Episode #351: The Truth of Whole Life and IUL In-force Rate History

Hi, welcome to another episode of Money Script Monday. My name is Brian Manderscheid. Today I want to discuss the truth behind whole life and index universal life renewal rate history. I put this video together for you because we're seeing a lot of misinformation about index universal life on popular social media platforms like TikTok and LinkedIn.

We take offense to these "finfluencers" who are pitching index universal life as a risk-free investment with the ability to earn double-digit average returns through the life of the policy without any risk, the ability to replace all of your traditional retirement vehicles, and to be your own bank. The critical point I want to deliver here is that index universal life can be an excellent addition to an overall holistic, well-balanced financial plan when done the right way for the right person while disclosing risks that exist, one of which I'll talk about here today.

For today's agenda, I'm going to talk a little about this "finfluencer" snake oil we're seeing and then get into a study that I put together to address one of the critical risks that we think exists within the policies and then go over the some of the averages and main points.

First, let's talk about the "finfluencer" snake oil. As I mentioned, we take most offense to the pitch of index universal life being a risk-free investment. I think that's a deceptive way to portray index universal life for a few reasons.

Number one, it is not risk-free. Some risks exist in the policy, such as performance risk, renewal rate, risk lapse risk, and even tax risk if the policy isn't set up correctly from the start. If the policy lapses due to indebtedness, it is essentially over-loaned and is not within the overload protection guidelines. Those risks typically aren't discussed or disclosed.

Number two is index universal life isn't an investment; it's a life insurance policy with a cash value component. That cash value component typically has returns tied to a major stock market-based index like the S&P 500 with some upper limit, like a cap or participation rate of how much returns the policy can achieve in a specific time frame with a trade-off being usually a floor of 0% to potentially reduce any downside risk. So, is it a risk-free investment? No. It has risks and is not an investment; it's life insurance with cash value.

There are valid IUL uses. As I mentioned, IUL can make sense when done correctly for the right person within the context of an overall financial plan. Typically, we see IUL used primarily for permanent insurance, which is the policy's primary purpose. Permanent insurance can be used for many reasons, whether that's spousal income continuation or to replace lost income like a pension or Social Security benefits.

Some clients or advisors use it as a bond alternative inside a plan. It could also be used as a volatility buffer. That would work if the stock market is down, and rather than pulling from risk-based assets to meet your income needs, you can take a tax-free withdrawal to basis or take a policy loan to cover the income needs and let those risk-based assets recover. It could also be used for a dedicated LTC pool, so that is how we see IUL being used but not used as a risk-free investment.

To get into the full transparency of what index universal life is and isn't, I want to talk about one of the main risks that we think exists with index universal life: renewal rate risk. To describe what that means, the upside limit of your returns will typically have a cap or participation rate applied to the upside limits. Now, those rates are usually only locked in for one year or the segment term, and once you get to your policy anniversary, those rates will renew based on whatever rate is available.

The problem is that some companies need to improve at maintaining renewal rate integrity. There are very valid reasons why cap rates should go

up or down, primarily based on interest rate movement, volatility, and the risk-free rate. Unfortunately, some carriers do not treat in-force policyholders equitably to new customers walking in the door. They'll offer lower rates for clients who have already purchased and higher rates for those potentially looking to buy. We think that is not fair practice, although this study and others we put together show which carriers are better or worse at maintaining renewal rates for in-force policies.

Secondly, interest rates impact both whole life dividends and index universal life cap rates. All carriers are essentially playing in the same sandbox, meaning when interest rates go down, that will impact not only IUL cap rates but also the whole life dividend rates. Effectively, interest rates affect many products within the insurance companies' product portfolios.

Lastly, there is a lag between new money rates and the insurance company's general portfolio yield. The insurance company's general portfolio yield is slightly more complicated to explain. When insurance companies receive premiums, they invest those dollars in roughly investment-grade bonds at today's interest rates. The insurance company's general portfolio is a collection of bonds purchased over multiple years at various maturity lengths versus new money rates. We typically describe new money rates as how much you can get for, let's say, a ten-year bond if you go out to an open market today.

There is a lag between the general portfolio yield and the money rates. If interest rates spike significantly upward or downward, there will be a lag effect on the CAP and dividend increases of the enforced policies and the downward side.

I will explain what we're looking at with the carrier study. I looked at about 20 different insurance companies that offer both whole life insurance and index universal life. I also looked at the renewal rates for dividends on the whole life side and cap rates on the IUL side over roughly the last ten years.

A couple of key points here are that we're not trying to say one of these products is better than the other; we're merely trying to gauge renewal rate integrity, trend lines between the two different product types, and lastly, how new money rates impact both dividends and cap rates on IUL policies.

First and foremost, a key observation is that both trend lines are negative, meaning that over the last ten years, dividend rates and cap rates on index universal have come down.

The second observation is that the trend line is more stable with whole life, and there's a more severe slope with index universal life, meaning that cap rates came down faster on IULs versus dividend rates on whole life. The study had some outliers; on the IUL side, there were carriers that had much worse renewal rate integrity. Those carrier outliers were left in, which is one of the key reasons that the slope is steep.

We think just using the good renewal rate companies would be misleading, but it would show a line that would be more in balance with what we saw on the whole life side. The other key observation here is that Moody's AAA corporate bond yield going up and down over that ten-year time frame supports the idea of this lag effect.

When interest rates came down over the 2010s, that impacted cap rates and dividend rates with IUL and whole life. Conversely, when interest rates rose over the last few years, there was a positive correlation between cap rates and dividend rates on those two product types. However, that slope was less drastic due to this lag effect.

Putting it all together, we believe there is validity in using index universal life when done correctly for the right person in an overall, complete, holistic financial plan. We believe that pitching Index Universal Life as a risk-free investment is dangerous and misleading.

Additionally, we also looked at how interest rates affect things like renewal rates for dividend-paying whole life policies, cap rates with index life, and the idea of this lag effect between new money rates and the general portfolio yield. Lastly, some carriers are better or worse with renewal rates, so it's crucial that when you're working with your financial advisor or insurance agent, make sure you're talking about these different types of risks and having them search multiple companies to find the best option for you. If you have questions about today's material, don't hesitate to contact the advisor who sent you this video. Thank you very much.