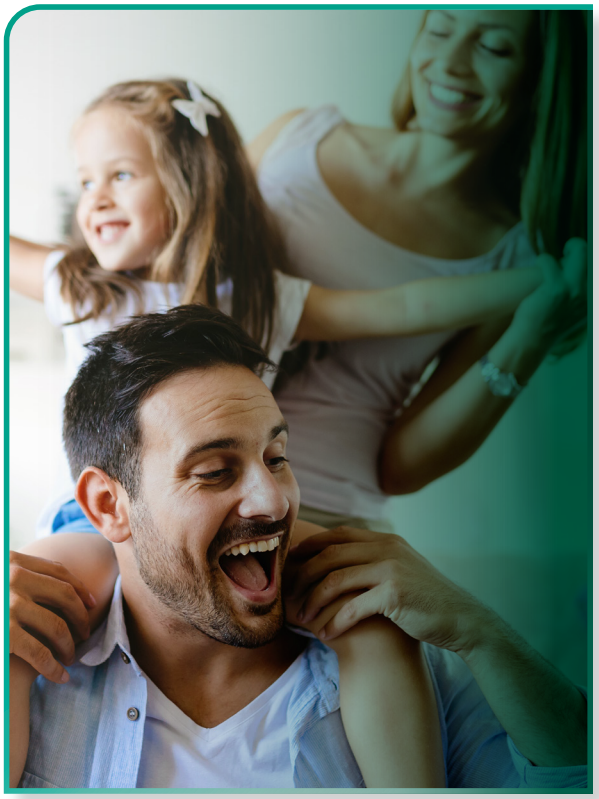
# The indexed universal life approach

## A North American white paper

## Introduction

Indexed universal life (IUL) insurance has existed since the late 1990s. In 2025, IUL premium represented almost 25% of total U.S. premium sold[1]. While IUL has become a widely sold product, the mechanics of how IUL works are generally not widely understood. This paper examines what makes indexed universal life insurance "tick."



### Where does IUL fit?

Indexed universal life products are ideal for clients who have a need for death benefit coverage and also want the potential for cash value growth without market risk. It occupies the space between current assumption universal life and variable universal life insurance. With uncertainty in the economic environment regarding interest rates, market volatility, and inflation, indexed universal life provides a balanced solution.

**Risk profile**

| Universal life | Indexed universal life | Variable universal life |
|---|---|---|
| CONSERVATIVE | POLICYOWNER RISK PROFILE | AGGRESSIVE |
| • Company-declared interest<br>• Minimum guaranteed interest rate<br>• Securities license not required | • Index-linked interest<br>• Credited interest guaranteed to never be below 0%<br>• Securities license not required | • Market-based performance<br>• Risk of loss<br>• Securities license required |

1. Source: LIMRA: Double-Digit Growth Drives Individual Life Insurance New Premium to Set New Record in 2025, March 2026.

# How interest is determined and credited

Purchasing an indexed universal life product is not an investment in the stock market. While interest credited in an index account is based on a selected index, funds are not invested in the stocks that make up each index, therefore an index does not include dividends paid by the underlying companies.

1. As premiums are paid, a portion is used for the costs of life insurance coverage; the rest is directed to an account that earns interest depending on the accounts selected.
2. Policyowners can choose to have premiums allocated to an account that offers a fixed rate of return (called a fixed account), to an index account, or to a combination of both.
3. With an index account, interest credited is linked to the growth (if any) of a stock market index, which is a well-known numerical value used to measure the performance of a group of stocks.
4. When premium is allocated to an index account, an index segment is created, and the beginning value of the index is recorded. At the end of a designated period (also known as an "index period"), the index value is used to calculate the index growth for the index period. The specific calculation depends on the index crediting method.
    a. If the index growth is positive, interest is credited to the policy's account value; the interest for that period is locked in and a new index period begins. Index credited is subject to an index cap, participation rate, floor rate, and sometimes a spread rate. The cap rate is the maximum amount of interest credit as determined by the movement in the market index. The participation rate is the percentage of the index movement that is credited to the Index Account, subject to any applicable cap. The spread rate is an amount subtracted from the index growth. Generally, there is no cap rate when a spread is in effect and vice versa.

       For the purposes of this white paper, we will examine the common scenario where a cap is in effect, the participation rate is 100%, the floor rate is 0%, and there is no spread rate.

    b. If the index growth is negative, the interest credit will at least be the currently declared index floor rate. In no case will the interest credited be less than zero percent. In this way, indexed universal life provides the opportunity for clients to earn interest based on the upward movement of the selected index but offers downside protection from a declining market.
5. On each monthly anniversary, deductions are made from the account value. The monthly deductions will reduce the amount in the index account and/or the fixed account.

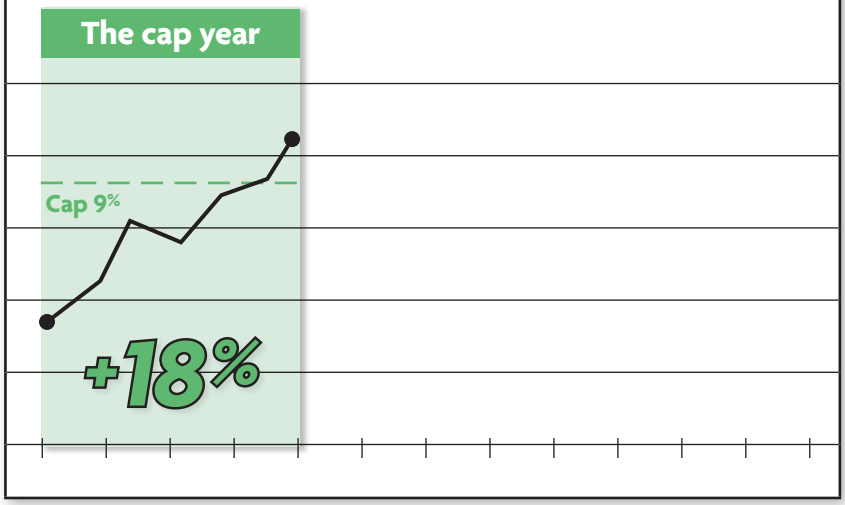
# Cap and floor rates in action

Next, we'll examine the cause-and-effect relationship between the index and the index account using a hypothetical index. There are three different scenarios that could happen — the cap year, the floor year, and the between year.

