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HEALTH & WEALTH

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# IUL EXPLAINED

How Indexed Universal Life works — with simple math,  
real-world examples, and the questions to ask before buying.

**UNDERSTAND IT FIRST. THEN DECIDE.**

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## INTRODUCTION

## Let's simplify it.

Indexed Universal Life insurance can sound complicated. There is life insurance, cash value, an index, interest-crediting strategies, caps, participation rates, policy charges, loans, and a long list of numbers in an illustration.

An IUL is first and foremost a permanent life insurance policy. It provides a death benefit and has a cash-value component. The interest credited to that cash-value component can be linked to the performance of an external market index, subject to the policy's specific crediting method and limits.

It is not the same as investing directly in the stock market. You do not own the stocks in the index, and the policy's cash value does not simply earn whatever the index earns.

**The details matter. This guide walks through them in plain language.**

## SECTION 1

## What Is an IUL?

An Indexed Universal Life (IUL) policy combines:

|                                 |                                                                                                                                                                                                                                                                                                                                                |
|---------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Life insurance protection       | Your policy provides a death benefit for your beneficiaries, subject to the policy terms.                                                                                                                                                                                                                                                      |
| Cash value                      | Part of what you pay can contribute to the policy's cash value after applicable insurance costs and charges.                                                                                                                                                                                                                                   |
| Index-linked interest crediting | The policy may credit interest based on the performance of an external market index. An index measures the performance of a group of investments or securities — the S&P 500, for example, tracks 500 large U.S. companies. The policy uses the index's performance according to a specific formula to determine whether interest is credited. |

Unlike variable life insurance, an IUL generally does not have you directly investing the policy's cash value in individual stocks or mutual funds.

**THE IMPORTANT DISTINCTION**

If the index goes up, that does not mean your policy earns the full index return. Your policy may have a cap, participation rate, spread, or other crediting provisions that determine how much interest is actually credited.

**SECTION 2**

## Where Does Your Premium Go?

When you pay a premium — the amount you pay to keep your life insurance policy in force — the entire payment does not simply go into an investment account.

A universal life policy has costs associated with providing insurance and administering the policy. Depending on the policy, charges can include the cost of insurance and other policy expenses. The remaining amount contributes to the policy's cash value.

**A SIMPLIFIED EXAMPLE**

| ANNUAL PREMIUM  | INSURANCE COSTS & CHARGES | TO CASH VALUE  |
|-----------------|---------------------------|----------------|
| <b>\$10,000</b> | <b>\$2,000</b>            | <b>\$8,000</b> |

The actual amounts will vary by policy, age, health, coverage amount, premium structure, and carrier. That's why you should always review the actual policy illustration rather than assuming a fixed percentage of your premium becomes cash value.

**SECTION 3**

## How Does the Index Part Work?

Suppose your policy uses an index strategy linked to the S&P 500, and the index has a good year, increasing by 12%. That does not automatically mean your IUL cash value receives a 12% credit.

Your policy might have, for example, a 90% participation rate, an 8% cap, and a 0% floor. These numbers are hypothetical and are used only to demonstrate the mechanics.

**STEP 1 — APPLY THE PARTICIPATION RATE**

A participation rate determines what percentage of the index's calculated increase is used when determining the policy's interest credit.

|                                     |                                      |                                          |
|-------------------------------------|--------------------------------------|------------------------------------------|
| <b>INDEX INCREASE</b><br><b>12%</b> | <b>PARTICIPATION</b><br><b>× 90%</b> | <b>CALCULATED RATE</b><br><b>= 10.8%</b> |
|-------------------------------------|--------------------------------------|------------------------------------------|

**STEP 2 — APPLY THE CAP**

A cap is the maximum interest rate that can be credited under that particular indexed strategy for the applicable period. The calculated rate of 10.8% is above the 8% cap, so the credited rate would be 8%.

|                                        |                                |                                   |
|----------------------------------------|--------------------------------|-----------------------------------|
| <b>CALCULATED RATE</b><br><b>10.8%</b> | <b>POLICY CAP</b><br><b>8%</b> | <b>CREDITED RATE</b><br><b>8%</b> |
|----------------------------------------|--------------------------------|-----------------------------------|

Actual IUL crediting methods vary significantly by policy, so the illustration and contract are what determine how a particular policy works.

**SECTION 4**

## **What Happens When the Index Goes Down?**

Suppose the index falls -10% and, for this hypothetical example, the policy has a 0% floor. A floor is the minimum interest-crediting rate specified by a particular indexed strategy. The index-linked credit would be 0% — the strategy would not credit a negative 10% based solely on that index decline.

**BUT HERE'S THE IMPORTANT PART**

A 0% index credit does not mean your policy cannot lose cash value. Policy charges and insurance costs can still be deducted. If those costs exceed the amount being added to the policy, the cash value can decline.

