# Was Your Client Sold the Most Expensive Life Insurance Policy on the Planet?

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At the time of this writing, we are approaching the four-year anniversary of the 2015 National Association of Insurance Commissioners Actuarial Guideline 49 (NAIC AG 49) regulating (1) the maximum illustration rate and (2) maximum policy loan leverage on Indexed Universal Life Insurance (IUL). What AG 49 did not address was:

- Equivalent return disclosure to the S&P 500 Total Return.
- IUL interest bonus / return enhancements.

Additionally, at this time:

- Regulators and associations are creating Best Interest conduct standards.
- All life insurance products are being repriced for the 1/1/2020 update to the 2017 Commissioners Standard Ordinary Mortality Table (2017 CSO) that is used for statutory legal reserve purposes.

That said, while the playing field may be changing, nothing is being proposed that will change the "win the illustration game" in the consumer's favor.

**Equivalent Return Disclosure to the S&P 500 Total Return**

Prior to the 2015 AG 49 calculation, life insurance companies were picking 20 to 25-year historical periods that would maximize the illustration rate based on their current 1-year Indexed Account cap – 1-year ending periods typically sometime in December.

- Dates that would make it difficult for consumers to compare to traditional 12/31 reporting of alternatives.
- Illustration rates in the 8% to 10% range that may have 14% to 16% S&P 500 Total Return equivalents.

The result was a non-security product illustration based upon market total returns that exceeded the 12% maximum hypothetical illustration rate on securities and 10% maximum when being compared to other alternatives [FINRA Rule 2210(d)(4)(C) defining "hypothetical illustrations of mathematical principles"].

NAIC AG 49 provides a defined annual calculation that:

- Determines the maximum IUL illustration rate for a given Indexed account methodology.
- Utilizes a 65-year lookback encompassing every 1-year period and further segments those returns into every 25-year segment.
- When applied to the S&P 500 Total Return, provides the common starting point for comparison to a VUL policy.

For 2019 the S&P 500 Total Return (dividends included) AG 49 equivalent rate is 10.95%.

Hence, for 2019, when a consumer asks the simple question "how does this AG 49 rate illustration compare to investing in a S&P 500 index fund in a ____?" the basis of that comparison *should* be the alternative illustrated with a 100% allocation to the alternative's S&P 500 index fund at 10.95% before fund fees (gross). We say '*should*' because:

- A "total return" discussion could violate state regulations regarding unlicensed investment advice.
- 10.95% would violate the 10.00% FINRA maximum.

To date we have not seen anything from regulators or insurance companies that would (1) help consumers understand the benefits and trade-offs of going from an index fund based alternative to an indexed account based insurance product or (2) provide the equivalent return information to securities licensed agents so they can conduct themselves in a FINRA consistent manner.

**IUL Interest Bonus / Return Enhancements**

Initially, IUL utilized traditional policy pricing:

- Lowest costs possible (policy risk costs plus indexed account costs).

- Issuers were marketing either (1) low costs that often had lower Indexed caps, or (2) high Indexed caps that had higher cost of insurance (mortality rates) and expense costs to pay for the higher caps.
- A few policies offered small fixed bonus credits, formula bonuses or persistency dividends starting in year 10 consistent with the features offered on their UL or VUL products.
- Policies offered a limited number of Indexed account options / formulas.

AG 49 reduced IUL illustration rates. To make-up for those reductions the issuers added:

- Fixed Bonus credits – Fixed returns commencing in a policy year regardless of market / consumer's selected Indexed account return.
- Formula Bonus credits – Bonus formulas based on what the consumer's selected Indexed account earns.
- Return Enhancements – Undisclosed issuer managed programs whose enhanced return is based on the consumer's selected Indexed account return.
- Multiple Indexed account options, formulas for consumers to anticipate market performance the next 1-5 years (monthly and annual performance).

Depending upon the specific IUL policy with various insurers, and we are certain this survey is typical although limited in scope to major insurers, we have seen with the same carriers cost of insurance (mortality rates) and expense costs for IUL that are 1,500% to 3,000% greater than a UL or VUL policy illustrated in a consistent policy management manner (No … that is not a typo!).