### The cap year

In the cap year, the index grows beyond the cap rate, so interest is credited at the cap rate. In this example, the index gains 18% for the year. An interest cap of 9% applies, so although the index gained 18%, interest credited to the index account will be 9%.

**Hypothetical index movement and account value**




**Account value**

We will assume the index account started with **$50,000** balance. The account grows to **$54,500 (9% growth).**

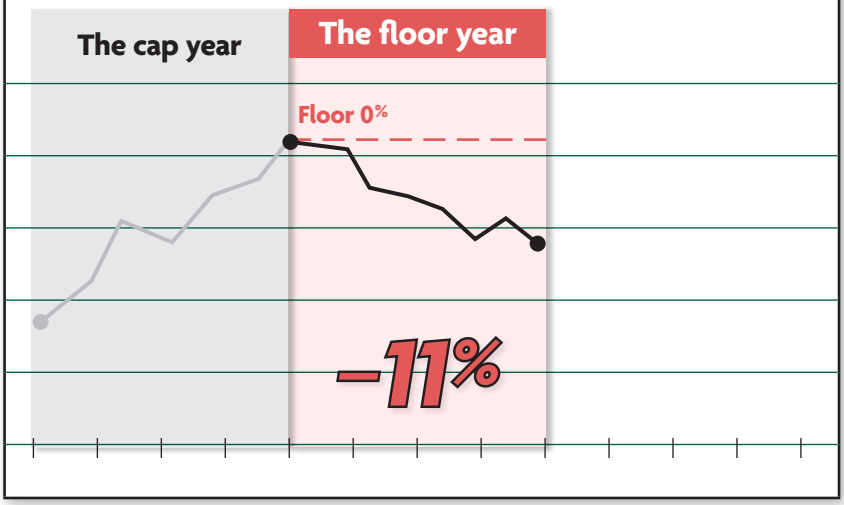
**$50,000**
**+4,500**
**$54,500**

The information presented is hypothetical and not intended to project or predict investment results.

### The floor year

In the floor year, the index has negative growth, so the zero percent floor rate comes into effect. At the end of this year, we find that the index is down 11% for the year. However, because of the policy's zero percent floor, interest credited to the index account is 0% instead of –11%.

**Hypothetical index movement and account value**




**Account value**

Credited at **0%** instead of **–11%**, the new account value is **$54,500**.

**$54,500**
**– 0**
**$54,500**

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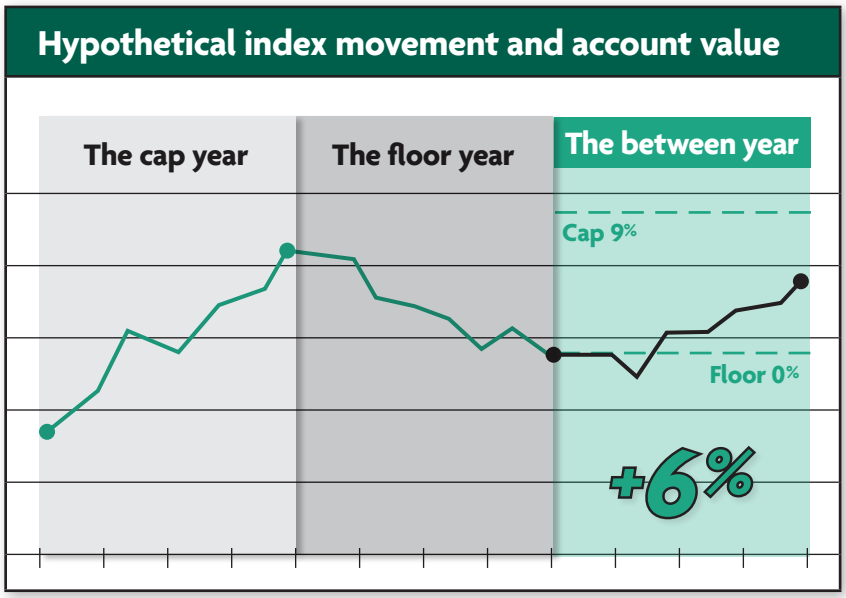
## The between year

In the between year, the index grows at a rate higher than the floor rate, but lower than the cap rate. At the end of this year, we find that the index has grown 6%. The cap and floor do not come into effect. Interest credited to the index account is 6%. Again, for the purposes of this white paper, we will assume one of the most common scenarios: the participation rate is 100% and there is no spread rate.




