and they're going to put it in what they call their general portfolio. Their general portfolio is their investments, it's extremely safe, they know exactly the rate of return they're going to get in that portfolio. They know that they can turn this $950 back into $1,000, to where your premium amount was at beforehand, and that's how they can give you that 0% floor on an index.

Then, they're going to take this other $50, which is actually up to what the client or what you want to do. Maybe you say, “Hey, I really like what they did with their general portfolio. I want to make sure that I know exactly what my policy is going to get and how it's going to get there.” They can take that $50, also put in their general portfolio, and you'll know you’re getting exactly 5% in the policy. Or you say, “Hey, I want a little more upside than just this 5% fixed account.” Well, if that's the case, then you can

choose one of these different index option accounts that are going to be available and going to give you more upside. Maybe you have a 12% cap in the S&P. Maybe you have an uncapped strategy that's called the volatility-controlled index. Or maybe you're investing in something else that's that is an option.

Well, they're going to take that $50 based on what you choose, and purchase options based on that choice and whether you choose the S&P, you're going to have that cap, whatever this $50 can buy for options in the S&P and if there's gains, you're going to get gains. If the S&P doesn't have any gains, then you're going to have no losses, even if it's negative, you're going to have no losses because, again, your account value is back up to what it originally was because of the insurance carrier. That's really at a high level how indexing works.

Well, I want to take a look at a few different bullet points over here and a few different pieces of information. First, one thing to note is that the average IUL carrier has between eight and nine different choices for you to make between index options. That's a lot of choices. When we look at the most popular option that most people are choosing well prior to 2014, it was actually the S&P 500, but currently it's what we call volatility-controlled indexes.

Now a volatility-controlled index is a new index that was created in 2014 and it usually has a bond component and an equity component, maybe like the Barclays RBI Bond index and the S&P500. Based on volatility in the market and the insurance carrier, the hedgers at the insurance carrier can move money from between the equities and the bond component based on that volatility. That's why it's called the volatility-controlled index, because volatility is literally controlling how the index performs. Those indexes have performed extremely well, all the way up until a few years ago when the interest rate environment started increasing, because that meant that bonds started underperforming and the bond volatility actually created the volatility control index or the VCI underperformance.

If you already have a policy, and you have gotten an annual statement over the past year or two, you've probably seen if you're in one of these VCIs 0 to low returns in there and you're like, “What the heck is going on?” Well, the reason for those low returns is because the insurance carrier when these were created in 2014 was in a low interest rate environment. We were in a bull market around on the equity side and it really performed well, and they didn't account for what would happen if there was bond volatility in the market.

Well, now we see that. So, what do we want to do? I want to look at one other graph. On this graph what we're doing is we're looking at the S&P 500. We’re looking at thousands of different data points for and point to point S&P 500 with a 0% floor and a 12% cap. What we did is we looked at how each of these singular data points performed and where they ended up out of these thousands of different data points. When we look at the numbers, 49% of those data points, the annual point to point S&P 500 actually capped out at 12%. 49% of the time, if you're in the S&P 500, you’re most likely going to receive that cap number or 12% or whatever that cap is.

Then when we look at the other end of the spectrum, the S&P earned a zero percent 25% of the time. So, 25% of the time an S&P earned zero, 49% of the time the S&P earned 12%, which means about 74% of the time that you are in an index or in the S&P 500 index, you're either going to get a zero or you're going to get a 12% or a cap. That means for the remaining amount, you're going to get somewhere in between. Well, I think that's a really important thing to realize. This is a swing for the fences almost. Granted, twice as many times you're going to cap out, but you're either going to cap out or you're going to get a zero most of the time. Not only does that happen for the S&P, but really for all these different index options.

When we look at every carrier having almost between eight and nine different index options, how do we know when we're going to get a zero or

when we're going to get a 12%? The answer is we don't, right? We can't really determine. We can't look into the future at how the markets are going to perform and how these different index options are going to perform. If we did, we would tell you one and two, we would invest a lot of money in them if we knew what was going to happen, but we can't do that.

What we do is actually recommend doing diversified approach. When we look at the eight or nine different options, let's choose three, four, or five of those to allocate our money to. That way, when you have one year that's a zero, you might have two or three that capped out or have that high rate of return. If you look at a five-year span, three of those years, you're probably going to have a higher return. In one to two years, you'll have an average return, and one to two years you'll have a zero return. If you're trying to pick and choose which one's going to do what, you're most likely not going to choose the right one. But if you are allocated to multiple, that means you'll never truly have a zero year, because you'll always have one or two that are in that high range or in that average range and that's important to note.

Today we really looked at, hey, how does indexing work? What are some data points, or what are some points you want to think about? How do these volatility-controlled indexes work? We really took a look at why diversifying your index options is an extremely strong choice. Hopefully today you're able to take one or two things away and really understand a little bit better how your index options work and what you might want to do the next time you get that annual statement. Again, my name is Luke. Thank you for joining us today on this episode of Money Script Monday.