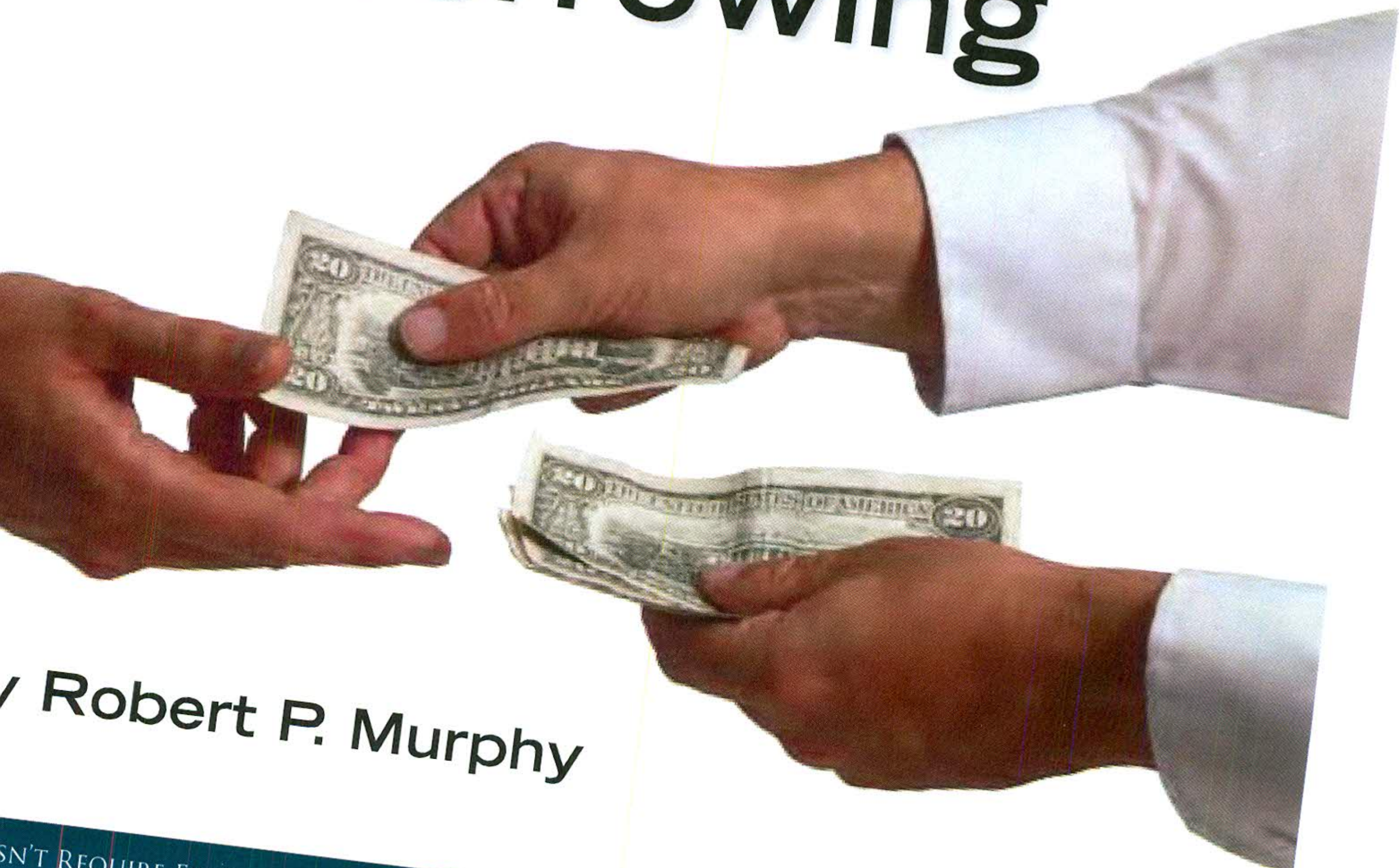
IBC Doesn't REQUIRE Frequent Borrowing



y Robert P. Murphy

SN'T REQUIRE FREQUENT BORROWING

One of the virtues of a dividend-paying whole life policy is the control the owner has over his money. In particular, policy loans are a very convenient way to access wealth stored in this fashion. Nelson Nash's Infinite Banking Concept (IBC) uses policy loans as a way to "become your own banker." Rather than relying on outside financiers and the associated interest payments, Nash encourages individuals to build up a warehouse of wealth inside one or more (appropriately designed) life insurance policies, so that major purchases can be financed through policy loans and paid back on the owner's own terms.

