February 2018

M Intelligence

Enhancing understanding of sophisticated planning strategies and their applications.

Market Volatility and Rising Interest Rates… What's Going on with my Life Insurance Policy?

The Volatility Index (VIX), which measures investor expectations of market volatility, has spiked.

From trading around 10 at the start of the year, the index rose to 37 on February 5 before retreating to the 20-range. This indicates a dramatic swing in expected volatility in 2018. https://www.bloomberg.com/quote/VIX:IND

Meanwhile, the U.S. 10-Year Treasury, a leading measure of long-term interest rates, is approaching 3%—a level not seen since May 2011—and inflation is ticking up.

It seems the market is absorbing the implications of recent changes that will impact the economy. How might the recent tax cuts and two-year budget agreement impact fiscal policy and further spur rising government debt? Does an uptick in inflation imply higher interest rates in the future?

Here are some considerations for the impact of these factors on life insurance products.

- **General Account crediting rates will likely respond slowly to changes in interest rates.** As interest rates declined over the past 30 years, the rate of change of a rolling 7-year corporate bond yield served as a good proxy for the change in general account returns. If interest rates continue to rise at a modest pace, we anticipate the 7-year rolling bond will remain a good proxy. This means it will take seven years for the portfolio to fully reflect the change in rates.

  If interest rates jump more dramatically, we may see crediting rate changes sooner, but it is anticipated the changes will still take several years.

- **Separate Account cash values will reflect more price volatility.** Fund prices in Variable UL policies are marked to market so the higher volatility will result in more price fluctuations for the underlying cash values. While not every investor is comfortable with volatility, it can create an opportunity to capture higher risk-adjusted returns. This can be beneficial for investors with long time horizons, which is often the case with VUL policyholders.

Product Considerations

Current Assumption General Account Products (Whole Life and Universal Life)

- If the recent pace of short- and long-term interest rate increases continues, crediting rates should begin shifting from a decreasing environment to slight increases over the next two to five years.
- If the pace of interest rate increases accelerates too quickly, carriers would likely come under increasing stress from the need to balance the costs associated with maintaining a competitive crediting rate with the need to protect against the cost of disintermediation, the need to liquidate cash values for policyholders in search of higher yields.
- Increased due care and carrier monitoring will be an essential part of managing in-force product portfolios.

No Lapse Guarantee Products (NLG)

- The rise in interest rates should reduce some of the negative pricing pressure associated with low interest rates.
- Compared to current assumption general account products, the disintermediation risk for NLG products is low, as these products typically have low or no cash values.
- NLG policyholders should monitor inflation risk and the impact on their overall planning. For new business, price reductions are unlikely due to new reserving rules for these types of policies.

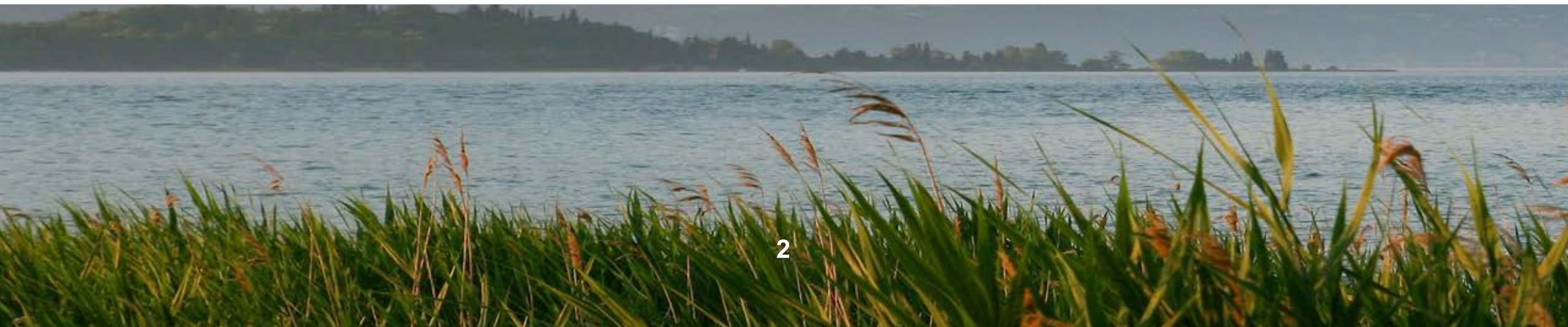
Indexed Universal Life Products (IUL)

- Over the short term there may be increased pressure to reduce caps and participation rates, as portfolio earning rates remain low and increased volatility increases the cost of the underlying options. This should ease as the general account portfolio is able to adjust to a higher yield environment.
- Since index products are a series of date-dependent investment buckets, diversifying the index strategies and spreading assets across various investment date buckets may help minimize the volatility risk.

