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TAKING AN IN-DEPTH LOOK: Bonus Multipliers on Index Universal Life Insurance

Index universal life insurance (IUL) is a popular product that can have many nuances. Designs and features are continually evolving. That's why it's essential for the advisor and consumer to review all components of an IUL product before deciding if it's right for their particular situation.

Summary of Important Considerations

Guarantees

What are the guaranteed components inside the contract?

IUL contracts may include a number of guarantees, such as cap rates, participation rates, policy charges, account value bonuses and multipliers. When comparing products, be sure to identify what is guaranteed, how the guarantees are similar (or different) and how they may impact illustrated performance of non-guaranteed values. Since IUL illustrations are mostly driven by non-guaranteed components, it's vital to understand how much they can change.

What are the non-guaranteed components inside the contract?

Proposed cap rates, participation rates, illustrated rates and policy charges are often non-guaranteed. They can be changed at the company's discretion to any level down to guaranteed base rates. The same can be true for account value bonuses and multipliers. Non-guaranteed bonuses and multipliers can be a key driver of illustrated performance, and even slight decreases can materially impact policy performance. It's important to look at a carrier's track record with these components on inforce policies to get a sense of how often, and by how much, they have changed in the past.

Overall Cost

Comparing total policy costs at lower illustrated rates

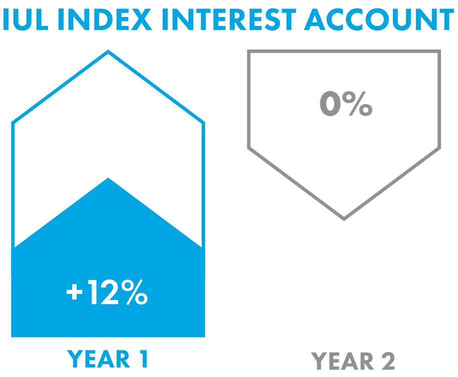
Many products have policy charges that are not apparent at maximum illustrated rates. Often, the illustrated rate is not the total rate at which policy values will grow if a bonus multiplier is involved. To better understand the cost structure and impact of bonus multipliers, run illustration comparisons at a lower rate than maximum and review the policy cost reports.

This enables the advisor and consumer to not only see how values change in different index interest return periods, but also to see the impact of total policy charges if index interest returns are lower than maximum illustrated rates. If the comparison is run equally, the illustration producing higher values at the point you wish to compare assumes lower total policy costs.

Competing for IUL Market Share

When IUL was introduced in 1997, it was in response to rising market conditions and the growing popularity of similarly-structured index annuities, which had been introduced two years earlier.

IUL gave consumers the potential to take advantage of rising market conditions, while also providing them with a safeguard in the event of market downturns. It was positioned as "the best of both worlds" between traditional universal life insurance (UL) and its more aggressive counterpart, variable universal life insurance (VUL). And it worked!



The popularity of IUL soared. And for many years, the growth of IUL has far outpaced the growth of traditional UL. According to the LIMRA U.S. Retail Individual Life Insurance Sales Survey, IUL sales climbed 12 percent year-over-year through 3Q2018, compared to no gain for UL sales overall.[1]

As a result of this success, growing numbers of companies began offering IUL as part of their product portfolios. Today, most life insurance carriers, outside of more traditional mutual companies, offer at least one IUL product in their portfolios.

As more carriers entered the IUL space, the race was on to gain as much of the growing market share as possible. Many products became more aggressive in their designs, features and benefits. Caps and participation rates were increased on new issue products. Participating and variable loan rates were priced aggressively. Illustration rates were increased to help products look better.

People began focusing on which product illustrated the best instead of the intended purpose of IUL – upside potential with downside risk protection. It became more difficult for producers and consumers to decipher the value propositions of the products, especially when looking at illustrated numbers that were never intended to project actual performance.

Leveling the Playing Field

To help consumers better understand IUL products and their intended purpose, the National Association of Insurance Commissioners (NAIC) put Actuarial Guideline 49 (AG49) into effect in September 2015. It placed more consistent limits on illustrating IUL interest credited, with the goal of more fairly depicting how these products may perform for the consumer. AG49 has two main components:

1. **Limiting the maximum illustrated rate a carrier may show in an IUL illustration.** All carriers must use the same guidelines when determining their maximum illustration rates in an IUL illustration. The intent was to help consumers understand that regardless of the carrier illustrations they were looking at, the illustrated rates were derived the same way.

2. **Limiting the spread between participating or variable loan rates and the maximum illustrated rate shown on the illustration.** Before, it was common for an illustration to show a spread of 3 to 6 percent between the loan rate charged and the illustration rate credited. This large spread created a false narrative during the distribution period in an illustration, as well as the assumption that values in the policy would continue to earn a large, positive spread every year. AG49 now limits that spread to a maximum of 1 percent in each policy year.

