Episode 7: What ever happened to IUL's downside protection?

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John: Hello everyone and welcome to Ohio National's Momentum podcast. I'm your host John Grevas and today we are going to be talking about indexed universal life insurance products. Now IULs have been typically sold under the value proposition of downside protection, which comes in the form of a contractual floor that protects against loss.

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John: Um, losses that are based on performance along with index based growth for upside potential. But, over time we have seen insurance companies make efforts to capitalize on that upside potential to ensure that their products illustrated really well. They've gone out and added riders and multipliers and those things mean that the contracts had the potential to grow more quickly in up markets. But, each new generation of those enhancement factors also came with new and escalating fees. So, in many cases, clients, and in some cases even financial professionals aren't necessarily aware of just how high those fees have gotten over time.
So, our conversation today is going to focus on those fees and the impact they have on these contracts, including how they can possibly drag down performance, and even limit the protection of these policies.
So, for that conversation, I'm joined today by Rebecca Walser of Walser Wealth.
Hi Rebecca, and thank you very much for joining me today.

Rebecca: Hi John, thanks for having me.

John: Absolutely. So, Rebecca I know you're a proponent of these low cost IUL products. But, before we get into the specifics of that, um would you mind telling a little bit about where you are using these products with your clients and what goals they are helping them meet?

Rebecca: Yeah, absolutely. Um we love life, you know general. So, whether it's whole life or an indexed life product. I don't use any type of variable products at all. So, I will just be restricted on my comment to whole life and indexed life. Indexed life, I think is a great ah tool to add to the life insurance tool belt. If you're like a whole life snob, like I kind of was and still am, um because of the flexibility you know. John, if you have somebody who comes to you and says they want to retire in seven years, it's kind of hard to do a ten pay. Right. Or, if you have a client who says I want to work fifteen more years, while a twenty pay is too long and a ten pay is too short. So, the indexed life really gives us a great flexibility from a timeframe perspective um that we just don't have on necessarily the whole life side.

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John: Now, when you're talking to clients, how are you getting them interested in them? How are you getting them excited about what they are going to do for them?

Rebecca: Well, the first thing I really start with is an education. And, obviously because I am a tax lawyer, I have no reason I can't do that. I have the credentials to speak tax and to speak to them about what I see coming in this particular decade. This is the decade that we have been talking about, really for, I would say since the forties. So, let's just say from the fifties on. So, we've been talking about this decade coming for seventy years and it's become known as kicking the can down the road. And no one has ever done anything about it. Now the decade is here. Now it's all happening. I'm specifically talking about the retirement of the baby boomers in mass in this generation. And by 2030, every single baby boomer will have reached FRA, or what we call full retirement age. Um we know the statistics show us that most people actually start taking social security at 62.The majority of Americans start taking it early. So, we expect fully that all of the baby boomers will be fully retired and on social security and Medicare. And because of that, the government has done some studies over the last you know twenty years of time of what's the impact of the mass retirement of the baby boomers. And they let us know very clearly that one of the impacts is larger taxation. And that's mathematically really, at this point, unavoidable. You know, where as before, you might have a client that says well yeah I really don't know what tax rates are going to do. I'm totally fine saving all of my wealth inside of my 401k at work or my IRA or just using an after tax brokerage. Knowing ah where tax policies must head from a mathematical perspective really allows us to say what levers and what asset classes are out there that are really tax favored and tax advantaged. And, obviously, life insurance is the most tax favored asset class in the tax code. I call it the golden child of the life insurance or the tax code. And so uh, there's four different tax provisions that favor life insurance very heavily. This the government is not unaware of this. The government is fully aware of this. They do this all the time where they use tax policy to encourage private behavior. They encourage the use of life insurance, not because they are being altruistic, but because they know that if somebody were to pass away prematurely while they have minors, so 19 years of age and younger and still in school, that person, that family can go to petition the U.S. government for social security um benefits for the minor children. So, they promulgate the use of life insurance so that there's, you know, not a need to depend on the government for the raising of those people. So, that's one of the reasons they use ah tax policy to encourage the use of life insurance. We've been able to leverage that to be beneficial for tax policy reasons for wealth building.

John: Great. And, you mentioned something that I want to dive in a little bit further there. You mentioned educating clients and how important that is. Do clients tend to understand the way these products work or are they more focused just on the end result, what it's doing for them? What's kind of your experience on that front, and specifically IUL products?