**Account value**

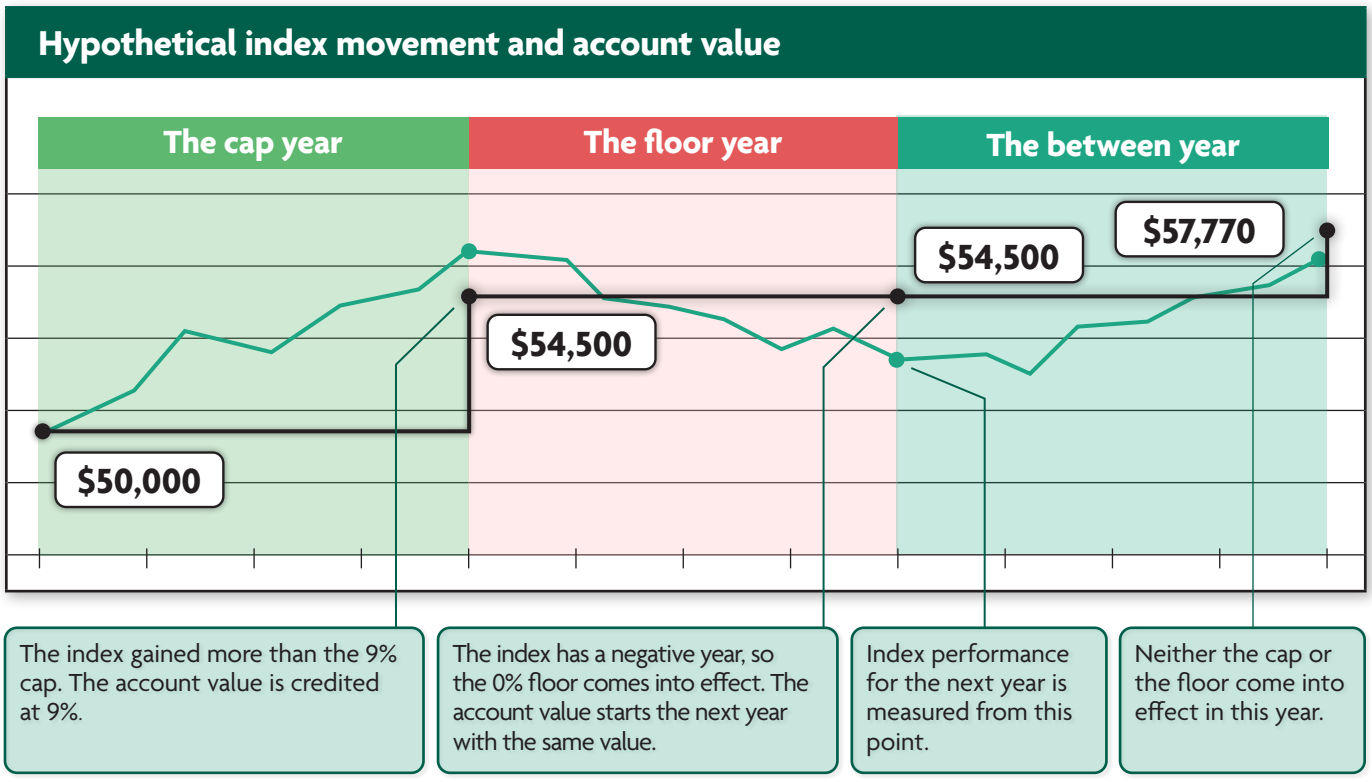
The index grew at a rate between the cap and the floor, so no adjustment is made. **6%** interest is credited on the account value.

**$54,500**
**+ $3,270**
**$57,770**

The information presented is hypothetical and not intended to project or predict investment results.

## Putting it all together with annual reset

For the purposes of this example, we'll assume that these years happen in the order shown below, although they can and do occur in any order throughout the lifespan of a policy. The zero percent floor rate and the index starting value are reset each year. Let's take a look at what that means in the graph below.




The above hypothetical scenarios use a hypothetical index and do not include dividends and are not intended to project or predict investment results. For simplicity, the policy illustrated does not include policy charges, nor ongoing premiums which may or may not offset policy charges.

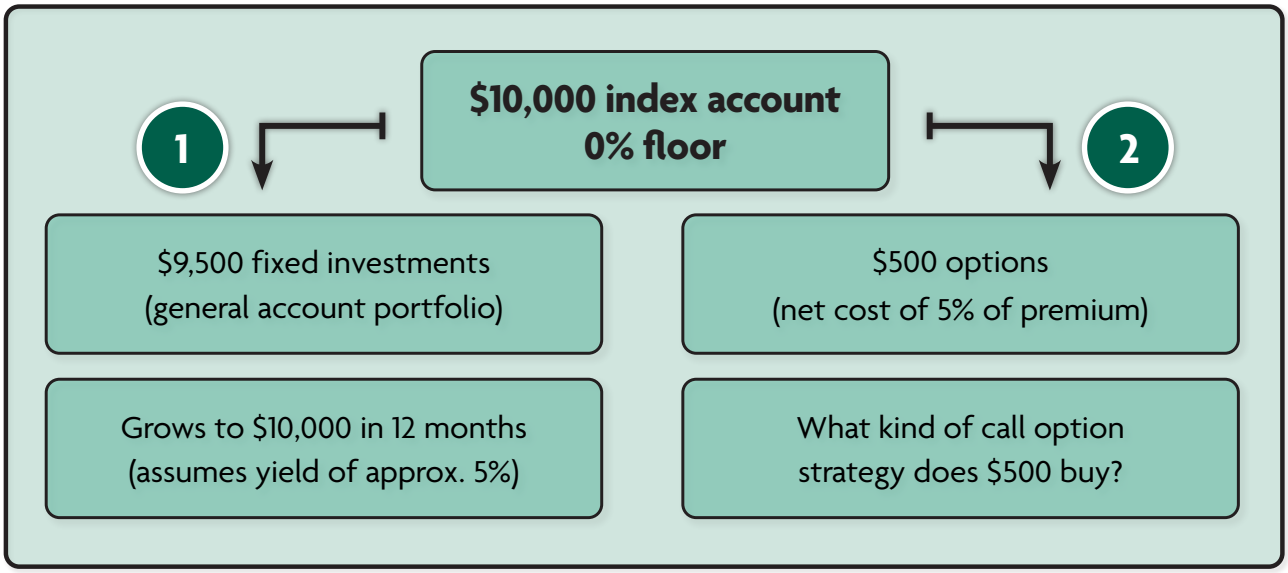
# IUL mechanics

## How insurance companies invest premium

As we explored earlier, an IUL policy's index account is linked to the performance of an index, with a cap, floor, participation rate, and spread rate. Exactly how does that linkage happen? Below is a simplified diagram of how an insurance company invests the client's premium in the general account while at the same time providing upside potential to the consumer. Assume a client were to pay $10,000 of premium into an IUL policy. We'll assume that the policyowner has elected an annual point-to-point with a cap rate, 0% floor, and 100% participation rate.

