

Indexed Insurance Policies Hedge against Inflation

High Interest Rates Increase Market-Linked Growth of Indexed Universal Life Insurance (IUL) and Fixed Index Annuities (FIAs)

BOULDER, CO, USA, July 24, 2023 /EINPresswire.com/ -- At the age of 65, an individual can expect to live about 25 years in retirement (a bit longer if married).

[Indexed universal life insurance](#), IUL, and [fixed index annuities](#), FIAs, are important asset classes for holistic retirement planning. Unfortunately, both are often ignored or rejected, and for the wrong reasons. Both IUL and FIAs provide market-linked growth with principal protection (0% floor), eliminating market risk.

High bond interest rates accompanying currently high inflation enable increased growth of cash value in IUL and FIA policy accounts, as explained in greater detail below. This enhanced growth potential together with protection of account principal builds retirement funds while protecting against market risk and thereby provides peace of mind to policy owners worried about inflation, recession and stock market crashes.

Indexed universal life insurance, IUL, 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)



Safe and secure retirement

- tax-free income protects against risk of rising tax rates
- tax-free income avoids high tax bracket and minimizes Social Security taxation and Medicare premiums
- income-tax-free death benefit
- asset protection (varies by state) during life of insured
- elimination of all taxes forever plus asset protection when owned in a [dynasty trust](#)

FIAAs generally provide the following benefits:

- Positive, tax-deferred gains (usu. pegged to one or more stock indices) are locked in when markets are up (no stock dividends)
- 100% principal protection (0% floor, i.e., your money will never go backwards due to negative returns in the markets)
- A guaranteed return in the form of one or more "bonuses" credited to the accumulation value, in a range of 5% to 10%, depending on the policy
- Useful to grow and protect "qualified money" in IRA, 401(k), 403(b) plans

Interest Rates and Options Budgets

Growth of cash value in IUL and FIA accounts is "linked" to one or more market indices, but policy cash value is not directly invested in the markets. The market-linked, risk-free policy growth is accomplished using options. The mechanism can be explained conceptually, as follows. At the beginning of crediting period (e.g., one year), the bulk of present policy cash value is allocated to fixed income vehicles, typically corporate bonds, having a 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 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 when options are exercised). In other words, higher interest rates mean increased potential cash-value growth. The reverse could also be true – when interest rates fall, corporate bond yields also fall, options budgets get smaller, and potential cash-value growth decreases. In fact, however, when corporate bond yields are high, insurance companies buy longer term bonds. As a result, the higher bond yields are locked in for longer time periods (e.g., 10 years), corresponding options budgets remain high, and potential cash-value growth persists. Conversely, when an insurance carrier needs to purchase bonds during a low-interest rate period, then it buys shorter-term bonds, which can be rotated out relatively quickly when interest rates go up. Thus, although there are lag times (measured in months and years) as insurance companies gradually replace lower yield bonds in their investment portfolios with higher yield bonds, options budgets and resultant cash-value growth inevitably increase along with bond interest rates.

Inflation and Bond Interest Rates

Inflation erodes policy cash value in IUL and FIAs, as well as the real value of policy loans and policy death benefit. In order to fight inflation, over the course of years 2022-23, the U.S. Federal Reserve Bank raised interest rates from close to zero to 4+%, causing corporate yields to climb to about 5+%. More increases are expected during 2023. 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, interest rates do not necessarily track inflation. In fact, the Fed might lower interest rates if the US economy falls into deep recession. But, then again, recessions often correlate with deflation.

Conclusion

IUL and FIA policies are useful, but underutilized alternative asset classes that protect principal against market downturns and enjoys substantial, tax-free growth in positive market years. The current high interest-rate environment increases potential cash-value growth in IUL and FIAs, which helps to offset the harm caused by inflation.

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