



# Index Universal Life

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# How Universal Life Works

# How Universal Life Works

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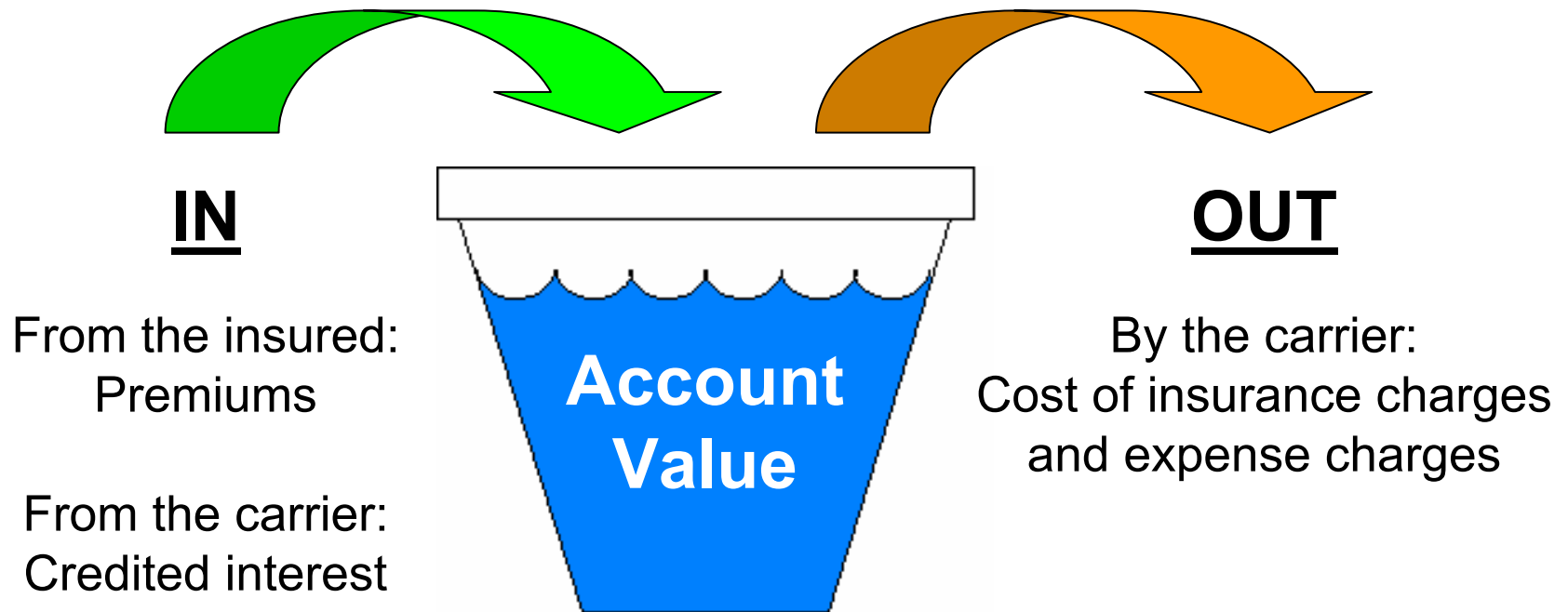
Universal life insurance is a combination of an account (like a savings account) and an insurance plan.

## Regarding the account:

- The insured pays premiums into the account
- The insurance company credits interest to the account
- The insurance company also deducts charges from the account to pay for the insurance coverage elected by the insured

# How Universal Life Works, *continued*

Premiums and interest go into the account, and monthly charges for the insurance plan go out of the account.



- If inflows exceed outflows, the account value rises

# How Universal Life Works, *continued*

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## More regarding the account:

- Beyond a certain minimum premium, the insured can generally pay in as much or as little as he wants
  - Of course, the more he pays, the more his account grows in value
- The primary reason he would want to pay in more than the absolute minimum is either:
  - Because the account is crediting an attractive interest rate, or
  - He wants the account to achieve a certain value goal in the future
- In the future, he can obtain his account value by canceling the policy or by taking a loan from the carrier collateralized by his account value

# How Universal Life Works, *continued*

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- The **cost of insurance charges** deducted monthly from the account:
  - Depend upon the premium class for which the insured qualifies
    - For example, the deduction is larger for a tobacco risk versus a nontobacco risk
  - Include charges for the basic coverage and any riders selected, so adding a rider increases the monthly deduction from the account
  - Increase over time as the insured grows older