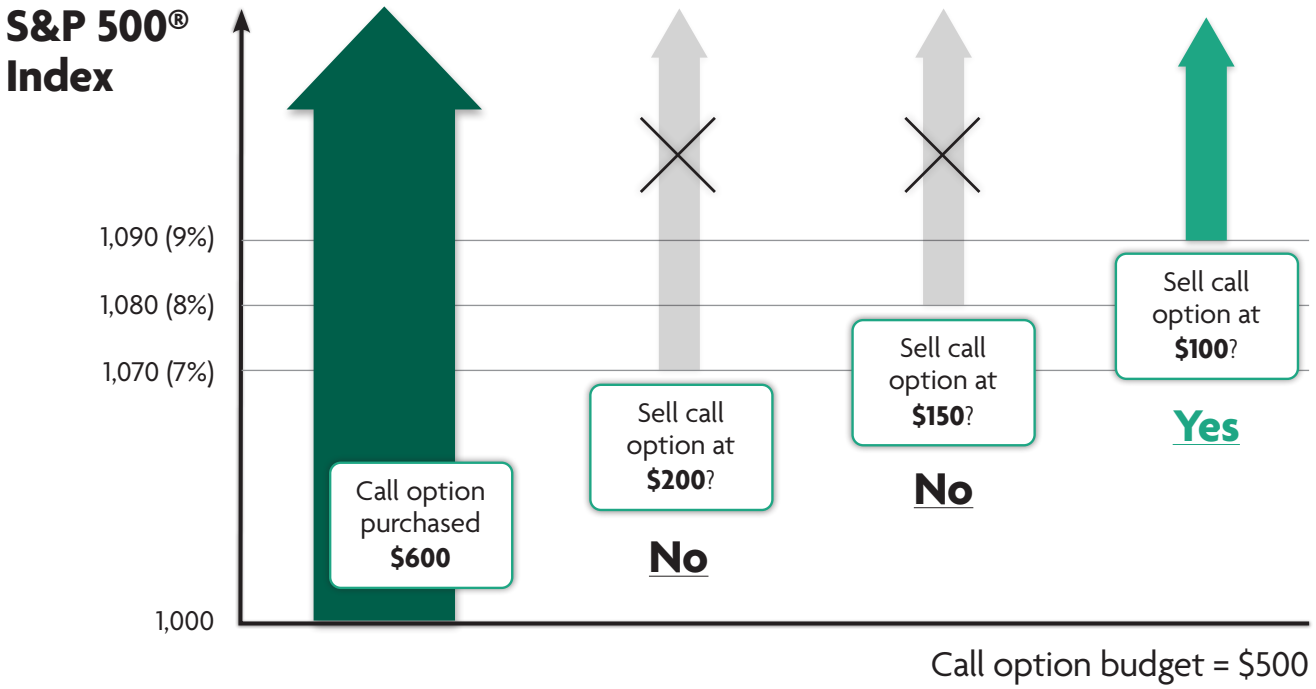
1. In this example, we will assume the general account portfolio as a whole is yielding just over 5%. The insurance company invests approximately $9,500 of the premium into fixed investments such as high-grade corporate bonds that become a part of the insurance company's general account. This amount will grow to the original $10,000 in one year, thus guaranteeing the index account's floor rate.
2. The insurance company uses the remaining $500 of premium to purchase a "bull call spread." This purchase is actually both a purchase and a sale. It starts with a purchase of a call option on the S&P 500 that is in-the-money. An in-the-money call option will provide a gain should the change in the S&P be positive one year later.

### Hypothetical example of a policy at issue

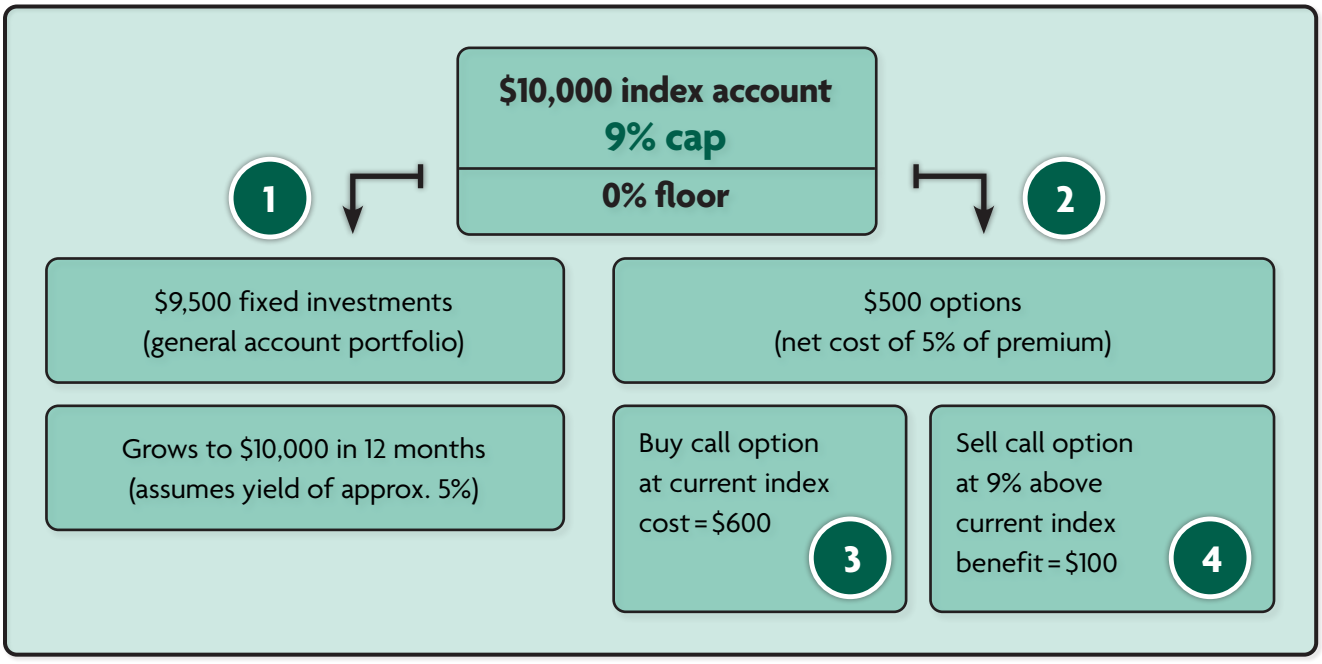



3. If the insurance only bought this one in-the-money call option, the sky would be the limit to the upside potential. However, this type of call option is generally expensive. In this example, we will assume this call option costs $600, which is $100 more than the amount the insurance company has to work with.
4. To make up this difference, the company sells a call option to somebody else. That person or entity would participate in gains beyond a certain point. This is how the index cap rate is determined.