The Passages Causing Confusion

To be fair, there are (at least) two places in *BYOB* that might lead the reader to believe that frequent borrowing is essential for the proper or "true" implementation of IBC. First, the discussion of equipment financing has the hypothetical owner discovering (p. 53 of the 5th edition) that if he gets richer by using policy loans on one of his logging trucks, then he does even better by using the practice with his second and third trucks.

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Some fans of IBC have focused on particular passages in *Becoming Your Own Banker (BYOB)* and concluded that if a *little* borrowing (and repayment) is a good thing, then a *lot* of borrowing and repayment must be great. In fact, some IBC enthusiasts believe that the ideal arrangement would treat a life insurance policy as a checking account. Unfortunately, this is not a correct interpretation of Nash's message. I have verified this with Nelson himself, but in the present article I'll walk through some other statements from *BYOB* to unpack the confusion.

Earlier in the book, Nash has an entire section titled, "Expanding the System to Accommodate All Income" (p. 48). He explains that "premiums and income should match," because your income must flow through *some*body's bank—why not your own?

In light of these points, it is understandable that a reader of *BYOB* could conclude that IBC taken to its logical limit would involve frequent loans and repayments. "After all," such a reader might think, "what distinguishes IBC from a simple investment in a whole life policy, is

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the loan activity. And if I'm going to take out enough life insurance so that my paycheck just covers the premiums, then surely I have to borrow that money right back out, so I can pay my bills."

Understandable though the above attitude may be, it is an incorrect interpretation of *BYOB*'s message. In the next section I'll bring up some counterpoints to show what I mean.

Passages Suggesting Nash Is Not Recommending Frequent Borrowing

First, Nash stresses that the IBC policyholder must not be afraid to capitalize. In the various examples from *BYOB*, the people (such as the logger or Susie Q. Student) make premium payments into their policies for several years, before taking out a single loan. IBC only "works" if one has built up a sufficient cash value to get started. That's why IBC requires not just insight, but discipline.

Now it's true, many real-world users of IBC transfer in large amounts of wealth from other sources, and begin borrowing immediately. Especially if such a person has high-interest-rate debt (like credit card debt) that he pays down with the policy loan, this can be a sensible strategy. But my point is, the standard examples in *BYOB* don't have people acting in this way; instead they spend years building up a policy before taking out a single loan.

It's also important to dwell on the phrase "warehouse of wealth" (the title of Nash's subsequent book). What distinguishes the warehouse from, say, the shelf in the grocery store? The shelf is constantly drawn down and replenished with items (such as cans of peas) from the backroom. Yet the *warehouse* is not as frequently altered. It is occasionally replenished by shipments from the suppliers, and the grocery store (or other business) occasionally replenishes its own, smaller stockpiles by drawing down the stocks at the warehouse. Relative to the day-to-day (or hour-to-hour) activity in the store, the warehouse turnover is a much more lethargic affair. Consequently, we should expect our warehouse of wealth to act as a buffer, and have less frequent financial activity than our day-to-day lifestyle requires.

Finally, there's the fact that Nash refers to having a regular checking account "for convenience." This proves that he doesn't actually think someone should use a life insurance policy as a checking account.

Knowing the Why

All of the above passages and themes are consistent with each other; they only appear to be contradictory. Let me try to reconcile them in the remainder of this article.

First, we need to understand why the logger in the equipment financing example does progressively better, when he expands the operation. It's not because of borrowing and repaying per se. Rather, it's that he's *redirecting cash flows as Paid Up Additions into his policy, that otherwise would have gone to outsiders in the form of interest payments*. As Nash himself says in footnote 1 on page 58:

> *Actually, this "interest" [paid to one's insurance policy] is not really interest—it is additional premium (capital) that has been paid into the policy that equals the interest that was being paid to the finance company. That is the reason that it is adding to the cost basis of the policy.*

This is a crucial point so let me spell it out with a simple numerical example. Suppose someone is planning on taking out a loan of $1,000 from a commercial lender, to be repaid in one year at 10% interest. But instead, the person borrows the $1,000 from the insurance company at 5% interest. In order to clear the loan, he could simply pay back $1,050 in one year. But instead he follows Nash's advice and plays "honest banker" with himself, and pays the full $1,100 into the policy. What actually happens under the hood is

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that the insurance company uses $1,050 to extinguish the loan, and the remaining $50 to buy additional life insurance. Thus, with the same outflow of cash—$1,100 due in a year—the man ends up with an extra $50 worth of Paid Up Additions in life insurance. That contribution will boost his death benefit and cash value in the policy.

In my simple example, it was not the borrowing and repayment per se that made the man wealthier. Rather, it was the fact that he directed the same cash flow toward a loan that he obtained at a lower interest rate, so that the difference could be used to buy additional life insurance.