# How Universal Life Works, *continued*

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- Agents illustrate universal life by showing two projections of possible future account values, making certain assumptions
  - The key assumptions are:
    - How much premium the insured will pay into the account
    - What rate of interest the carrier will credit to the account
    - What rate of charges the carrier will deduct from the account

# How Universal Life Works, *continued*

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- Two scenarios are calculated
  - Both scenarios assume the same amount of premium payments from the insured, but they differ in what account values result in the future
- **Current Basis – expected scenario**
  - Interest = rate the carrier is currently crediting or plans to credit if the future is similar to the past
  - Charges = the carrier's current scale of charges against this plan (note that they increase with age)
- **Guaranteed Basis – worst case scenario**
  - Interest = the minimum interest guaranteed by the carrier
  - Charges = the maximum scale of charges the insurer is allowed by contract to charge against this plan

# How Universal Life Works, *continued*

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- What is the point of showing two scenarios?
  - The Current Basis scenario is probably the closer of the two to what the insured can expect
  - But it is not guaranteed, thus it is not 100% reliable
  - Actual results may be better or worse than the Current Basis scenario
  
- So, both law and prudence require carriers to show the Guaranteed Basis scenario to make sure the customer understands this
- The Guaranteed Basis scenario will show much lower future account values than the Current Basis scenario

# How Universal Life Works, *continued*

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- In general, insurance coverage lasts **as long as the account value is greater than zero**
  - So, the duration that the coverage is predicted to last will differ between the Current Basis scenario and the Guaranteed Basis scenario
    - The Guaranteed Basis scenario will show coverage expiring sooner
  - Also, as long as the account value is sufficient, the insured has the option to skip premium payments or in some cases stop premium payments altogether



# How Index Universal Life Credits Interest

# How IUL Credits Interest

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Most index universal life (IUL) plans offer two interest crediting methods.

- **Traditional fixed interest method**
  - Interest rate is a fixed interest rate (such as 5%) declared in advance every year by the carrier
  - This rate in future years is contractually guaranteed never to fall below a minimum rate (such as 1%)
- **Indexed method**
  - The interest credited is based largely upon the annual performance of a stock market index, such as the Standard and Poor's 500 (S&P 500), within a certain range
    - The S&P 500 is the performance benchmark against which most mutual fund managers are evaluated

# How IUL Credits Interest, *cont'd*

For example, the carrier may declared that its indexed method will credit interest like this ...

- A fixed interest rate of 1% is credited throughout the year
- At the end of the year, an additional interest rate is credited equal to:
  - The percentage increase in the S&P 500, if the S&P 500 has gone up for the year, less the 1% the account was already credited
  - Not to exceed the cap rate for the year, which is currently 17%
  - If the S&P 500 went down of the year, the loss is ignored

S&P 500	Interest Credit
Down 20%	1% during year (floor)
Up 9%	1% during year + 8% at end of year = 9%
Up 30%	1% during year + 16% at end of year = 17% (cap)

# How IUL Credits Interest, *cont'd*

- If this method were used over the past ten calendar years, here are the interest credits that would have resulted

Year	Change in S&P 500 Index	Interest Credit
1997	+31.0%	17%
1998	+26.7%	17%
1999	+19.5%	17%
2000	-10.1%	1%
2001	-13.0%	1%
2002	-23.4%	1%
2003	+26.4%	17%
2004	+9.0%	9.0%
2005	+3.0%	3.0%
2006	+13.6%	13.6%

- Average credit: 9.66%

# How IUL Credits Interest, *cont'd*

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Comparing the two methods:

- **Traditional fixed interest method**
  - Safe and predictable
  - Credits a steady rate of interest declared in advance
  
- **Indexed method**
  - Also safe, since the interest credit is never negative
  - But is unpredictable, since the interest credit at the end of the year is based upon stock market index performance
  - May credit more interest than the traditional fixed interest method over a period of years