Looking at the figure below, the arrows indicate the different kinds of call options that might be available. The insurance company could sell an option that is out of the money until the index reaches a 7% gain from its current level, which is 1,070 in this example. The sale of this call option generates $200 to the insurance company. The insurance company only needs $100, so it can sell the call option on the far right, which is a 9% out of the money call option. Therefore, because anything above 9% growth is passed on to somebody else, the cap on the index account is set at 9%. Neither the life insurance company nor the client participate in any gains above 9%.



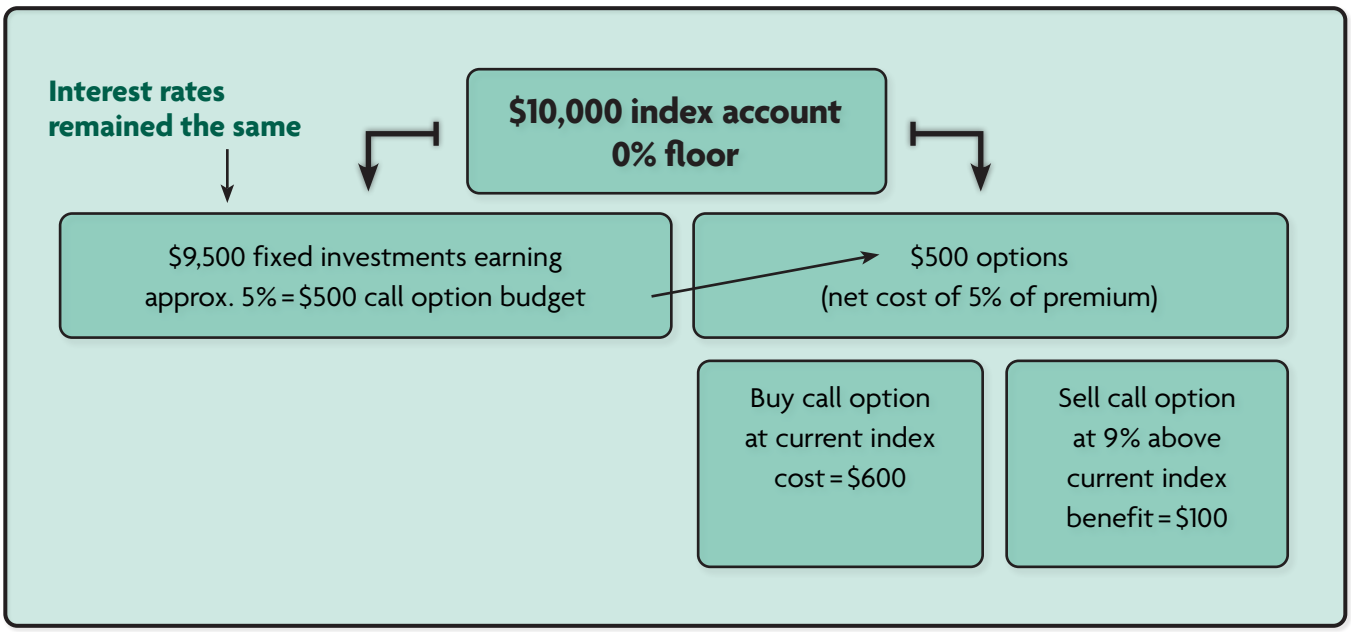

## Hypothetical example of a policy at issue



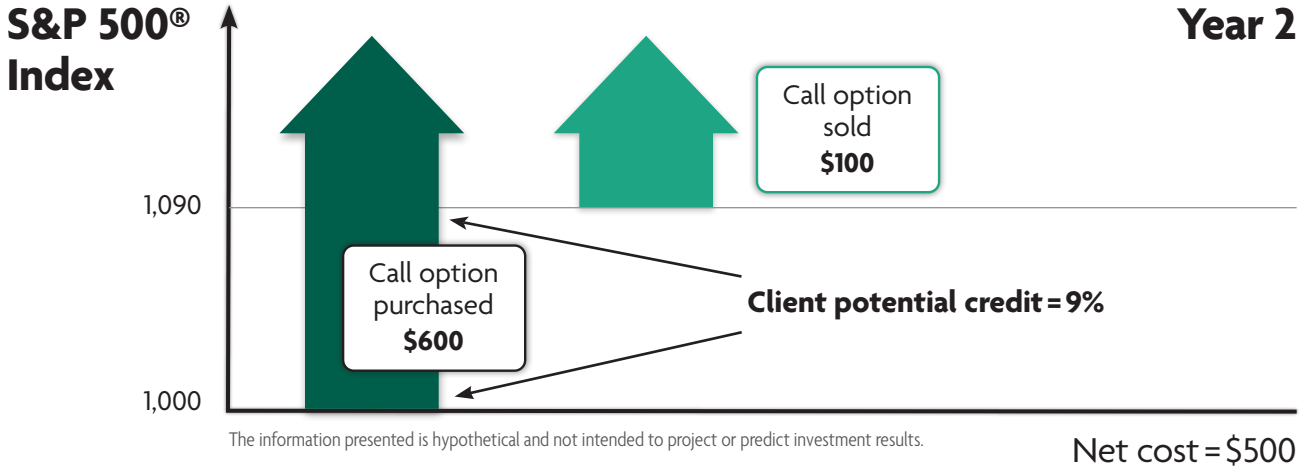
## The mechanics of changing cap rates

The interest rate environment has significant effect on where an insurance company sets cap rates. We will look at the effect of interest rate changes and option pricing on our hypothetical example. We will first consider what happens when rates don't change. It is now policy year two and interest rates have not changed on the general account. The $9,500 that was placed in the general account has grown to $10,000 due to the general account portfolio's 5% yield. If the general account is still yielding 5% in policy year two, the insurance company would repeat the same actions as in policy year one. Take a look at the figure below.