Most recently, issuers have turned these types of programs into account options or policy riders:

- Option to choose lower cap Indexed accounts that have a bonus or higher cap accounts that do not.
- Riders that may increase lifelong illustrated value 20% in return for a 750% increase in cost of insurance (mortality rates) and other policy costs.

Currently the NAIC is reviewing the post-AG 49 IUL issues.

**Applying AG 49 Principles to Consumer Planning Assumptions**

On the positive side, NAIC AG 49 includes all 252 1-year ending returns within a calendar year. The following summary:

- Provides a 25-year summary of all 1-year return averages within calendar years.
- Includes the minimum and maximum return within those years.
- Assumes a 7.00% consumer long-term S&P 500 index return assumption and applies 25-year return differentials to calculate equivalent illustration rates for different products and management assumptions.

## 25-Year Annual Minimum - Maximum - Average Returns

Based on all 1-year ending returns between 1994-2018.
Annual Range of Return

**S&P 500 Total Return vs Sample Indexed Return Alternatives** | **Gross Index Average Returns**

| | | Variable | | | | | | Indexed UL | | | Bond | S&P 500 | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | 0.15% Fund Fee | | | | | | 10.00% Cap, 0.00% Floor | | | Vanguard | Index | Total | MA-200 |
| | | S&P 500 TR Index Fund | | | S&P 500 TR MA-200 Mgmt | | | Capped 1-Yr PtP | | | Total Bond | Return | Return | Tot Return |
| | | Min | Max | Average | Min | Max | Average | Min | Max | Average | Average | Average | Average | Average |
| 1 | 1994 | -1.48% | 13.22% | 4.72% | 3.02% | 12.03% | 7.92% | 0.00% | 10.00% | 2.36% | 0.52% | 2.00% | 4.87% | 8.07% |
| 2 | 1995 | -0.22% | 41.79% | 20.86% | 2.64% | 25.30% | 10.40% | 0.00% | 10.00% | 8.20% | 9.49% | 17.76% | 21.01% | 10.55% |
| 3 | 1996 | 14.01% | 40.54% | 26.83% | 24.04% | 32.15% | 29.00% | 10.00% | 10.00% | 10.00% | 7.83% | 24.07% | 26.98% | 29.15% |
| 4 | 1997 | 16.67% | 52.29% | 32.33% | 22.60% | 34.39% | 27.60% | 10.00% | 10.00% | 10.00% | 7.65% | 29.91% | 32.48% | 27.75% |
| 5 | 1998 | -0.11% | 52.78% | 26.71% | 23.23% | 37.13% | 31.64% | 0.00% | 10.00% | 9.52% | 10.18% | 24.86% | 26.86% | 31.79% |
| 6 | 1999 | 9.85% | 40.92% | 24.04% | 18.83% | 23.38% | 21.18% | 10.00% | 10.00% | 10.00% | 3.44% | 22.50% | 24.19% | 21.33% |
| 7 | 2000 | -11.73% | 20.95% | 8.89% | 7.99% | 22.53% | 15.36% | 0.00% | 10.00% | 7.30% | 4.33% | 7.75% | 9.04% | 15.51% |
| 8 | 2001 | -33.43% | 1.30% | -15.35% | -0.15% | 7.92% | 2.91% | 0.00% | 0.29% | 0.00% | 12.50% | -16.23% | -15.20% | 3.06% |
| 9 | 2002 | -33.50% | 3.93% | -15.96% | -0.96% | -0.13% | -0.80% | 0.00% | 2.67% | 0.03% | 6.74% | -17.03% | -15.81% | -0.65% |
| 10 | 2003 | -30.41% | 35.99% | 0.81% | -0.98% | 13.86% | 3.34% | 0.00% | 10.00% | 4.66% | 7.06% | -0.83% | 0.96% | 3.49% |