# Examining Some Index Universal Life Illustrations

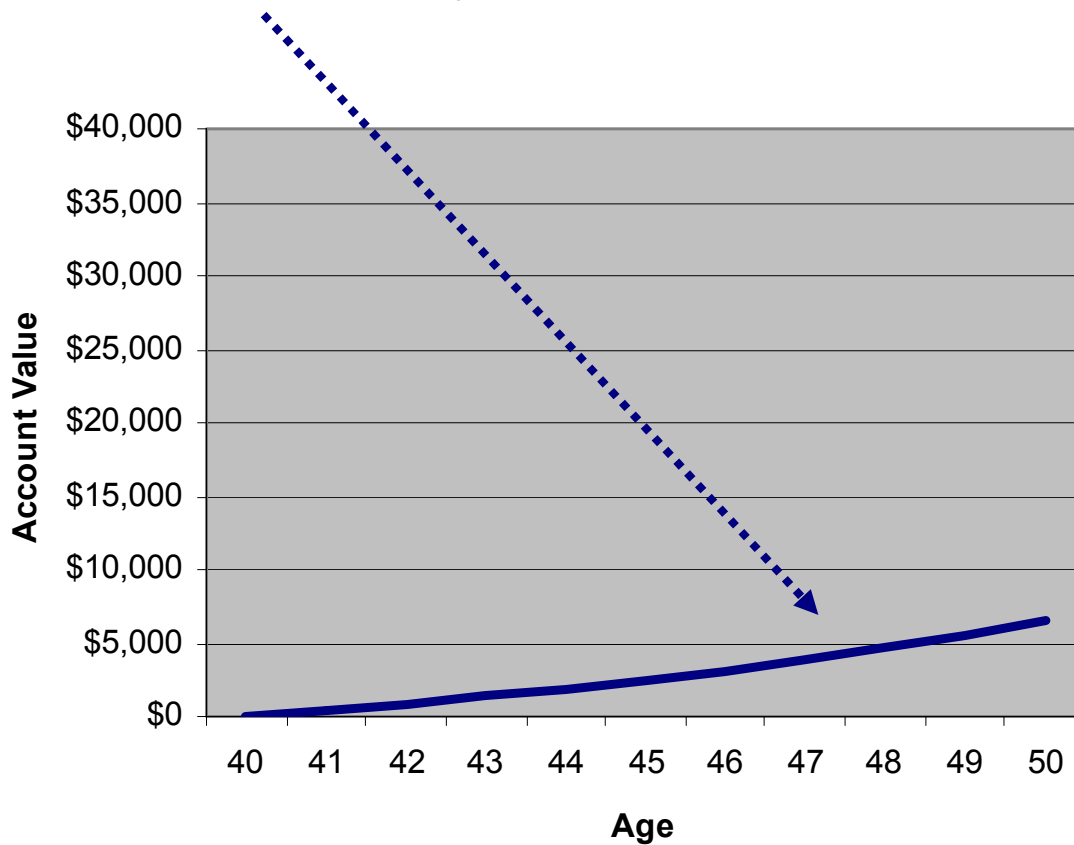
# Examining Some IUL Illustrations

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- In this section, we will compare some projected future account values on a sample IUL product to show how the product works
  - These illustrations will all be based on a male age 40 nonsmoker purchasing a \$250,000 face amount policy
  - These are “current basis” scenarios
- Remember that with universal life, the insured can generally pay in as much or as little as he wants
  - The more he pays, the more his account grows in value
- Also remember that, in general, insurance coverage lasts as long as the account value is greater than zero
  - The more he pays, the longer his coverage stays in effect

# Examining Some IUL Illustrations, *cont'd*

- Our first illustration will assume that the insured pays a premium of \$1,200 annually



## Year 1

- \$1,200 in premium paid in
- Approx. \$800 in charges deducted
- Approx. \$400 in account value at end of year