### Hypothetical example of a policy — year 2




The next figure shows essentially the same scenario as in policy year one if we assume that option costs have not changed. However, if the in-the-money option (dark green) were to get more expensive than $600, the insurance company would need to sell a more expensive out-of-the-money option (light green), which would require the insurance company to lower caps. The start of light green arrow illustrating the out-of-the-money option would reach further down below the 1,090 index value. This option would be more expensive because it has a higher probability of being in the money by year end.

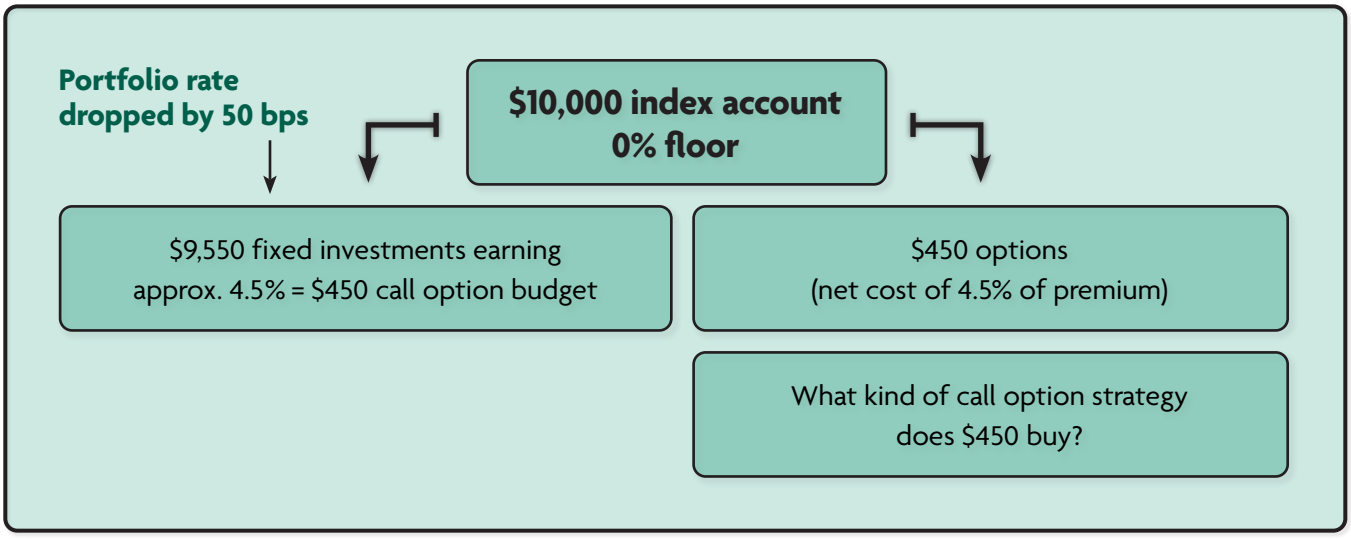



The information presented is hypothetical and not intended to project or predict investment results.

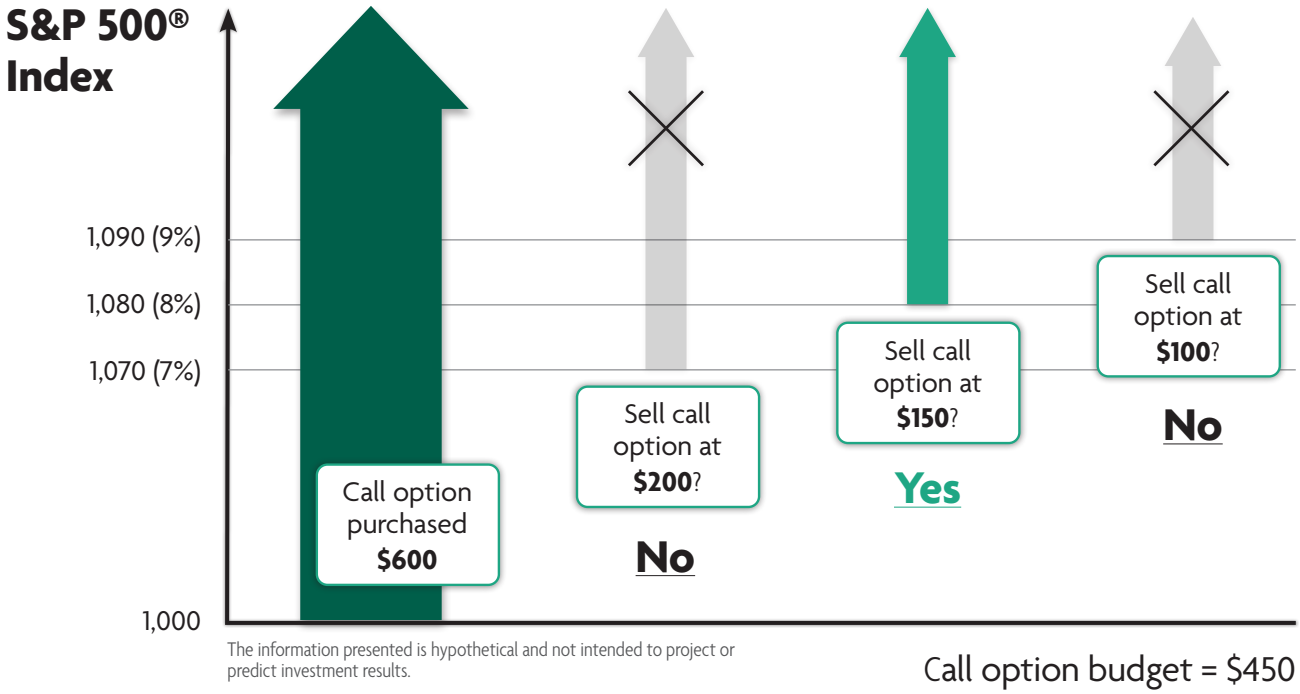
## The effect of declining yields

Consider what would happen if the general account portfolio yield has decreased to 4.5% before the start of policy year three. Assuming a $10,000 premium, the insurance company would need to allocate $9,550 to the general account to create the zero percent floor, leaving a smaller call option budget of 4.5% or $450. The figure below illustrates this scenario.