AG49 was built on good intentions. For consumers it meant maximum illustration rates would be calculated consistently. For life insurance carriers, it created regulations for maximum illustrated rates. But it wasn't long before carriers found ways to continue their "illustration wars," while still following the letter of AG49.

Introduction of Bonus Multipliers

In 2015, the concept of bonus multipliers on IUL products and illustrations was introduced as a way to help boost illustration performance and provide more upside potential, thus reigniting the illustration wars that were popular pre-AG49. Today a majority of IUL products offer a bonus multiplier of some kind. And the number continues to grow.

What is a Bonus Multiplier?

A bonus multiplier is a percentage increase that is used to boost the index interest earned in positive market performance years. Here is a hypothetical example of bonus credited to IUL policy values:

Index Return		Bonus Multiplier		Bonus Multiplier Credit
10%	X	30%	=	3%

Index Return		Bonus Multiplier Credit			
10%	+	3%	=	13%	Total Interest Credited

It is important to understand that a bonus multiplier is NOT a percentage credit of the policy's accumulation value. Rather, it is an increase to the interest crediting rate earned during positive crediting periods.

This means bonus multipliers only produce a positive outcome when the index interest earned is positive. When market performance is flat or negative, there are no positive index interest returns, and therefore, the bonus from the multiplier is 0 percent as well.

Index Movement	Bonus Multiplier	Total Interest Credited
10%	30%	13%
5%	30%	6.5%
0%	30%	0%
-5%	30%	0%

Bonus multipliers take on many forms and vary widely by carrier and by products. They range from 10 percent to as much as 75 percent or more! Some products offer a bonus multiplier without disclosing the percentage amount or the calculation method for determining it.

Some bonus multiplier percentages are guaranteed, while others are non-guaranteed, creating an additional layer of confusion.

In positive market performance years, bonus multipliers have the opportunity to increase total interest credited to IUL policy values for the consumer. But with the opportunity for increased return potential, comes increased risk and volatility.

Important Considerations with Bonus Multipliers

Bonus multipliers can drive up illustration performance and the potential to increase total interest credited. But it's important to understand **all** the components of a bonus multiplier.

When AG49 was implemented, the use of bonus multipliers was still in its infancy. There were no rules regarding how bonus multipliers factored into the maximum illustrated rate calculations required by AG49. This omission allowed carriers to follow the letter of AG49, while also allowing them to include bonus multiplier percentages in the growth of policy value – **on top of** the maximum illustrated rate. This results in illustration values that seem to be growing at the maximum allowable AG49 rate (as printed on the illustration ledgers), when the actual total gross rates of policy value growth could be much larger than the printed illustrated rate.

For example, a policy using a 7 percent illustrated rate with a 30 percent multiplier actually grows at a rate much higher than 7 percent. The calculation is:

7% + (7% x 30%) = 9.1% Actual Interest Rate

As such, when you add the bonus multipliers on top of the AG49 illustrated rates, it's common for the policy values to actually be growing at rates of 8.5 percent to 10 percent or higher! That's why it's vital to understand bonus multipliers inside an illustration and how they increase policy values.

While a limited number of bonus multipliers are provided at no cost, there is usually a charge associated with it being on the policy. The charges vary widely by carrier and product. Today, they generally range between 2 percent and 7 percent. Some products don't disclose the charge, and charges for bonus multipliers can have unrecognized consequences on policy values.

Two Important Notes

First, the charges are usually assessed against the policy's accumulation value allocated to index accounts using the multipliers. While 2 percent to 7 percent of the policy value may seem insignificant in the early years of the policy, when values tend to be their lowest, the charges can have a significant impact in later policy years as the accumulation value continues to grow. Being assessed 2 percent to 7 percent every year for the life of the policy to have a bonus multiplier, can result in a significant amount of money being deducted from the policy values.

Second, remember the value proposition of IUL. At its core, it is upside potential with downside risk protection. The value proposition works because the floor on an IUL policy is 0 percent. The least amount of index interest credited in any given policy year, regardless of market performance, is 0 percent. While this narrative still holds true on IUL policies that have a bonus multiplier, the multiplier charges don't stop being assessed in years when the index performance is poor or negative. So in a negative index performance year, where 0 percent is credited to the policy values, the consumer is still charged the fee for the bonus multiplier – even though they realized **no benefit of the multiplier** in that year. The bonus percentage is only applied on positive index gains.

Where 0 percent is recognized as the floor in any given policy year, the bonus multiplier charge assessed every year can create a negative interest amount earned, netting the consumer a negative balance at the end of the crediting period.