Rebecca: Yeah, ah, certainly. No, they don't know how they work at all. Right. They definitely have to be educated. Um, so, there's no understanding at all about how an indexed product works. Even a whole life product, you know. It's the concept in general of leveraging insurance as a wealth building tool, as an asset building tool, that is foreign. Most people think of life insurance still to this day as a death benefit, you know, only. And, when you start talking to them about leveraging this as a living benefit tool, long term care, um, you know, potential cash flow that's tax free during your retirement years, um, notice I say cash flow and not income. Um, those things, they are not aware of those differences, they are not aware of how this policies are workable and usable for living benefits. So, it's definitely and educational process. But, even beyond just how the product works, you can't offer a solution if someone doesn't believe they have a problem. So, the first thing is to really educate them at a really 33,000 foot level of what is happening and why this decade is, everything is changing in this decade, and what can we do with the opportunity of the time we have left to prepare for. And, that's really where the education first starts. And, then once they understand, yes I understand I need to really look at some of these tools. That's when we start to talk about the actual mechanics of the different products and why we use what we use.

John: It's really interesting to me and this touches on something that you just said. It's really interesting to me that clients think of these as the protection products. They think of these as that death benefit, that legacy protection type product. And, yet, IULs have succeeded by focusing on that upside potential.

Rebecca: That's right.

John: So, you know, it makes me think about how companies have or insurance companies have accomplished that. And, um, I guess one of my questions related to that is, that zero percent floor, the downside protection aspect of these IUL products. When you are talking to clients about these products, how much of a focus is that in your conversations? How important are they considering that downside protection aspect?

Rebecca: You know. It's interesting. We, obviously have, recently come out of an almost eleven year bull market cycle. And so, there's been a lot of people that over the years um have said you know I think I'm okay and I think the markets going to do well for a while. But, you have to talk to them about and that's where the other part of the education is. We literally pull up S&P 500 for the last thirty years or three decades and we literally walk them through the history and I explain how economics is cyclical, how we've had two bull market runs over ten years. On the last one, a little under ten years on the first one. And in the middle, we have the ten years of the lost decade. And I talked them and I walked them. It's very painful to walk through that volatility. So, if anybody thinks well, gosh, you know I've got fifteen more years, I'm fine. You walk them through the lost decade and you show them that those two big corrections, specifically the dot com crash and the Great Recession. Both took just around five years to fully recover what you lost. And, they start to realize that even if I have fifteen

years left. If I had fifteen years to grow this wealth and I lose five of those fifteen years just recapturing, what it was lost, I could really knock out 33% of my earning time just because I'm recapturing losses. And, they start to see that while we're not anti-market, cause we're, we're money managers. We believe in the market. But, while we are not anti-market, we also know that it's very important to build a true fiscal house. A house that has stability, meaning it has a foundation that is not subject to volatility. It has walls that have maybe potentially upside growth with the market, yet no risk of loss. That floor, that's where the index product comes in so greatly. We call that a hybrid asset class where we have a safety of a foundational asset. But, we get market based growth on, the you know, market through options obviously. And, then we, obviously, have some money still invested in the market. But, it's a different way of looking at their portfolio and, and most people come in and they have one of two asset classes they're invested in the market with some kind of stock bond split and they have some kind of cash savings for emergencies. And, that's pretty much your average, typical client, and that's what they've been taught, and that's what they know. And, so, this is really an educational process to explain to them there is new asset classes that have really been designed and developed in the last twenty years that offer us opportunity to participate in the market. But, with a safety of not risking all that principal.

John: Yeah, you've got that the geared those life insurance products, whole life, IUL, they're great for taking that volatility risk out of their investment portfolio. They really help smooth that out.

Rebecca: Exactly.

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John: So, what does your product selection process look like when you're working with a client? Or do you have are you talking to them about the fees and the impact of those things? Or are you vetting the products ahead of time and really only putting in front of them the things that you're, that, you know, you really want to recommend? What does that process look like for you?

Rebecca: It's a great question. So, I will tell people right up front. Listen, we're independent, because we are. I mean I am not a career agent. I know a lot of this people watching this will probably are a career agent. So, they won't be able to use this part of my explanation, but I do tell people that when I started my practice going on almost seven years ago now, I was a tax attorney and I was familiar with leveraging life insurance for tax purposes as practicing tax law. And, I, when I opened my practice, I really vetted myself and just and wanted to find out what company was the right company to offer our clients as an independent advisor. I had bought my first whole life contract with Northwestern Mutual when I was twenty one years old. I had just graduated from with my degree in finance and I had was there. And I don't know if you know anything about Northwestern Mutual, a great company, but they really target

certain segments and certainly my, my segment was targeted. And, I remember the whole life agent coming in and explaining to me, you know, this is uninterrupted compound interest because it's a dividend every year and I was a finance major. And, of course, you know Albert Einstein's eighth wonder of the world, compound interest. So, I said stay say no more. Sign me up. So, I signed up with Northwestern Mutual at twenty one years of age not understanding how life insurance products are designed. Or how they work. And, it wasn't until becoming an actual tax attorney where I saw us leveraging life products for tax planning and, and legacy planning purposes, that I really got into the semantics and the specifics of how these actual products are designed.