### Hypothetical example of a policy — year 3




The following figure illustrates the policy year three option purchase scenario. The insurance company would purchase a call option for $600 and simultaneously sell a call option that is 8% out of-the-money because it generates $150 of income. This results in a lower cap of 8% on the index account.

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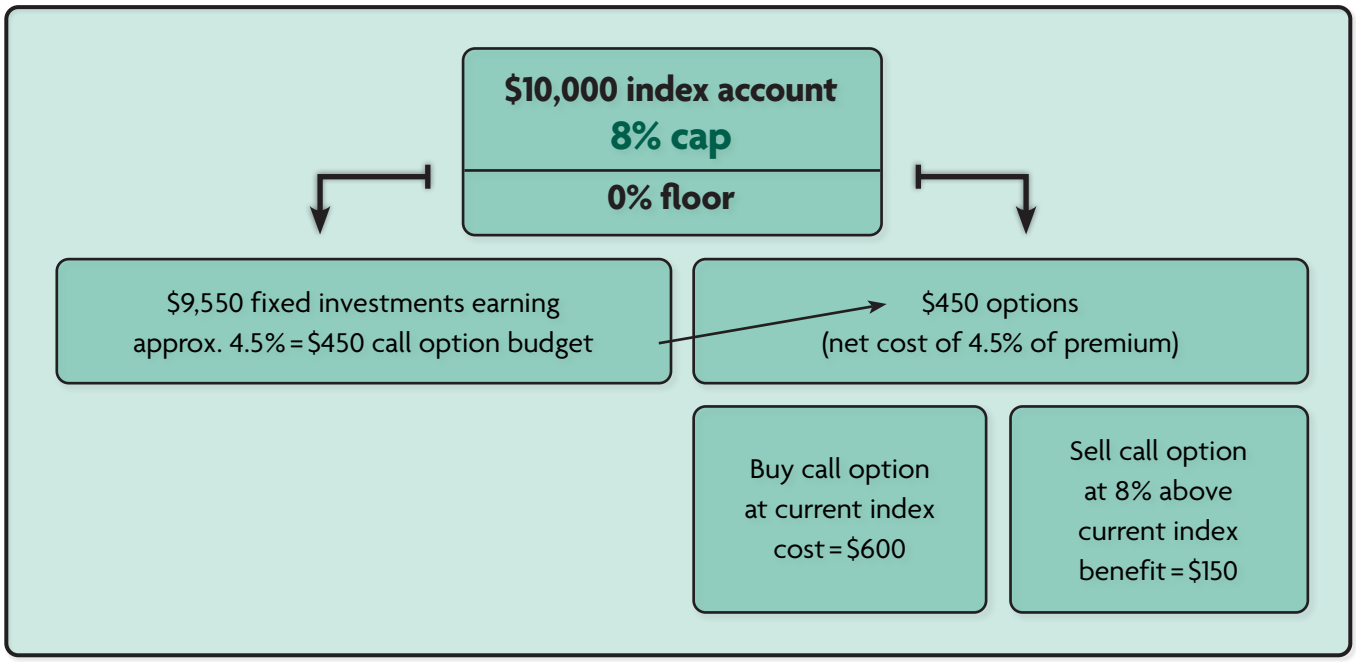
The next figure below illustrates the mechanics for a scenario where the call option budget is reduced.

## Hypothetical example of a policy — year 3




### The effect of low interest rates on the portfolio rate

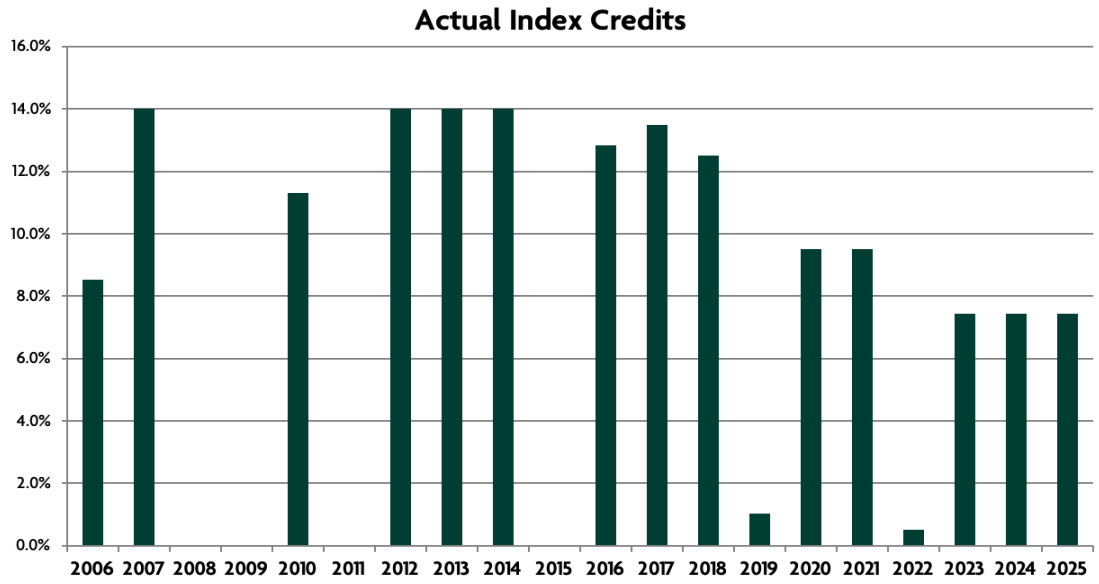
The interest rate environment has an effect on the insurance company's general account portfolio, but only over long periods of time. A long-term interest environment will slowly lower the general account's yield over time as the insurance company continues to invest. The opposite is true as rates rise. The general account's yield will rise as the insurance company continues to invest. Since the general account's yield is responsible for the zero percent floor, as the yield gets lower, the amount of the premium needed to support the floor will go up, leaving less premium to invest in the bull call spread. As the yield goes up, more premium is available to purchase a bull call spread.