## By year 10

- \$6,500 in account value

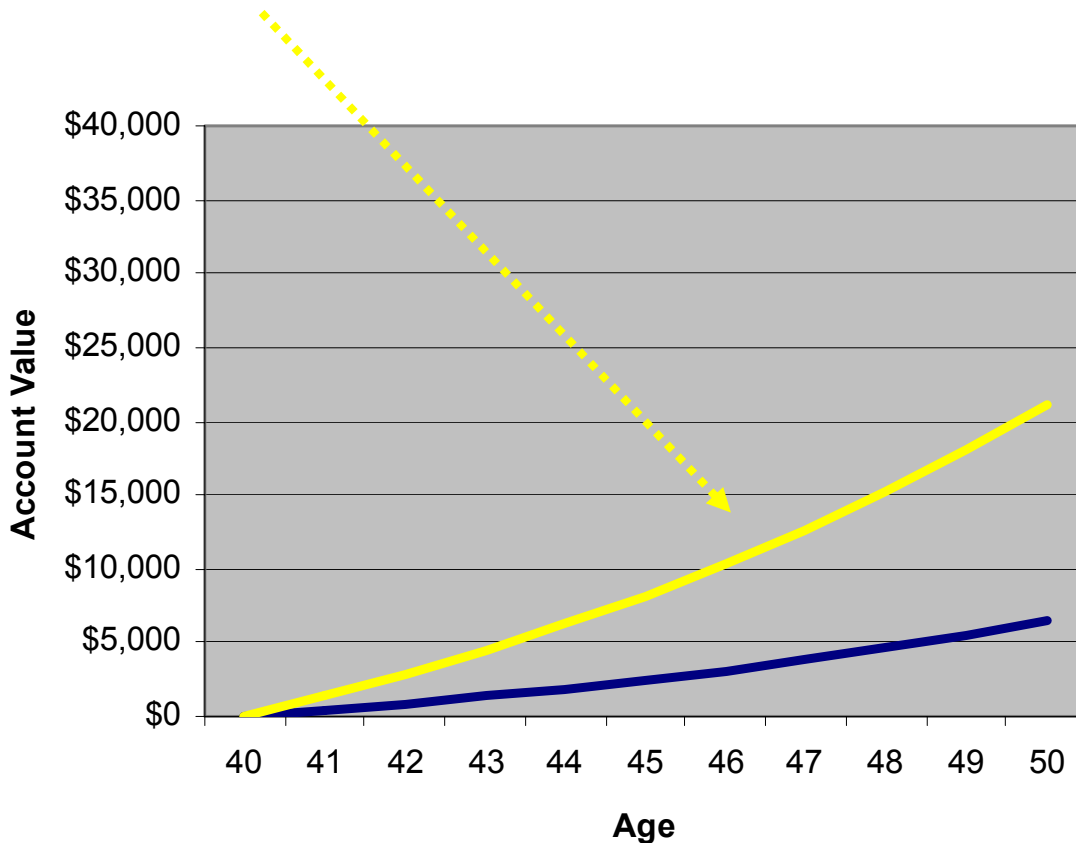
# Examining Some IUL Illustrations, *cont'd*

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- Now, let's see what happens when the insured chooses to pay a slightly higher premium of \$2,200 annually
  
- What would you expect?
  - Higher account values
  
- Why?
  - The insurance coverage is unchanged, so the entire extra \$1,000 that is being paid in goes into the account value and earns interest

# Examining Some IUL Illustrations, *cont'd*

- Our second illustration will assume that the insured pays a premium of \$2,200 annually



## Year 1

- \$2,200 in premium paid in
- Still \$800 in charges deducted
- Approx. \$1,400 in account value at end of year