Rebecca: And, that's really what led me to Ohio National. I met an Ohio National, my, my actual marketer, you know, I met him by random and, and so you know started really doing the research on Ohio National. The second thing is I want a company that's been in business over 100 years. I want to know that they have the track record they have gone through the Great Depression the Great Recession. They've gone through all of these things and they're very financially stable and sound because people are concerned that they're using an alternative asset class, with the stability of that money. Then we start to look at what are our options. You know if there's a lot of carriers that are just whole life only, and there's no flexibility there. So, that might not be where we're at. But, the, the, then we could start getting down into the three things that really make a life insurance policy tick. And what does perform. And how does it work, you know. And, so we're talking about what is the return? What are the COI and what is the mortality? And so, Ohio National being the tightest mortality in the industry. Which really, I mean, I've had people I have been doing this now for a while ago now. Ohio National, I've had people deny with Ohio National that have been approved with Mass Mutual with a preferred health rating. I am not kidding you. So, you know when you do this that you can see other carriers and their, their, health ratings. And, their risk pools are so much greater that, that is telling us that their expenses are going to be so much greater, if they're paying a lot more claims. Then there's no way that the costs of insurance can't be going up, so we're looking for tight mortality and lowest expenses. And really, when you go through all of that criteria, the last name in the pile that's left is Ohio National.

John: Fantastic. It's a great commercial for us that I did not ask for at all. But let's talk about fees a little bit. You got into that. So, let's go into a little bit more detail. What impact do those fees? And, obviously, every insurance product is going to have the cost of insurance. You're not going to be able to get away with that, away from that, excuse me, with Ohio national or anybody else. But as we start tacking on these additional fees from the multipliers and the enhanced. Since. What is that doing to the to the actual wealth accumulation from and even from the protection of these products?

Rebecca: Yeah. It's really interesting because now, you know, when you had the index product come out and you started having carriers just illustrate these crazy illustrations. I mean, I saw some of them years ago that looked like man I could invest,

like, you know, $20,000 a year for ten years and I would get paid, you know, $50,000 into perpetuity and I still have like $500,000 left when I died. And my and, you know, it was such crazy illustrations because the rate, they rates of return they were using where you know double digit rates of return. Then, we had AG49 come along, which obviously dealt away with all of that, but it had an unintended consequence and as being a lawyer, we, we always talk about the law of unintended consequences. You, you write something to deal with one specific thing and then all these other things happen as a result. Because people, you know, for every action there's an equal and opposite reaction. And, so that's exactly what happened with AG49 is we basically then got the built in bonuses. Right? And, so if you compare Ohio National's product, which I call it, has a true zero floor. So, that's really what I zoom in on is the true zero floor in comparison to other carriers. That yes, they might demonstrate a higher rate of return, but that's because they're building in, not even optional, you cannot opt out of their market based multipliers, that if you do not have a year of a positive return, could cost you up to as much as 3% of your hard invested dollars in that year. And, when you look at the fact, for my perspective of forecasting really where the economy is going in these next ten years between 2020 and 2030, with everything that's happening and the fact that we're due for volatility because markets are cyclical, so we're due for a period of volatility here. We're going to have a couple of years, and these next ten that the market doesn't perform and does do bad. And, so, when you're taking away, potentially it's costing you 3% and these market base, you know, multipliers are not going to come to fruition. Then you're going to see a big problem where people thought that their money was protected, and in fact they're losing money because of the costs of these multipliers. So, Ohio National being the lowest, and I don't think I said this before, but Ohio National being the lowest cost product on an index, you know, cost basis in the country. Which last year I haven't, I didn't do it and take a fair disclosure down and do it in 2020. But, last year I did attend a competitors workshop where they ranked the top 11 or 12 IUL carriers, and they confirmed that Ohio National had the lowest cost. And, then of course, I asked for that report from Ohio National who also confirms that they have the lowest cost. So, it's like the Ronald Reagan trust, but verify. When you have competitors confirming that Ohio National has the lowest cost index policy, for me, that is so important because costs are where your policy can go wrong. Especially on the index side, because you're not getting that dividend that is religiously coming in no matter what the market is doing.