### The effect of market volatility

One of the major components that determines the price of options is the volatility in the stock market. The "VIX Index" measures stock market volatility. As market volatility rises, the price of options rises. As options get more expensive to buy, the index cap rate availability may be lower. The options budget might not be enough to afford purchasing the call option for a high cap, even with selling a call option to make up the difference. There might not be a buyer for the high-priced call option the insurance company would need to sell.

# North American's IUL

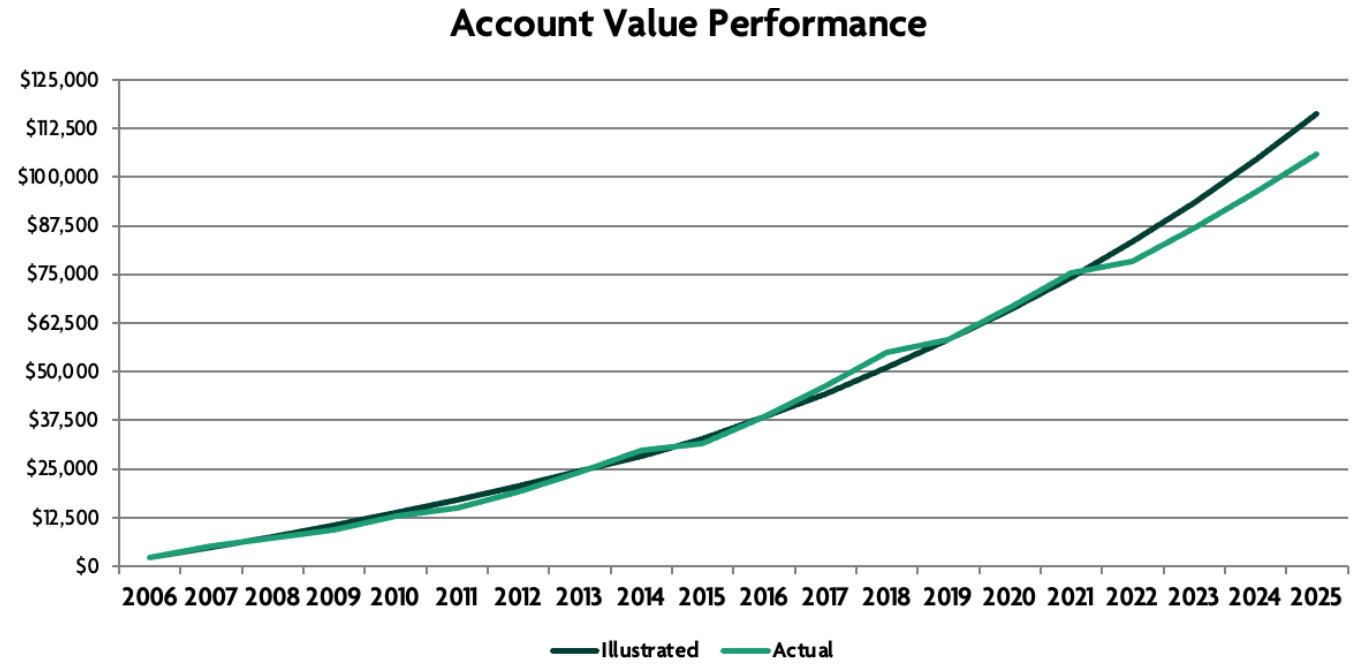
How have North American's indexed universal life (IUL) insurance products fared? Let's look at Custom Builder® IUL, the original version of North American's cash value IUL product. The chart below shows the index credits for a hypothetical policy issued on October 1, 2005.




Source: S&P Global, January 2026.
S&P 500 Index, Annual Point-to-Point, October 1 of each year.
*Past performance is not indicative of future results*

As you can see, there have been multiple times where the zero percent floor has come into play over the past decade. Undoubtedly, while earning zero percent in any given year isn't an exciting prospect, it may be less disheartening than receiving an annual statement showing a market loss.

The graph below compares actual index credits to an illustrated rate of 8.2%, which was the default illustrated rate as of October 1, 2006. Throughout the ups and downs of the market, and through different economic environments, it has performed as illustrated back when it was first sold.




Source: Internal calculations, January 2026.
Builder IUL (Gen 1) Issued October 1, 2005, Male Preferred Plus Issue Age 45
Death Benefit = $150,000, Annual Premium = $3,000 allocated to S&P500 Annual Pt-to-Pt
*Past performance is not indicative of future results*

## Key points to remember

In conclusion, this white paper has examined the following items:

- Where indexed universal life insurance fits in the broad spectrum of life insurance products.
- How interest is credited within the policy index account.
- How interest caps and floors affect the interest crediting.
- The mechanics of the investments that create a zero percent floor and the index cap.
- The external forces, such as interest rates and market volatility, affect cap rates.
- And finally, how Custom Builder, the original version of North American's cash value IUL product, persisted through a low interest rate environment and volatile markets, yet continued to perform as illustrated between 2005 and 2025.

Now it's time to put this knowledge to use. Put the protection and power of North American's indexed universal life insurance products to work for your clients. Contact your MGA to illustrate a solution!

Indexed universal life insurance products are not an investment in the "market" or in the applicable index and are subject to all policy fees and charges normally associated with most universal life insurance.

**THE S&P 500® COMPOSITE STOCK PRICE INDEX**
**THE S&P 400® COMPOSITE STOCK PRICE INDEX**

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