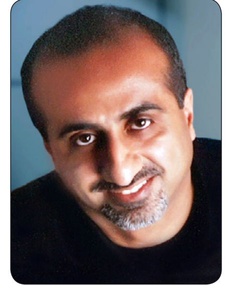
Could Indexed Universal Life products be the next big thing in Asia?



Indexed Universal Life (IUL) has been a popular product in the US for close to a decade. Could it do well in Asia? **Mr Naveed Irshad** of **RGA International** discusses its prospects.

Over the past decade, sales of individual Indexed Universal Life (IUL) insurance policies have grown with great rapidity in the US.

According to statistics from LIMRA International, from 2006 to 2011, new annualised premium from IUL grew at a staggering 24% compound rate while life insurance sales in the aggregate decreased over the same period. The trend has continued into 2012: IUL sales now comprise more than 10% of total new sales in the US.

Why is IUL so popular, and why have its sales increased so rapidly and significantly? There is one overriding fundamental reason: it is a product that strikes a good risk-reward balance between traditional UL and variable universal life, both for the buyer and the insurance company offering the product. This has resulted in substantial recent IUL product development and marketing activity. Also, as IUL is not considered a security in the US, life insurance agents selling the product do not need separate securities licenses, substantially increasing the number of potential sellers.

Understanding IUL

Indexed Universal Life is a general account universal life product. The "indexed" portion of the name refers to the manner in which the crediting rate is determined.

IUL products in the US come with a wide variety of design features, as well as a range of indices available for crediting strategies. Its risk profile for buyers falls about midway between that of traditional portfolio rate universal life (UL), which is lower in both market risk and potential upside, and that of VUL (known as unit-linked UL in Asia), which has much higher upside potential as well as more market risk.

Its chassis is also similar to portfolio rate UL, except that the crediting rate is indexed (or linked) to one or more equity indices (such as the S&P 500). What makes IUL different is that the rate credited to policy account values is based on the appreciation in the index (or indices), subject to participation rates or caps that would limit upside, and to floors that would limit downside.

The participation rate represents the percentage of the index's appreciation with which IUL policyholders are credited, while the cap represents the maximum amount to be credited to policyholders in a given period. The floor represents the minimum amount to be credited in a period. (Most US companies currently have 0% floors.)

IUL is offered on a flexible premium basis, so there are many different sales approaches, from accumulation-oriented sales featuring high early funding strategies to death benefit-oriented sales structured for lower relative levels of premium funding.

Crediting strategies

Three main crediting strategies are commonly used for IUL products. The most prevalent – and simplest – is the Point to Point method. Here, values for the index used are compared at the beginning and end of the crediting period segment. If, for example, the index used is 1000 at the beginning of the segment and 1100 at the end, the crediting rate will be based on the index's 10% increase. Most companies offer one-year crediting period segments, but some have longer segments.

The second strategy, Monthly Sum, bases the crediting rate on the sum of monthly changes in the value of the

Why IUL is so attractive

Here is more detail about the reasons for the recent surge in the US for IUL sales.

Balanced product

IUL products offer an attractive balance between traditional UL and VUL. The availability of crediting rate floors removes much of the risk of investment volatility and of spiralling mortality charges that are associated with VUL plans. Many IUL policyholders see the cost of this downside protection as worth the sacrifice of some upside potential. The upside potential for IUL is also greater than that for fixed UL products, which are currently harder to sell due to the continuing low interest rate environment, as product guarantees are currently more expensive.

IUL product illustrations use a growth rate determined by back-testing the crediting strategy. For currently offered IUL products, companies in the US have been assuming growth rates in the 7% to 8% range, significantly higher than for fixed UL.

Better risk profile for life insurance company

IUL's attractive risk profile is spurring many life insurance companies in the US to focus new product development and marketing efforts on this product. It is interesting to note as well that the parent companies of some of the largest writers of IUL in the US are based in Europe. As most European insurance companies report profitability using Market-Consistent Embedded Value (MCEV) Principles, IUL's impact on embedded value is considered a positive for their risk-reward balance.

The hedging strategy for IUL is straightforward: The minimum interest rate floor and any implied guarantees are backed by a fixed-income portfolio for which disintermediation risk has been carefully assessed, as IUL products are generally not designed with market-value adjustments. Crediting strategies are hedged through the use of call options on the appropriate index. Future interest rate and financial market volatility can be mitigated through policy features that enable adjustments to costs and rates.