John: Right, well, I think the other thing in addition to what you mentioned there I agree with everything you said, but the other thing that I would add is that those fees, even if you are experiencing growth, they're cutting into the pool of assets that that growth is applied to. So, the, you know, the sequence of returns, the order of operations comes in and. You don't have as many assets to apply the growth to, which compounds over time.

Rebecca: Absolutely.

John: So, I think that's another factor there.

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John: Now the other thing that you mentioned there is AG 49. As of the time that this episode is going live, AG 49 A, which was an update to the illustration requirements for these IUL products. That limits client expectations of certain features and the kind of growth that they could experience. Limits what carriers can illustrate. Those have that's just gone into effect. Limits the maximum rates as a result of multipliers and enhancements. Do you anticipate what sales approach changes do you anticipate either within the industry or for yourself as an advisor?

Rebecca: I mean and I would love to get your impression on this, John. I'm working actually with Ohio National, but my perspective is I always I am running and I have been for probably I want to say at least maybe 16-18 months now I'm running my IULs at 5.35%. So, I think the maximum right now with the adjustment is 6% on the S&P 500. Not unlimited, not the end cap, but the S&P 500 annual point-to-point I. I think that the max on the new illustrations is 6%. I run mine conservatively, I believe at 5.35. And, I really use on our on the Ohio National illustration, specifically, I really use that page 6 to go through the statistical probabilities and to show clients what the product at the current, you know, ceiling and rate actually does. And, I think that when they see the, the 65 year period and we look at every single 25 year and what the probability of distribution is of the rates, that they feel comfortable with 5.35. And you just have to explain to the client that this is an average rate of return that we're expecting. Over, you know, a period of time that there will be years where we're going to get a 0 because the market doesn't perform and they're going to be years where we do well above the average because the markets performed more at the ceiling. So, I feel like for us it will actually be beneficial because Ohio National has never built in that market based bonus multiplier and made their, their illustrations look a lot more rosy compared to the others. And, I feel like it will affect more the others that are being a lot more too optimistic and then bring those, those illustrations more in line with reality that will make our, the Ohio National product, look more in line with what reality is. Instead of instead of like oh, I can run, I won't mention a company, but I have one in mind it's the most expensive where their, their illustration looks really rosy, and like, kind of like what I described at first. You know, put in $20,000 for ten years and get all this money out. And be a millionaire. It will bring those more in line with reality and so we won't be such an outlier as to what the, the actual illustration looks like.

John: Right and, and since you asked, I mean, that's kind of always been our philosophy. We always wanted to design lower cost products because we felt like, especially in the IUL space that was more realistic and it would, it would provide more value to the client. That's kind of always been our philosophy, so fortunately we do have, I mean, there are some other things in the regulation. There are some changes we'll have to make, but not related to those aspects of the regulation. You know, because we didn't have those bonuses, we didn't have those enhancements. So, let's talk. Since we we're talking about illustrations already, let's talk about that a little bit

further. What role do illustrations play for you during the sales process? I mean, you've touched on that a little bit, but could you go into some more detail about you know how you're using illustrations with clients?

Rebecca: You know, it's really funny because I think a lot of your top producers are not even showing illustrations. That's not me. I do show an illustration, but it's very late in the process. Plus, it's not about the product. You have to really get the client to buy into your philosophy, and the fact that they need an alternative asset class outside of just traditional market based investments. Once they are on your page with the philosophy, then you start talking to him about the choice. And, then at that point you start making selections and then you explain. Then why are we choosing an Ohio National product over on any other carriers product? You know, I start with the big picture of what kind of carrier do we want? And then I wind it down to it's only Ohio National left standing as the best option, and from there we then are looking at the illustration. I do disclose the illustration and walk them through it. I, like I said, I mentioned that page 6 so they can see the statistical distribution 'cause I think they need to understand what that average rate is so that they know that not every year we're going to get this. We're going to get higher years, lower years. And, also we need to walk them through, you know, the guaranteed side versus, you know, the, or you know, with the IUL is a little bit different. I'm looking at thinking of whole life right now, but IUL is a little bit different. But, you know, you need to walk them through. Obviously, the, the actual account value versus the cash surrender. You know, the cash available versus the death benefit and. And, so it's important to me to show the illustrations. But, I wouldn't say the illustration is a sales tool, it's, it's really more of, you know, just them being educated even further about what the product could be expected to look like. And they, and then you understanding and know that there is a surrender, especially with IUL, the surrender is longer. We know it's fifteen years and not ten. So, you know, they need to understand that, you know, if they change their mind, these things will, obviously, have a cost of changing our mind. We need to make sure that they're sure because, you know, but the great thing about IUL can do, John, is we can do it in as fast as, you know, I can do. We can do as fast as five years. I know that it's a seven-pay rule, but, obviously, you can work out the non-MEC line to, to be able to do a 5-pay and that's the biggest flexibility that you have with index life. And, I think that, that also gives clients, I have found that, that's one of the best selling assets to the IUL. Because people don't necessarily say I want to say, I want to lock myself into a ten year commitment, or a twenty year commitment on the whole life side. But, you know, five years is a lot easier to swallow. Yes, I see that I have stability for the next five, seven years. And, I think I can take this on. So, it's important to show the illustration, but it's not really apologized for that. It's just not really, you know, something that I, there's some, there's some people that don't show it at all. And, obviously they have to, the client has to sign it, so they've seen it at some point. But, you know, I'm not, I'm not bringing out that illustration until we're pretty far along into the process.