## By year 10

- \$21,000 in account value

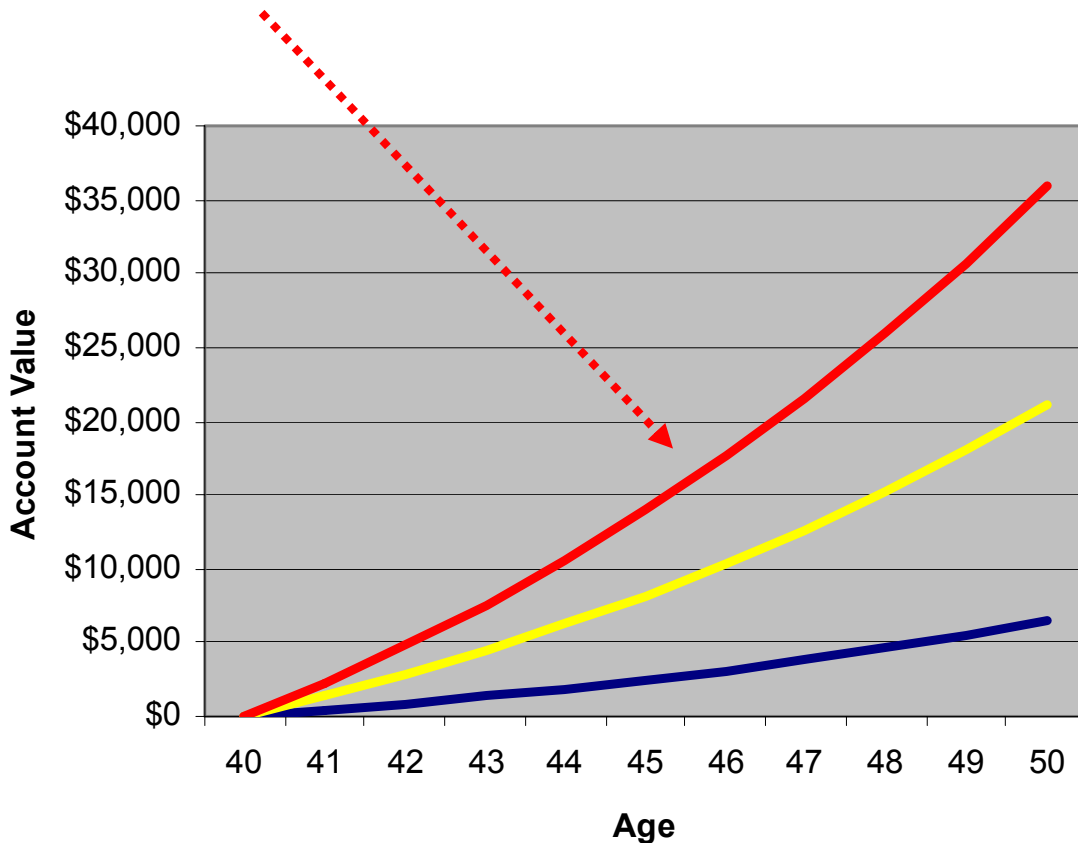
# Examining Some IUL Illustrations, *cont'd*

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- Now, let's see what happens when the insured chooses to pay a slightly higher premium of \$3,200 annually
  
- What would you expect?
  - Even higher account values
  
- Why?
  - The insurance coverage is unchanged, so the entire extra \$1,000 that is being paid in goes into the account value and earns interest

# Examining Some IUL Illustrations, *cont'd*

- Our third illustration will assume that the insured pays a premium of \$3,200 annually



## Year 1

- \$3,200 in premium paid in
- Still \$800 in charges deducted
- Approx. \$2,400 in account value at end of year

## By year 10

- \$36,000 in account value

# Examining Some IUL Illustrations, *cont'd*

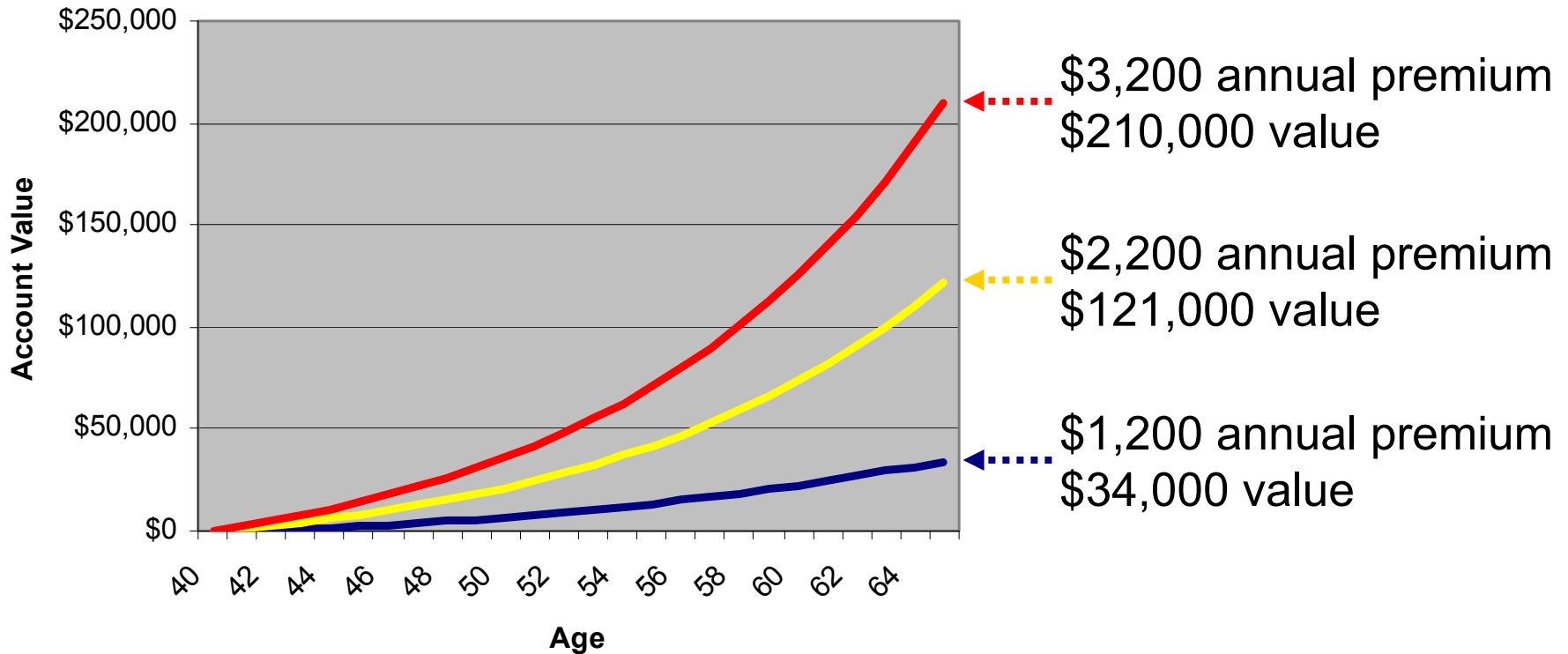
## UL sales concept #1: Return of premium