**0% index credit ≠ 0% total policy cost**

## SECTION 5

## A Simple Two-Year Example

Suppose, purely for illustration, that \$10,000 is available in a policy's index account at the beginning of a crediting period, with a 90% participation rate, an 8% cap, and a 0% floor.

**YEAR 1 — INDEX RISES 12%**

$12\% \times 90\% = 10.8\%$ , but the cap is 8%. So  $\$10,000 \times 8\% = \$800$  credited.

|                                          |                                       |                                         |
|------------------------------------------|---------------------------------------|-----------------------------------------|
| <b>STARTING VALUE</b><br><b>\$10,000</b> | <b>INDEX CREDIT</b><br><b>+ \$800</b> | <b>END OF YEAR 1</b><br><b>\$10,800</b> |
|------------------------------------------|---------------------------------------|-----------------------------------------|

**YEAR 2 — INDEX FALLS 10%**

The floor is 0%, so the index-linked credit is  $\$10,800 \times 0\% = \$0$ .

|                                          |                                     |                                         |
|------------------------------------------|-------------------------------------|-----------------------------------------|
| <b>STARTING VALUE</b><br><b>\$10,800</b> | <b>INDEX CREDIT</b><br><b>+ \$0</b> | <b>END OF YEAR 2</b><br><b>\$10,800</b> |
|------------------------------------------|-------------------------------------|-----------------------------------------|

Both figures are shown before applicable policy charges. This is deliberately simplified. Actual IUL calculations can involve different crediting methods, measurement periods, index calculation methods, segment dates, averaging methods, charges, bonuses, withdrawals, loans, and other contract provisions.

## SECTION 6

## Cap, Floor & Participation Rate

These three terms are worth knowing.

|                    |                                                                                                                                                                                                                                       |
|--------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Cap                | The maximum interest rate that can be credited under a particular indexed strategy for the applicable period. If the calculated credit is higher than the cap, the cap limits the credited rate.                                      |
| Participation rate | Determines how much of the index change is used in calculating the indexed credit. For example, a 10% index increase $\times$ 80% participation = 8%. If the policy also has a cap of 6%, the final credited rate would be 6%.        |
| Floor              | Establishes the minimum index-linked credit under that particular strategy. Some IUL strategies may have a 0% floor, but never assume every IUL has the same floor, or that a floor protects the entire policy value from all losses. |

The actual policy determines these features.

## SECTION 7

## You Don't Invest Directly in the Index

This deserves its own section because it is one of the most common misunderstandings.

If your IUL uses an S&P 500-linked strategy, you are not buying shares of the S&P 500. Instead, the insurance company uses the index's performance according to the policy's crediting formula to determine interest that may be credited to the policy. The index is essentially being used as a reference for calculating interest.

**So if the S&P 500 earns 15%, you should not automatically expect your policy to earn 15% — and if it falls 15%, your policy's indexed credit does not necessarily fall 15% either.**

## SECTION 8

## What About Cash Value?

The cash value is the part of the policy that can accumulate over time. But cash value is not the same thing as the death benefit.

Your policy illustration should show how values and benefits may develop over time under the policy's assumptions. The NAIC recommends reviewing illustrations and understanding which values and benefits are guaranteed and which are not.

### When reviewing an illustration, ask:

- What is guaranteed?
- What is non-guaranteed?
- What assumptions are being used?
- What are the policy charges?
- How much premium is required?
- What happens if I pay less?
- What happens if I stop paying?
- How does the cash value change over time?

**Don't look only at the projected cash value at age 65 or 70. Look at the entire year-by-year illustration.**

## SECTION 9

## Can You Access the Cash Value?

Generally, a policy owner may be able to access cash value through withdrawals or policy loans, depending on the policy's terms. But accessing cash value is not simply "taking money out of a savings account."

Withdrawals can reduce available cash value and potentially affect the death benefit. Policy loans can accrue interest and can reduce the policy's value or death benefit. If a policy with an outstanding loan lapses or is surrendered, there can also be significant financial and tax consequences.

**A SIMPLE EXAMPLE**

|                                       |                                       |                                        |
|---------------------------------------|---------------------------------------|----------------------------------------|
| <b>CASH VALUE</b><br><b>\$100,000</b> | <b>POLICY LOAN</b><br><b>\$20,000</b> | <b>LOAN ACCRUES</b><br><b>INTEREST</b> |
|---------------------------------------|---------------------------------------|----------------------------------------|

You still have a \$100,000 policy account value in this simplified example, but the loan is an obligation against the policy and can accrue interest. If the loan grows and the policy does not have enough value to support its costs, the policy could be at risk of lapsing.