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John: Once you've got clients interested, once they want this product, they understand what it's going to do for them. They understand the value. When it comes to investment selections, what does that process look like for you? Do clients tend to want to stick to just the big end indices like the S&P 500? Do you use, you know, is does it, is it a different portfolio for every client? Kind of, what's that process look like for you?

Rebecca: I mean, I think I pretty much stick with the S&P 500 point-to-point, 'cause that's what I'm a big believer in. I like annual, annualized compounding with really clear, you know, just very straightforward. I don't like to have anything beyond a cap and like the spread on the other one, it's just not something that I'm interested in because I feel like statistically it does, it performs worse. You could tell me differently, but that's my personal preference. I have had a lot of clients say, can I get, you know, the can we get, can we buy options on ETFs? Can I get them? You know, the NASDAQ, especially in the tech boom, a lot of people have really wanted to be NASDAQ specific. So, if you can pull any strings John on Ohio National getting the tab stack otherwise.

John: I'll see what I can do.

Rebecca: Otherwise, I pretty much I'm a plain Jane S&P 500 point-to-point, not the, not this cap, but not the end cap, the spread.

John: Now you touched on this a little bit before, but kind of my last question for you. Actually would be that you were more of a whole life devotee, but you've increased the proportion of IUL within your portfolio. What drove you to do that and are there any thoughts you would like to leave with our whole life devotees to maybe convince them to come to the dark side and give IULs a try?

Rebecca: So, obviously, I've spoken extensively about the flexibility, which is incredible. You know, there's just some times, and over the years, people have come in and they've only had two or three years before retirement. And, it's really hard to structure a two or three year before I retire plan with a 10-pay whole life so it, it, it has included the ability to use 10-pays or 20-pays depending on the situation. While the IUL now really can fill that need. The other thing that I really like to do is, if we're insuring both a husband and a wife, I pretty much like to stick with whole life for the wife because of long term care. And, we know that we want a really death benefit rich contract for the wife, in case we do need to use some long term care rider options that are built into the contracts. Or as men, we need long term care less than 1/3 of the time. And, so for them we can stick more with the index. More of a lean death benefit policy where there still is that long term care benefit. But, we're expecting the death benefit to be a little bit more lean. So, not as used for long term care, and that's okay. So, I look at it as kind of a nice symbiotic relationship between the whole life and the index when I have it for working for both a husband and a wife. Right? Because the

wife is going to get that consistent dividend year in and year out, we hope. No matter what the market conditions are happening. And, yet the husband is going to be able to get in, and that says I'm just giving an example of structuring it that way, it could be the reverse. But, you know, the other spouse is going to be able to get you know the upper, the higher growth returns that that whole life is never going to achieve. And, that can kind of give us a bigger boost for bigger growth years in the market. But also, even when the market isn't performing, we're getting that protection and we still have the wives account, or the other spouses account, doing some kind of, you know, standard dividend when the market hasn't performed. So, it's a really good way to sort of divests and diversify between two spouses. That one product is getting consistent, compound interest without interruption, being whole life. And, the other is getting some higher upside, yet still downside protected. And, and knowing that there will be years where we're going to get a 0.

John: Great information. Makes perfect sense to me. Rebecca thank you again for joining me today and thank you to all our listeners for joining us, as well. That'll do it for this one. We'll see you next time.

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[Disclosure read by John]

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