Notice that the year 10 account value of \$36,000 exceeds the premiums paid in of \$32,000. So, the insured could cash his policy and receive back in excess of what he paid in.

- Moving on ...
- We have looked at account value projections for the first 10 policy years
- Let's suppose that the insured is willing to pay the annual premium for 25 years, that is, to age 65
- Let's see what sort of account value growth occurs over these three scenarios

# Examining Some IUL Illustrations, *cont'd*

- Here are projected values at age 65 under our three premium payment scenarios



# Examining Some IUL Illustrations, *cont'd*

## UL sales concept #2: Saving for retirement

Notice that you can use the account value of a universal life plan to save to reach a desired goal, such as to build retirement savings.

So, you can use universal life to save to reach a funding goal, and to provide that the goal will be immediately funded in the case of premature death.

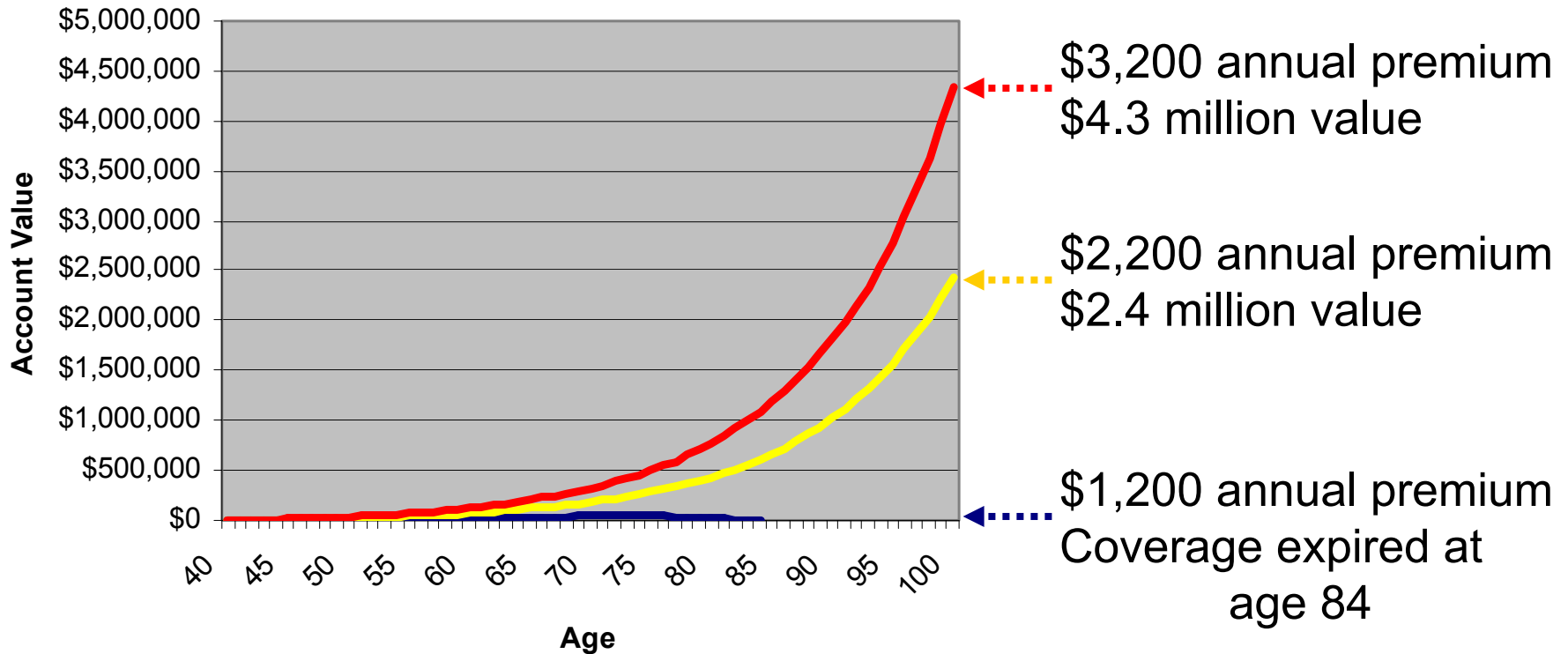
# Examining Some IUL Illustrations, *cont'd*

