

Indexed universal life insurance faces fresh scrutiny

Regulators homing in on whether insurers are presenting a picture of performance that's too rosy

By **Darla Mercado** | *October 15, 2014 - 2:26 pm EST*

Financial advisers working with indexed universal life insurance are finding themselves in the middle of a heated battle between state regulators and the life insurance industry.

In an otherwise sleepy corner of the product market, indexed universal life insurance has been a stand-out seller. As of the second quarter, it accounted for 17% of overall individual life insurance premium this year, according to Limra.

But now, regulators are taking a closer look at indexed universal life insurance out of concern that amid today's low interest rates, insurers are promoting a rosy picture for clients and promising outsized performance for the policies. Broker-dealers are also keeping a close eye on how these IUL products are presented.

InvestmentNews Reprints

This copy is for your personal, non-commercial use only. To order presentation-ready copies for distribution to your colleagues, clients or customers, click the link below.

- [Order a reprint article](#)

“There is nothing inherently wrong with indexed universal life, but the chances of earning 8% or 9% — it's not going to happen,” said Larry J. Rybka, chief executive of Valmark Securities Inc. “Advisers need to look at this and say we can't take a bond yielding 3.5% and turn it into something that produces 9%. That's financial alchemy.”

Like its indexed annuity cousin, indexed universal life insurance credits interest to a client's policy based on the performance of a market index, up to a stated cap. These life insurance policies also buffer clients' cash value from downward movement in the event the product fails to perform.

Also like the indexed annuity, IUL policies aren't directly invested in the market itself. Instead, the performance of the index is used to calculate how much interest is credited to the cash value of the life insurance policy. IUL is a general account product, and the ability of the carrier to credit interest to the product depends on how well its own investment portfolio of bonds is doing.

REGULATORY CONCERNS

Ben Lawskey, New York's superintendent of financial services, is investigating the sales practices of 134 carriers that sell policies in the Empire State , [according to the Wall Street Journal](#).

At the same time, the National Association of Insurance Commissioners' life actuarial task force is weighing a pair of proposals from the American Council of Life Insurers and, separately, a consortium of carriers including MetLife Inc. and New York Life Insurance Co. on how to address the issue.

The ACLI's plan concentrates on helping clients get a better sense of how the policy performs in different interest rate environments over time. The illustration will depict a chart with the low, middle and high return level for cash value.

The highest rate that could be illustrated is the lowest of the average return of the index over the last 25 years based on the policy, the amount that can be actuarially justified based on the requirements in the NAIC's illustration model regulation or 10%. The low return level would be the minimum guarantee defined in the contract, and the middle rate is the between the higher illustrated rate and the guaranteed minimum.

The ACLI was unable to provide someone to comment by press time, but submitted the following written comment attributed to ACLI vice president and senior actuary John Bruins: "ACLI's proposal would require improved disclosure in IUL illustrations, providing brokers, agents and all financial advisers engaged in the sale of indexed universal life insurance with uniform guidelines for illustrations. It aims to help consumers understand how the product they may be considering works."

The proposal from MetLife and the other carriers seeks to change how the industry calculates the expected investment returns behind the policies.

"Our proposal ties into the investment strategies the IUL companies employ to support their illustrations," said Gene Lunman, senior vice president of retail life and disability insurance products at MetLife. "To support the rates [currently] proposed, companies would need to make exorbitant long-term profits on the derivatives they buy to support

these products.” MetLife and the group of insurers proposed a maximum rate of return of 12% on the derivatives. Mr. Lunman noted that while he personally felt that such a rate over the long term is still aggressive, it's a compromise.

Ultimately, broker-dealers are also sharing their concern with regulators that clients will underfund their policies if they're given unrealistic projections, and that their policies will ultimately lapse as a result.

The scenario is further exacerbated if the client decides to take loans from the policy, which come from the cash value. Some insurers say they will credit nonguaranteed interest to the client's account if he takes a loan from the cash value, a practice some insurance gatekeepers say is worrisome, particularly if the policy doesn't perform as expected.

“If we borrow from the policy at a 4% rate and have a year or two where the index's performance is zero, and I'm assuming I'm making money on the loan but I'm not, then what happens in the long term?” asked Jim Swink, vice president of Raymond James Insurance Group. “That scares me.”

REALISTIC DEPICTIONS

In the meantime, broker-dealers and insurance marketing organizations are coming up with ways to encourage realistic depictions of IUL policy performance.

“We call it 'Don't trust the ad on the box of software,’” said Allie Miller, CEO of AMZ Financial, an insurance marketing organization that distributes and designs insurance products.

“We tell the advisers to take the current illustrated rate [of return], say it's 8%, and show them a 7% or 6.5% rate and see if it meets the client's long-term objectives,” he added. “If it does and you beat that level of return, then you're a hero.”

Mr. Swink noted that some companies will depict policies earning as much as 8.5% in credited interest. At Raymond James, advisers are required to show a maximum interest crediting rate of 6%.

At Valmark, the firm supervises IUL sales as it does indexed annuities, and it requires disclosures to the client to ensure they understand the basics of the policy: You don't get dividends, the insurance company can change its rates and that this is a general account product. Advisers are required to run their illustrations with a 5% crediting rate assumption, Mr. Rybka noted.

“I think every broker-dealer should do that,” he said.

Reproductions and distribution of the above news story are strictly prohibited. To order reprints and/or request permission to use the article in full or partial format please contact our Reprint Sales Manager at (732) 723-0569.