| 11 | 2004 | 6.81% | 43.57% | 19.80% | 14.00% | 25.08% | 20.84% | 5.13% | 10.00% | 9.67% | 3.67% | 17.89% | 19.95% | 20.99% |
| 12 | 2005 | 2.65% | 18.37% | 8.59% | 7.59% | 14.45% | 9.26% | 1.00% | 10.00% | 6.51% | 3.59% | 6.82% | 8.74% | 9.41% |
| 13 | 2006 | 2.28% | 18.90% | 10.50% | 8.11% | 10.45% | 9.26% | 0.54% | 10.00% | 7.53% | 2.19% | 8.61% | 10.65% | 9.41% |
| 14 | 2007 | 1.82% | 27.78% | 14.88% | 10.46% | 16.45% | 13.83% | 0.08% | 10.00% | 9.05% | 5.86% | 12.89% | 15.03% | 13.98% |
| 15 | 2008 | -45.79% | 4.02% | -15.62% | -0.16% | 14.21% | 5.55% | 0.00% | 2.16% | 0.02% | 5.86% | -17.23% | -15.47% | 5.70% |
| 16 | 2009 | -47.65% | 48.63% | -16.56% | -5.91% | 7.64% | -0.93% | 0.00% | 10.00% | 2.25% | 6.61% | -18.56% | -16.41% | -0.78% |
| 17 | 2010 | 3.75% | 72.11% | 24.33% | 7.84% | 29.29% | 20.84% | 1.86% | 10.00% | 9.36% | 7.90% | 21.90% | 24.48% | 20.99% |
| 18 | 2011 | -1.53% | 33.48% | 13.59% | 12.45% | 17.29% | 14.97% | 0.00% | 10.00% | 7.39% | 5.14% | 11.49% | 13.74% | 15.12% |
| 19 | 2012 | -1.63% | 34.34% | 11.52% | 5.81% | 13.21% | 9.33% | 0.00% | 10.00% | 5.88% | 6.51% | 9.25% | 11.67% | 9.48% |
| 20 | 2013 | 11.84% | 35.63% | 21.83% | 12.75% | 23.37% | 18.09% | 9.46% | 10.00% | 9.99% | 0.31% | 19.28% | 21.98% | 18.24% |
| 21 | 2014 | 10.28% | 28.65% | 19.99% | 18.73% | 24.94% | 22.74% | 8.20% | 10.00% | 9.98% | 2.53% | 17.67% | 20.14% | 22.89% |
| 22 | 2015 | -4.75% | 20.04% | 9.65% | 9.22% | 18.69% | 14.55% | 0.00% | 10.00% | 6.86% | 3.23% | 7.58% | 9.80% | 14.70% |
| 23 | 2016 | -9.82% | 18.93% | 3.66% | 2.42% | 9.16% | 4.68% | 0.00% | 10.00% | 2.92% | 3.11% | 1.59% | 3.81% | 4.83% |
| 24 | 2017 | 13.08% | 29.20% | 19.35% | 7.54% | 18.86% | 14.87% | 0.00% | 10.00% | 10.00% | 0.84% | 17.03% | 19.50% | 15.02% |
| 25 | 2018 | -10.84% | 27.71% | 14.48% | 13.19% | 19.59% | 17.91% | 0.00% | 10.00% | 8.69% | -0.57% | 12.42% | 14.63% | 18.06% |
| **Average:** | | **-5.59%** | **30.60%** | **10.95%** | **8.97%** | **18.85%** | **13.77%** | **2.25%** | **9.00%** | **6.73%** | **5.06%** | **8.94%** | **11.10%** | **13.92%** |
| Std Dev: | | 18.48% | 16.85% | 14.25% | 8.17% | 9.03% | 8.97% | 3.88% | 2.77% | 3.50% | 3.28% | 13.95% | 14.25% | 8.97% |
| **Average vs. S&P 500 Index Return:** | | **22.60%** | | | | | **54.13%** | | | **-24.72%** | **-43.37%** | | **24.27%** | **55.81%** |

**Hypothetical Illustration Rates utilizng 25-Year Average Differentials and 7.00% S&P 500 Index Return Planning Rate**

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Net of Fund Fee | 8.55% | | 10.76% | | **5.27%** | **3.96%** | **8.70%** | **10.91%** |
| | | | | Std Dev | 2.74% | 2.57% | 11.17% | 7.03% |
| 2019 Maximum Permitted Illustration Rate | | | | | **6.12%** | Variable Products | **12.00%** | **Maximum** |

MA-200 – 200 Day Moving Average management.

