Policy Loan *Types*

What are the different Loan types available on IUL and how do they affect insurance contracts?

Participating Loans - Index Loans / Variable Loans

While insurance carriers may use different names for Participating loans such as Index, Alternative, or Variable rate loans. Indexed Loans typically have a set loan rate attached, typically about 5% in todays market. Variable or adjustable rate loans typically float with the moody's bond index plus a spread. there are several differences between carriers and how they administer variable loans. Some carriers have a cap on how high the rate can adjust up, some carrier have a policy of limiting it to some spread percentage over or under the fixed crediting rate, and other carries allow it to float freely. It is important to understand the loan rate policy of the company because it can affect the long term performance of the policy. Additionally, a loan is considered a loan from the death benefit (also reduces the cash surrender value, not accumulated value). It is the accumulated value that is invested into the indexed accounts. If the index segment provides interest, the policy will credit interest on the borrowed money. We call this a arbitrage spread, which is the positive difference between the loan interest and the interest credited on the borrowed money. Conversely, if the index segment dose not credit, the interest on the borrowed money will be deducted from cash surrender value and death benefit causing negative policy performance. Another items to consider when a loan is taken from the policy is whether the carrier requires funds to be moved to a index account with lower caps or participation rates than the originally selected index.

Fixed Loans

The Fixed policy loan also called a wash loan offers a loan rate similar of equal to the fixed crediting rate in the contract.   It is important to understand how this loan type affects the future performance of the insurance contract. When a fixed rate insurance policy loan is elected, for each dollar that is borrowed, the insurance company will allocate cash value into the Fixed Account. The insurance company's Fixed Account is required to have an interest rate that earns **no less** than their Fixed Loan interest rate, and many times it actually guarantees a nominal rate of return (within .25%), resulting in what is essentially is seen as a wash.

Example: John Doe has an IUL with $100,000 cash value allocated to the S&P 500. John Doe take a Fixed Loan for $50,000 against his policy with an interest rate of 2%. The Loan does not reduce the current cash value of the contract at all. Instead, the Loan is on a separate balance sheet with the insurance company to be used as collateral, almost like a line of credit. In addition, the insurance company will move $50,000 of current policy cash value out of the S&P 500 and into the Fixed Account, which earns an interest rate of 2.25%. Since the contract technically still has $100,000 in its ledger it is well positioned to continue to compound while still earning through performance with the S&P 500 Index and the Fixed Account. If the historical average for investment returns on the S&P 500 is 6%, John Doe can be expected to outpace the н% interest on his policy loan by п%, Ŧ2ℕ the $50,000 űKl·ű ℕŜY l·ƛƴƛƴűKŜ {ɘt рлл LƴŘŜȅ ăŜƎYŜƴű. {ƛƴŎŜ űKŜ CƛȅŜŘ !ŎŎ2ďzƴű 2ŦŦŜℕă l· ƎďzI·ℕl·ƴűŜŜŘ ℕl·űŜ 2Ŧ ℕŜűďzℕƴ at 2ɸнp̥̂ and ℕ2Kƴ52Ŝ's Fixed Loan has an interest rate of 2% he enjoys a small net-gain of 0.25% on this $50,000 of policy value. The 0.25% is so nominal it might as well be a wash, in fact many times the Fixed Loan is referred to as "wash loan."