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- Now, the insured does not want to pay any additional premiums
- If he stops paying premiums, does the coverage terminate?
  - No, it does not terminate
  - The insurance company will continue to credit interest to the account value and take deductions for the cost of the insurance coverage from the account value
  - As long as there is sufficient money in the account value to cover the deductions, the insurance coverage stays in effect
  - In fact, if the interest credits exceed the deductions, the account value will continue to grow

# Examining Some IUL Illustrations, *cont'd*

- Here are projected values at age 100 under our three premium payment scenarios



# Examining Some IUL Illustrations, *cont'd*

UL sales concept #3: Insurance for a lifetime without paying for a lifetime

Notice that our client stops paying premiums at age 65, but the coverage continues much longer, perhaps even for the rest of his life.

# Examining Some IUL Illustrations, *cont'd*

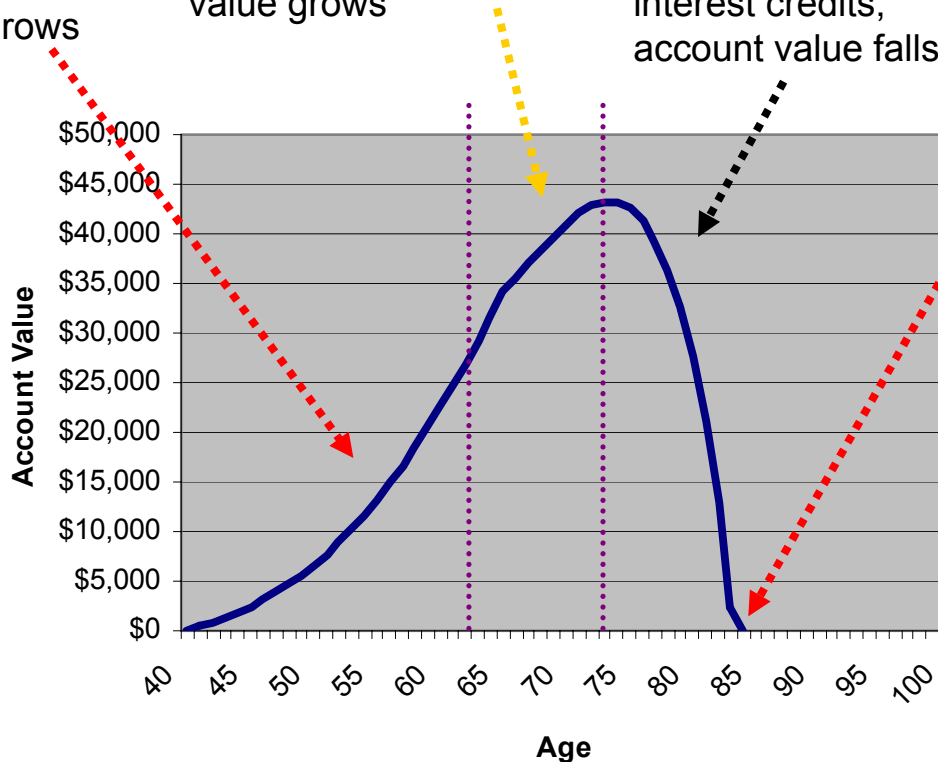
- Let's examine that \$1,200 annual premium scenario a little more