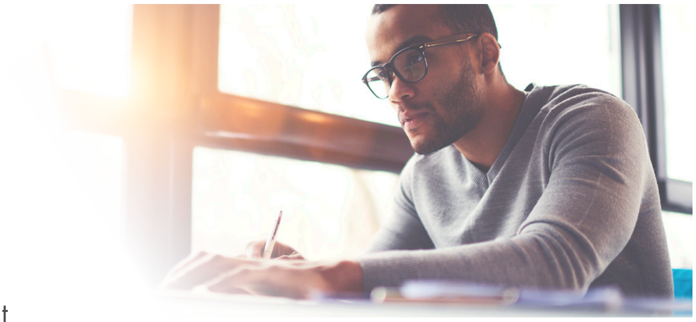
Determine the Break-even Point

So how do you decide when the bonus multiplier credits outweigh the associated charge? Here's the simple formula. Divide the charge for the bonus multiplier by the bonus percentage, as in this hypothetical example:

Bonus Multiplier Charge		Bonus Multiplier		Break-even Index Return
2%	÷	**30%**	=	**6.7%**

In this example, in order for the 30 percent bonus multiplier credits to net a positive impact on the policy values in any policy year, the index return must be higher than 6.7 percent in that year. This has to happen in every single policy year! In any year where the index return is less than 6.7 percent, the consumer paid more for the bonus multiplier than they received in bonus multiplier credits!

Advisors and consumers must ask themselves whether or not they are comfortable with the break-even point to justify paying for the bonus multiplier every single policy year.



The Sequence of Returns is Key

Another important component for the growth of policy values inside an IUL, or any interest sensitive product, is sequence of returns. The index interest rate credited in any given policy year matters, but the order in which the index interest credits are received also matters. And its impact can be compounded on policies with bonus multipliers that assess a charge against policy values.

Zero Is Your Hero with IUL!

But remember, when an index has negative returns, the policy holder is still assessed the yearly charge for the bonus multiplier against the entire accumulation value allocated to the index accounts providing the multiplier. So while the index interest credits are 0 percent, deducting the charge from the accumulation value creates a lower starting balance for the next crediting period. If negative index returns happen in consecutive policy years, the charge will have a compounded negative effect on the policy values.

This scenario can have an even larger impact in later policy years when the accumulation values are higher, since the bonus multiplier charge is assessed in all years against the entire accumulation value allocated to the index accounts providing the multiplier!

With any product, it is vital that the producer and consumer fully understand all aspects of how their IUL policy works. While there are many non-guaranteed components inside an IUL contract, bonus multipliers are the newest and least understood.

Tying It All Together

Bonus multipliers can create the potential for increased index interest returns in positive performance periods, depending on the charge assessed. But it's important to consider all the factors that apply.

- There could be a **charge associated** with the bonus multiplier, especially for those multipliers with high percentages.
- The bonus multiplier percentage may be **non-guaranteed.** Even when they're guaranteed, they only guarantee the formula, not the actual returns, which are still subject to market performance. The multiplier is earned on positive index interest returns only. There is **NO** bonus multiplier credit when the index return is 0 percent or negative.
- Charges are assessed **every policy year** against the **accumulation value** allocated to index accounts with multipliers. And the charge has the potential to lower policy values.
- Bonus multipliers **increase values on an illustration,** since many carriers believe they may be excluded from the maximum illustration rates dictated by AG49.
- To determine the index return breakeven point **divide the charge for the bonus multiplier by the bonus multiplier percentage.**
- Sequence of returns matters!

What's Next?

The NAIC has tasked the IUL Illustration Subcommittee to provide recommendations to modify AG49. One of the points of discussion is around bonus multipliers. Bonus multipliers break the connection between AG49 maximum illustrated rate guidelines and the effective illustrated rate by which policy values increase. They also add interest earned from them on top of the 1 percent maximum illustrated loan spread restrictions.[2]

If bonus multipliers seem too aggressive for you, other options are available -- including IUL policies that don't use bonus multipliers or their associated charges in the product design.

Review all options to find the best fit for you AND your client when offering IUL as a solution to their life insurance needs!

Carriers mentioned in the presentation are peer group competitors of American General Life. Every attempt has been made to verify the accuracy of competitor information included in this presentation. Product information and rates are subject to change at any time.

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[1] LIMRA U.S. Retail Individual Life Insurance Sales Survey, Third Quarter 2018. Published 11/20/2018.

[2] Source: https://lifeproductreview.com/2018/11/21/quick-take-7-regulators-revisit-ag49/, Bobby Samuelson, November 21, 2018

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