Variable Universal Life Products (VUL)

- Separate Account portfolios will be more volatile. This can be positive over the long term, as increased volatility should drive higher risk-adjusted returns.
- Strategies like dollar cost averaging and rebalancing can help reduce volatility risk.
- Policyholders should review their investment allocations and monitoring policy's performance to make sure the funding stays on track.

Due Care is a core component of M Financial's commitment to client advocacy. M will continue to provide Member Firms with regular updates on carrier financial strength, including analysis of how this can impact life insurance products.



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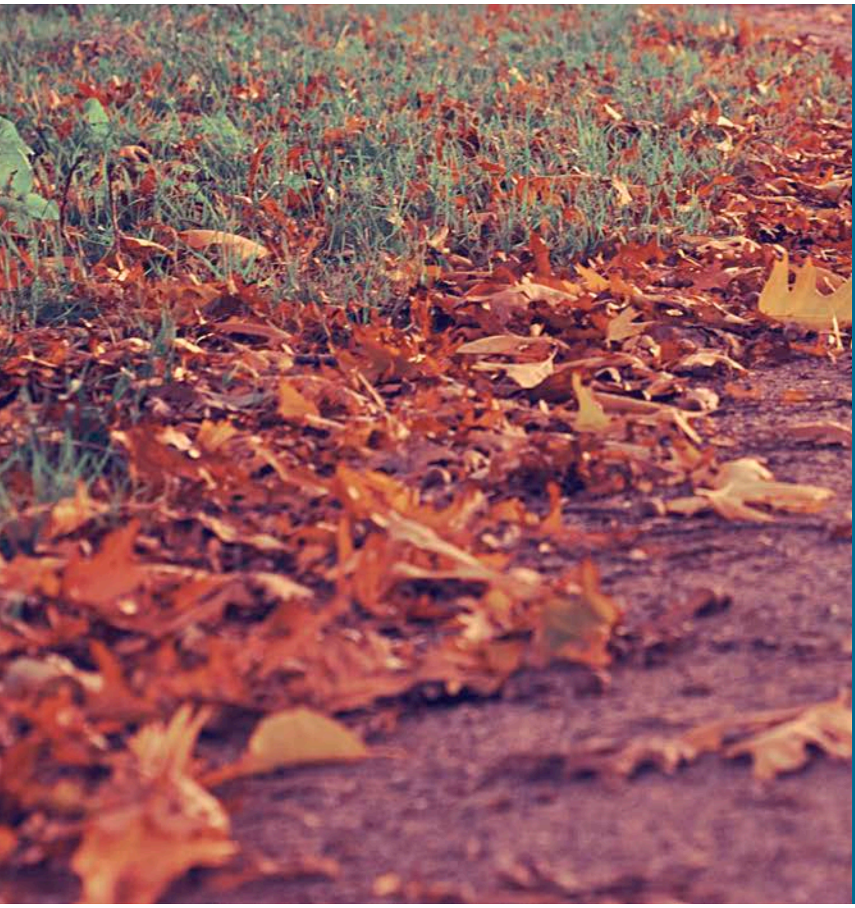
Variable life insurance products are long-term investments and may not be suitable for all investors. An investment in variable life insurance is subject to fluctuating values of the underlying investment options and it entails risk, including the possible loss of principal.

Variable Universal Life insurance combines the protection and tax advantages of life insurance with the investment potential of a comprehensive selection of variable investment options. The insurance component provides death benefit coverage and the variable component gives you the flexibility to potentially increase the policy's cash value.

Variable annuities are long-term investments designed for retirement. The value of the investment options will fluctuate and, when redeemed, may be worth more or less than the original cost. Withdrawals and other distributions of taxable amounts, including death benefit payments, will be subject to ordinary income tax. If withdrawals and other distributions are taken prior to age 59 1/2 a 10% federal penalty may apply. A withdrawal charge may also apply. Withdrawals will reduce the value of the death benefit and any optional benefits.



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