Up to age 65:  
Premium payments  
and interest credits  
exceed deductions,  
account value grows

Ages 65-73: Interest  
credits exceed  
deductions, account  
value grows

Ages 74+:  
Deductions  
increase with age,  
start to exceed  
interest credits,  
account value falls

Age 84: Account  
value is depleted,  
coverage expires





## Other Things to Know About Index Universal Life

# Other Things to Know

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Now, we need to complete your introduction to index universal life by briefly touching on the following topics:

1. Surrender charges
2. Policy loans
3. Guaranteed basis scenario
4. Secondary guarantees
5. Death benefit options

# Other Things to Know, *continued*

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## 1. Surrender charges

- The policyholder can obtain his account value by canceling the policy
- However, most universal life plans have a surrender charge that is deducted in the early years of the policy if the policy is cancelled or a withdrawal is taken
- The surrender value is the account value less the surrender charge
- Thus, a universal life plan is not appropriate for short-term savings needs

# Other Things to Know, *continued*

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## 2. Policy loans

- If the policyholder wants to access a portion of his account value without canceling the policy, he can take a loan from the carrier collateralized by his account value (less surrender charge)
- The loan is charged interest but the account value held as collateral is credited with interest, and so there is typically a 2% or so net spread between the two interest rates
- The loan does not need to be repaid while the policy is in effect, however ...
  - If the insured dies, the loan balance is deducted from the death benefit
  - If the insured cancels the policy, the loan balance is deducted from the account value
  - If the loan balance grows to exceed the account value less surrender charge, the policy terminates

# Other Things to Know, *continued*

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## 3. Guaranteed basis scenario

- So far, we have only been looking at the Current Basis scenario
- Carrier illustration systems also print out a Guaranteed Basis scenario, which is a worst case scenario and assumes:
  - Premium = the same premium shown on the Current Basis projection
  - Interest = the minimum interest guaranteed by the carrier
  - Charges = the maximum scale of charges the insurer is allowed by contract to charge against this plan
- Of course, the Guaranteed Basis scenario will show:
  - Lower account values
  - The coverage terminating sooner

# Other Things to Know, *continued*

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## 3. Guaranteed basis scenario, *continued*

- Which scenario, the Current Basis or the Guaranteed Basis, will actually occur?
  - Neither
  - Guaranteed Basis = worst case scenario
  - Current Basis = reasonable expectation, but not a guarantee
  - The policyholder will receive statements from the carrier summarizing his account activity each year, and these can be compared to the illustration provided at policy issue
  - The policyholder can adjust his premium payments in future years to keep on track with his targeted goal

# Other Things to Know, *continued*

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## 4. Secondary guarantees

- Most carriers will provide a secondary guarantee that is unrelated to the growth of the account value, for example ...
  - If you pay a certain periodic premium, your coverage is guaranteed to last 15 years even if your account value runs out prior to that time
  - Or, if you pay a certain periodic premium, your coverage is guaranteed to last forever (such as to age 100 and beyond) even if your account value runs out prior to that time
- Carriers will also often provide a catch-up provision, so that you can retroactively pay the premium required to obtain a certain secondary guarantee

# Other Things to Know, *continued*

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## 5. Death benefit options

- Universal life plans also typically provide death benefit options, such as:
  - Option A: the death benefit is the face amount
  - Option B: the death benefit is the face amount plus the account value
  - Option C: the death benefit is the face amount plus the premiums paid
- If you pay the same premium, the first option (“A”) will result in higher future account values than the other two options because you are paying for a lower death benefit
- Regardless of the option chosen, the death benefit will always be at least as high as the account value

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