- Remain in the S&P 500 fund when the current share price is greater than the 200-day average.
- Move to cash when the current share price is less than the 200 day average.

Moving Average typically utilizes 30, 50 or 200 day averages. A management strategy that can be applied to variable insurance products (VA & VUL) utilizing end-of-month share price averages to determine monthly management options within the 12 no-cost reallocations offered by most products.

Utilizing this methodology, the 7.00% planning rate would equate to comparing:

- IUL policy with 10% 1-yr point to point (PtP) cap at a 5.27% illustration rate.
- Planning alternatives (VUL, VA [variable annuity], IRA, Roth IRA, 401(k), Roth 401(k), etc.) allocated 100% to the S&P 500 index fund at 8.70% before fund fees (gross).
- IUL policy to planning alternatives at a 3.96% AAA bond return.
- Pros and cons of using Indexed account vs the Moving Average index fund management alternative.

Indexed insurance products provide an important consumer planning option, and have also evolved into a level of complexity that is extremely difficult for consumers and professional advisors to separate financial 'sizzle' from financial 'steak'.

**Best Interest**

"Best Interest" has become a widely used term:

- The SEC has drafted regulations that would encompass Best Interest standards for both qualified and nonqualified assets.
- The CFP Board has included Best Interest in its Code of Ethics and Standards of Conduct effective 10/1/2019.

Best Interest also has a complement – Dispute Defensible Practice Management. Advisors and fiduciaries must be able to document their recommendations and purchases in anticipation of being questioned in the future. If the provider is not

providing adequate information to say “yes”, we believe you are obligated to say “no”.

**What’s Coming Down The Pipe?**

The next 12-24 months should be very interesting, to say the least:

- Greater access to $0 agent commission, $0 surrender charge products for the direct access and fee-based planning ‘space’.
- More insurance policies with just placement commissions – elimination of lifelong policy commission structures.
- More insurance policies that differentiate agent placement and ongoing TPA services compensation.
- Differentiation of highly compensated, accredited investor socio-economic risk class and life profile.
- More VUL policies offering Indexed accounts as asset allocation alternatives.

And, hopefully, recognition by the insurance companies that different types of distribution have different disclosure responsibilities or the advisor needs to say “no”.

**Remember, the first life insurance decision is an investment decision.**

Both of us entered the insurance business in the early 1980’s with the introduction of universal life based (UL, VUL, AL [adjustable life], etc.) policies – “buy term and invest the rest” products where the first agent and consumer decision was how they wanted to invest the cash values that pay the monthly term insurance costs.

Today, thanks to medical advancements extending life expectancy, many products offer greater living benefits than comparable investing in taxable structures (brokerage account or nonqualified annuity) while offering the consumer a planning gain at death for their heirs.

Regardless, the policy structure, cost structure and cost curve remains the second life insurance decision. For example, what costs have to be paid when the return is low, zero or negative? As shown in our 25-year summary, 60% of the time someone received a 0% IUL crediting rate.

The lapsing policy crisis of policies issued in the past are primarily the result of not applying reasonable investment return assumptions to life insurance purchases. Declared interest rates are no longer in the 8% to 11% range - but the same issues are facing consumers today:

- IUL policies with 6% to 7.5% illustration rates that assume a 10.95% S&P 500 Total Return.
- IUL policies with bonus interest and performance enhancements that typically do not get paid when markets correct.
- IUL policies with cost of insurance (mortality rates) and other expense pricing of $30,000 to $45,000 compared to $1,000 to $1,200 for the same amount of protection in a VUL policy.

To wrap up, Agents / Advisors / Trustees … can you explain why you considered a $30,000 cost of insurance, rather than a $1,000 cost of insurance, was in the clients Best Interest?