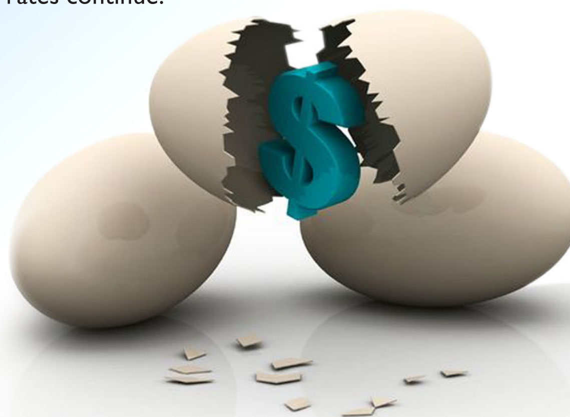
Caps and/or participation rates offered by US IUL underwriters for their products are not fully guaranteed, and so can be adjusted regularly by the life insurance company, subject to some minimum constraints. As annual crediting rate floors are lower for IUL than for fixed UL as well, implied interest rate guarantees are lower, resulting in less interest rate risk for the life insurance company.

The product's adjustability features mean an IUL policyholder bears more investment risk than a UL policyholder, but less than a VUL policyholder. Strong disclosure to this effect is very important. Some companies have also added secondary guarantees to their IUL products, but the current trend is away from this.

Leveraging portfolio investment returns

A typical IUL crediting strategy uses a portfolio-rate approach. A new customer's premium is invested into an existing asset portfolio, but instead of receiving dividends or the actual credited interest, the insurance company uses the credited interest to purchase call options on the pertinent index, so that the policyholder can be credited with an amount based upon that index's appreciation.

Over the past few years, as interest rates have dropped, the differential between the rate of return on existing, seasoned portfolios of insurance company assets and new money rates has widened. Insurance companies can leverage this differential by illustrating higher future growth rates, and for the first few years, policyholders will receive higher crediting rates. Once again, policyholder disclosure needs to be robust, as actual caps or participation rates might need to be reduced in the future should low interest rates continue.



index used. The third strategy, Monthly Average, bases the crediting rate on the average of the monthly change in index values, using higher participation rates relative to the other strategies to develop an appropriate annualised crediting rate.

Most IUL products sold in the US provide guaranteed cash surrender values to satisfy non-forfeiture requirements, low long-term policy loan spreads that permit policyholders to access funds in an efficient manner, and a fixed account investment option that operates similarly to the one commonly used for traditional UL cash values.

Target markets

While IUL can meet many market needs, two strong needs stand out: retirement planning for mass affluent customers, and estate planning for high-net-worth individuals.

When purchased for retirement planning, an IUL policy is initially funded at a high level, usually on a limited-pay premium basis, and is structured so that enough net amount at risk is available to qualify the policy as life insurance and its favourable tax treatment. Account value growth is tax-deferred, and tax savings will generally more than offset mortality charges for healthy individuals. When the time comes, retirement income from the policy can be accessed in two ways: partial withdrawals that are tax-free up to the total premiums paid into the policy; and tax-free policy loans.

For a high-net-worth customer's estate planning needs, the total premium needed to fund a properly structured tax-free death benefit may be lower than it might be for traditional UL plans due to the upside potentially available from the crediting strategies. Some IUL policies can even have a portion of the premium financed via bank loans, with the IUL policy itself pledged as collateral.

Could IUL do well in Asia?

As the US life insurance market is the largest in the world, product trends there can often be a good leading indicator of what is to come in other markets. Many of the economic conditions fuelling IUL's popularity in the US, such as stock market volatility and low current interest rates, also exist in Asia. New money rates are far below portfolio investment returns, and current interest rates are highlighting the higher cost of providing strong underlying guarantees for traditional participating and UL products.

Demographics in Asia line up favourably relative to the US in terms of IUL's potential. In many Asian countries, a large and increasing percentage of the population is focused on accumulating assets for retirement planning.

For example, according to 2010 United Nations statistics, 28% of the population of Hong Kong and Singapore together is between the ages of 40 to 64 (vs 24% for the U.S.). Many members of this demographic are part of the mass affluent cohort – individuals who have amassed property and savings and built families – and an efficient, balanced insurance product oriented around retirement planning could be very attractive.

IUL's characteristics also match well with the estate planning needs of Asia's high-net-worth cohort. According to the World Wealth Report 2012, published by Cap Gemini and RBC Wealth Management, in 2011, the number of high-net-worth individuals in Asia surpassed the number in North America for the first time, and total assets held by high-net-worth individuals has experienced a global shift toward Asia.

Members of this demographic have also completed their major lifecycle expenditures, and are looking for strategies that will let them preserve their wealth and pass it on to the next generation. Life insurance companies operating in Asia are focused on tapping into this growing market, and improving the risk profile of their new UL-style product offerings. Many Asian and offshore life insurance companies have already been successful in selling US-style portfolio-rate UL products to high-net-worth individuals, and much of this business has been financed through bank loans as well.

Overall, the number of new UL product offerings and new entrants in Asia has been increasing significantly, but companies are struggling to differentiate their offerings, especially as product features and guarantees for portfolio-rate UL products being sold in Asian countries have been scaled back due to the current economic environment. IUL could very well be the right product to offer to high-net-worth individuals interested in estate planning and to mass affluent individuals interested in retirement planning in order to create this differentiation.

All in all, given the similarities between the US and Asia target markets, IUL is certainly a product line worthy of a closer look.

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