**Never take an IUL loan without understanding exactly how it affects your policy.**

**SECTION 10**

## What Happens If You Stop Paying?

Universal life insurance generally has flexibility in premium payments, but flexibility does not mean premiums are optional forever. The policy needs sufficient value or premium funding to cover applicable insurance costs and other charges.

If the policy does not have enough value to cover those costs, it can lapse and your coverage can end. Before reducing or stopping premiums, ask your agent:

**“If I stop paying this amount, how long can the policy realistically remain in force under different scenarios?”**

**SECTION 11**

## Guaranteed vs. Illustrated

This is perhaps the most important section of the entire guide. An IUL illustration can show projected values based on assumed future crediting rates. But a projection is not a promise.

**Ask your agent to show you:**

|                       |                                                                                                                  |
|-----------------------|------------------------------------------------------------------------------------------------------------------|
| Guaranteed values     | What the policy contract guarantees if the required conditions are met.                                          |
| Non-guaranteed values | Values based on assumptions about future performance, charges, bonuses, or other policy factors that may change. |

Don't purchase an IUL based solely on the highest illustrated scenario. Instead, understand what happens if future results are lower than illustrated.

## SECTION 12

# What Can an IUL Be Used For?

Depending on the policy and the individual's circumstances, an IUL may be considered for goals such as:

- Long-term life insurance protection
- Building cash value
- Supplemental retirement planning
- Wealth accumulation
- Legacy planning
- Providing financial protection for a family

But an IUL is not automatically the right solution for these goals. It is a life insurance product with a cash-value component, and its suitability depends on the person's needs, financial situation, policy design, and ability to maintain the policy.

## SECTION 13

# The Questions to Ask Before Buying

Before purchasing an IUL, don't be afraid to ask your agent:

## ABOUT THE POLICY

- What exactly am I paying for?
- How much is my death benefit?
- How much premium do I need to pay?
- How long do I need to pay it?
- What happens if I pay less than planned?

**ABOUT THE CASH VALUE**

- How much of my premium goes toward cash value?
- What are the policy charges?
- When does the cash value begin to build?
- What happens in a year when the index earns 0%?
- What happens if the index performs poorly for several years?

**ABOUT THE INDEX STRATEGY**

- Which index is being used?
- What is the current cap?
- What is the participation rate?
- What is the floor?
- Can these rates change?
- How is the index return calculated?

**ABOUT THE ILLUSTRATION**

- Which values are guaranteed?
- Which values are not guaranteed?
- Can you show me a more conservative scenario?
- What happens if future credited rates are lower than illustrated?

**ABOUT ACCESSING MONEY**

- How do policy loans work?
- What interest rate applies to loans?
- What happens to my death benefit if I borrow?
- What happens if the policy lapses with a loan outstanding?

## SELF-ASSESSMENT

## Your IUL Reality Check

Before moving forward, see how comfortable you are with each statement.

| STATEMENT                                                     | YES                      | NOT SURE                 | NO                       |
|---------------------------------------------------------------|--------------------------|--------------------------|--------------------------|
| I understand that an IUL is life insurance first.             | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| I understand that I don't directly invest in the index.       | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| I understand how the cap works.                               | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| I understand the participation rate.                          | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| I understand the policy's floor.                              | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| I understand the policy charges.                              | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| I know which values in my illustration are guaranteed.        | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| I understand how loans and withdrawals can affect the policy. | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| I understand what happens if I stop paying premiums.          | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| I understand that illustrations are not guarantees.           | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

If you answered "Not Sure" to any of these, that's a good question to take to your agent before making a decision.

## THE BOTTOM LINE

## Ask a better question.

An IUL can combine permanent life insurance protection with a cash-value component whose interest crediting can be linked to an external index. But the policy's actual performance depends on much more than what the index does.

Caps, participation rates, floors, policy charges, premiums, loans, withdrawals, and other contract terms all matter.

**THE RIGHT QUESTION ISN'T****"How much can this IUL make?"****A BETTER QUESTION IS****"How does this particular policy work, what does it guarantee, what could change, and does it fit my goals?"****YOUR NEXT STEP**

## See How an IUL Could Fit Your Plan

A 254 Financial Group agent can walk you through an actual policy illustration, explain the guarantees and non-guaranteed assumptions, and help you understand the costs, benefits, and risks before you make a decision.

**SPEAK WITH A 254 FINANCIAL GROUP AGENT**

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*This guide is for educational purposes only and is not personalized financial, tax, legal, or insurance advice. IUL policies differ by insurance carrier and contract. The mathematical examples in this guide are hypothetical and are not projections of actual policy performance. Index-linked crediting does not mean that policy cash value earns the index's full return. Policy charges and insurance costs can reduce cash value, and policy loans or withdrawals can affect policy values, death benefits, and lapse risk. Review the actual policy contract and illustration for the specific product being considered.*