Indexed Universal Life Insurance (IUL) Adapts to Inflation and High Interest Rates

High Interest Rates Increase Market-Linked Growth of Cash-Value Life Insurance

BOULDER, CO, USA, November 19, 2022 /EINPresswire.com/ -- High bond interest rates accompanying currently high inflation enable increased growth of cash value in indexed universal life insurance (IUL) policies. This can provide peace of mind to IUL policy owners worried about inflation, recession and stock market crashes.

> The forecast for US recession within the year hit 100%”
>
> *Bloomberg.com*

Cash-value life insurance, particularly IUL, is a well-known alternative asset class. It offers a wide range of potential benefits.

Summary of IUL benefits
- an immediately available death benefit (in case of untimely death)
- immediately available living benefit options (e.g., for chronic, serious, terminal illness)
- tax-free market-linked growth, linked to (but not invested in) one or more selected market indices
- risk-free growth of policy value via 0% “floor” (no exposure to negative market returns)
- potential protection against inflation
- tax-free lifetime income (via policy loans paid back with death-benefit proceeds)
- tax-free income protects against risk of rising tax rates
- tax-free income avoids high tax bracket for other, taxable income
- income-tax-free death benefit
- asset protection (varies by state) during life of insured
- elimination of all taxes plus asset protection, forever, when owned in a dynasty trust

Thus, IUL can provide good growth and tax-free income in the form of policy loans, while the 0% floor effectively eliminates the risk of losses during market downturns. For example, although the S&P is currently down 17 percent year-to-date, IUL cash values are protected against market loss. What about inflation and high interest rates?

Interest Rates and Options Budget

Growth of cash value is "linked" to one or more market indices, but policy cash value is not directly invested in the markets. This risk-free growth is achieved by investing the bulk of present policy cash value in fixed income vehicles, typically corporate bonds, at a guaranteed, fixed interest rate. This generates a known return, guaranteeing preservation of starting cash value (i.e., 0% floor). The insurance company uses the balance of cash value, the options budget, to purchase market index options. If a market index goes up during a crediting period, then the options are exercised, growing cash value. If an index goes down, the options are allowed to expire, but the starting cash value has been protected (0% floor). Clearly, when corporate bonds pay higher interest rates, then less of the present cash value need be invested in bonds to guarantee the 0% floor, and more cash is available in the options budget to invest in index options. This increases cash-value growth potential (in the form of higher caps and participation rates). In other words, higher interest rates mean increased potential cash-value growth. The reverse is also true – when corporate bond yields fall, options budgets get smaller, and potential cash-value growth decreases. There are, of course, lag times in these processes because insurance companies replace lower yield bonds in their investment portfolios with higher yield bonds (and vice versa) only gradually (measured in months).

Inflation, IUL and Interest Rates

Inflation erodes IUL policy cash value as well as the real value of policy loans and policy death benefit. In order to fight inflation, over the course of year 2022, the U.S. Federal Reserve Bank raised interest rates from close to zero to 4+ percent, causing corporate yields to climb to 5+ percent. More increases are expected before end of 2022. For the time being, therefore, the relatively high interest rate environment has enabled insurance companies to increase IUL options budgets and, thereby, potential cash-value growth. Of course, as described below, interest rates do not always track inflation. In fact, the Fed might lower interest rates if the US economy falls into deep recession.

IUL in Today’s Uncertain Economy

The forecast for US recession within the year hit 100%, reported Bloomberg.com on October 17, 2023. "Right now, the market’s going lower – it could be 30%, 50%, it could be 60%, 70%...until we get a genuine pivot and/or we get an inflation rate less than 4%", warns fund manager Michael Pento. And former institutional money manager Alf Peccatiello predicts: "If today the Fed goes to 5%, stays there for a year, you are ensured to see massive damage to the real economy, and you are ensured to see a recession. Over the last 100 years, every recession in the US managed to bring down inflation...by 7 points on average." Thus, for the short-term, experts predict a recession and additional stock market declines. When the recession becomes more severe, however, the Fed will likely pivot to lower interest rates to stimulate the economy. The resulting decline in corporate bond yields would inevitably reduce options budgets and lead to lower caps and participation rates (less cash-value growth). The 0% floor protects policy cash value, in any case, against severe stock market declines. Further, a steep decline in a market index sets the stage for a big positive bounce in a future crediting period.

Conclusion

IUL is a useful, but underutilized alternative asset class that protects principal against market downturns and enjoys substantial, tax-free growth in positive market years, and further provides tax-free income and death benefit. A high interest-rate environment increases potential IUL cash-value growth, which helps to offset the damage caused by inflation.

Thomas Swenson, JD
Shoreview LLC
+1 303-442-3100
tjs@shoreviewllc.com
Visit us on social media:
Facebook
LinkedIn
