

[Print](#) | [Close Window](#)

PacLife's High-Flying Indexed UL Lacks Transparency, Expert Says

By Warren S. Hersch April 11, 2018



Pacific Life's corporate headquarters in Newport Beach, Calif.

A top-selling offering from **Pacific Life** is emblematic of a wave of indexed universal life products that employ increasingly complex, but opaque formulas, a product expert says in a review obtained by *Life Annuity Specialist*.

The company's marketing documents include illustrations with aggressive returns that risk disappointing policyholders and underscore the urgent need for revised rules governing the illustrations, according to **Bobby Samuelson**, an executive editor of *The Life Product Review*.

In a nine-part review, much of it published earlier this year, Samuelson says an in-depth analysis he did of Pacific Life's Discovery Xelerator (PDX) IUL product produces both higher costs and illustrated rates of return than offerings from competitors. But the carrier, he contends, provides insufficient information about the index-linked product's inner workings, including how it calculates a "performance factor" that magnifies returns.

"What we appear to have...is a product that has quantifiably the highest charges of any IUL product in the market with an unspecified performance factor, and somehow the combination of the two generates the most competitive accumulation, income and sometimes even death benefit premium solves," writes Samuelson in the document. "It is little surprise that some people have been unsettled by what PDX represents." Samuelson formerly worked in senior roles in product development at **Brighthouse Financial** and **MetLife**.



Bobby Samuelson, an executive editor of The Life Product Review.

Larry Rybka, president and CEO of **Valmark Securities**, echoes Samuelson's broader concerns about indexed universal life products and their "high cost, complexity and lack of transparency." Valmark's analysis of PDX and similar products support Samuelson's arguments, he said in e-mailed replies to questions.

"[We] believe that these products have perhaps the greatest 'overpromise risk' of any life insurance products in the market the way they are being illustrated," says Rybka. "They are also a way for insurance companies to hide the impact of low bond yields."

An internal study by Valmark showed that 72% of "promised value" to IUL policyholders is "at the discretion" of the insurer, depending in part on carrier decisions about policy charges and caps on index-linked gains.

Returns can vary widely, based on changes in caps. For example, with a 12% cap, using 30-year rolling-period returns dating back to 1926, indexed universal life products earn at least 5.87% a year. In contrast, when the cap rate drops to 6%, historical returns shrink to as little as 3.04%.

Something approximating this last percentage could be in store for indexed universal life policyholders, says Rybka, if carriers reduce caps to the levels they currently impose on fixed-indexed annuities. In that case, actual average earnings rates may not surpass 3.5% to 4%, according to Rybka.

Much at stake

The purported gap between actual and illustrated performance, and the lack of transparency in IUL product designs, is not only an issue for state regulators and consumers. Carrier claims about the products also are a growing concern for agents and advisors.

In respect to Newport, Calif.-based Pacific Life's PDX, the issue is already being voiced. Samuelson says he knows of agents and brokers that have refrained from marketing the offering because of the performance factor's complex functioning. That pullback could take a toll on sales.



Larry Rybka, president and CEO of Valmark Securities.

In an e-mailed response to a request for comment, Pacific Life says that PDX's "innovative" product design is "based on deep product knowledge," and that the offering is but one of several in the carrier's IUL product

portfolio.

"Our expectation is life insurance professionals interested in learning more about our products allow Pacific Life representatives an opportunity to explain the features that we believe drive long-term value to our policyowners," the company says in a statement. "We have significant experience educating life insurance professionals about the product, and we create educational and marketing materials to assist with transparency and disclosure."

Nonetheless, Pacific Life, and other IUL manufacturers that feature high hypothetical returns in illustrations, could suffer if many more agents and brokers get cold feet about marketing the products. The stakes are high: Sales of indexed universal life products climbed 6% in 2017 to almost \$2 billion in 2017, according to **Wink's** Sales & Market Report. Pacific Life led all insurers, with fourth-quarter sales of \$575.2 million, an 18.5% market share.

PDX was the best-selling indexed life product in the fourth quarter of 2017, according to Wink. The product ranked No. 1 in both the bank and independent agent distribution channels.

Pushing the envelope

Helping to fuel the sterling sales gains are the impressive numbers on display in PDX illustrations. To calculate product gains, Samuelson says in an interview, Pacific Life multiplies index credits by a performance factor after the third year of the contract. If, for example, the illustrated rate is 5.5%, and the performance factor is 1.5, then the actual illustrated rate is 8.25%. But the formula for the performance factor isn't disclosed, he says.

Distinguishing PDX from other products, says Samuelson, is the fact that the performance factor is directly funded in part from very high "base" policy charges, which are deducted monthly and determined by the policy's at-issue face amount. The "base" policy charges in PDX are among the highest of any life insurance product in the industry and, unlike other life insurance policies, are charged for the entire duration of the contract.

"What Pacific Life has done is to take more money [in policy charges] and put it to work — funneling it back into the index mechanism — at the illustrated rates," says Samuelson. "That's why the policy charges and illustrated returns are so high. Every dollar from the charges that goes into the index mechanism gets multiplied in the illustration."



Barry Flagg, founder of Veralytic Inc.

A bigger issue is that agents are often comparing illustrations of returns from different products as part of their due diligence, according to **Barry Flagg**, founder of **Veralytic Inc.**, an online publisher of life insurance pricing and performance research and product suitability ratings. But the numbers in the hypothetical illustrations aren't solid enough to be relied on, observes Flagg.

Comparing illustrations "is now considered misleading, fundamentally inappropriate and unreliable by financial, insurance, and banking industry authorities for many of the reasons discussed [by Samuelson]," says Flagg in an emailed reply to questions. "A far more prudent means of product due diligence is to examine and compare internal product costs."

Time for a regulatory revamp?

Underpinning illustrations is the “aggressive” and “unproven” assumption that an insurer can indefinitely assume up to 50% returns on equity call options used to support an indexed universal life product’s cash flows, says Samuelson. There’s a need for a new, more realistic model regulation governing the illustrations, he says. The prevailing standard, Actuarial Guideline 49, promulgated by the **National Association of Insurance Commissioners** in 2016, represented an industry compromise that, Samuelson says, he had a hand in crafting.

But the real problem is the companies’ lack of transparency in detailing the mechanics of their products, he says, citing Pacific Life’s PDX offering.

“Pacific Life is [illustrating returns] in a way that’s very complicated, undisclosed and could be extremely problematic to administer,” he says. “PDX is a prime example of the many IUL products that are using increasingly complex index mechanisms that are entirely and solely designed to increase illustrated performance.”

Clarification: An earlier version of this story was unclear about the source of Samuelson's comments in the first four paragraphs. This revised version also includes corrections to comments attributed to Samuelson.

Life Annuity Specialist is a copyrighted publication. Life Annuity Specialist has agreed to make available its content for the sole use of the employees of the subscriber company. Accordingly, it is a violation of the copyright law for anyone to duplicate the content of Life Annuity Specialist for the use of any person, other than the employees of the subscriber company.

An Information Service of Money-Media, a Financial Times Company