What does all this mean? Yes, you should expand your IBC loan process *so long as you continue to use outside financiers*. But once you reach the point where you are no longer borrowing money from outside entities, you don't need to engage in further policy loans in order to "do IBC." If you have extra cash that you can divert into the policy, you are allowed to make more PUA purchases with it; you don't have to go through the motions of borrowing money in order to pay yourself back at a high interest rate.

Premiums Can Equal Income, Without Frequent Borrowing

Finally, let me show how a standard checking account can interact with a large whole life policy with premiums equal to annual income. My point in this demonstration is simply to show that even at the theoretical limit, where a person has to devote every penny of income to keeping his policy in force, it does not follow that the person must make monthly policy loans in order to pay his living expenses.

To keep things simple, suppose our hypothetical person has a monthly salary of $10,000, a monthly whole life premium of $10,000, and living expenses of $9,000 per month. One might at first think that this person needs to take out monthly policy loans, but this isn't true. So long as the person has a well-capitalized checking account to act as a buffer, he only needs to occasionally borrow money from the insurance company.

For example, if the person starts out with a checking account balance of $108,000, he only needs to take a policy loan once per year:

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Month	Checking Account Balance Before Monthly Living Expenses of $9k (ignoring interest)	Policy Loan Balance (ignoring interest)
January	$108,000	$0
February	$99,000	$0
March	$90,000	$0
April	$81,000	$0
May	$72,000	$0
June	$63,000	$0
July	$54,000	$0
August	$45,000	$0
September	$36,000	$0
October	$27,000	$0
November	$18,000	$0
December	$9,000	$0
January	$108,000	$108,000

IF YOU HAVE EXTRA CASH that you can divert into the policy, you are allowed to make more PUA purchases with it; you don't have to go through the motions of borrowing money in order to pay yourself back at a high interest rate.

Admittedly, some might balk at keeping an entire year's salary in the checking account. The necessary amount can be cut in half, if the person wants to make two policy loans per year:

Month	Checking Account Balance Before Monthly Living Expenses of $9k (ignoring interest)	Policy Loan Balance (ignoring interest)
January	$54,000	$0
February	$45,000	$0
March	$36,000	$0
April	$27,000	$0
May	$18,000	$0
June	$9,000	$0
July	$54,000	$54,000
August	$45,000	$54,000
September	$36,000	$54,000
October	$27,000	$54,000
November	$18,000	$54,000
December	$9,000	$54,000
January	$54,000	$108,000

EVEN AT THE THEORETICAL LIMIT, where a person has to devote every penny of income to keeping his policy in force, it does not follow that the person must make monthly policy loans in order to pay his living expenses.

And just to make sure the pattern is clear, a person could devote his entire salary to policy premiums, and yet still only take out three policy loans per year, if he had four months' worth of living expenses initially saved in his checking account:

Month	Checking Account Balance Before Monthly Living Expenses of $9k (ignoring interest)	Policy Loan Balance (ignoring interest)
January	$36,000	$0
February	$27,000	$0
March	$18,000	$0
April	$9,000	$0
May	$36,000	$36,000
June	$27,000	$36,000
July	$18,000	$36,000
August	$9,000	$36,000
September	$36,000	$72,000
October	$27,000	$72,000
November	$18,000	$72,000
December	$9,000	$72,000
January	$36,000	$108,000

IT WAS NOT THE BORROWING and repayment per se that made the man wealthier. Rather, it was the fact that he directed the same cash flow toward a loan that he obtained at a lower interest rate, so that the difference could be used to buy additional life insurance.

NASH STRESSES that the IBC policyholder must not be afraid to capitalize.

In all three of the above scenarios, the person starts the next year with a $108,000 policy loan balance, because that is the sum of his annual living expenses and (remember) his entire paycheck was absorbed by life insurance premiums.

I should be clear that I am *not* recommending that a person operate in this fashion. Beyond the hurdle of underwriting—in other words, convincing the insurance company to grant enough coverage so that one's entire income equaled premium payments—there are numerous other practical issues we would need to consider, before pushing someone to this extreme. As Nash himself says, having premiums equal income is the upper theoretical limit of IBC.

The point of my demonstrations above was simply to show that *even if* someone devoted his entire paycheck into life insurance premiums, it wouldn't follow that this person had to engage in frequent policy loans just to eat. Rather, the person could have first built up a sizable checking account balance. Then, the frequency of policy loans would be related to the number of months' worth of expenses in the checking account.

Conclusion

Certain passages in *Becoming Your Own Banker* might lead the reader to conclude that IBC requires frequent loan activity in order to "work." Yet this is a misinterpretation of Nash's message—as he himself has confirmed to me in private communication. It makes perfect sense to use a policy loan to *replace* outside financing, but the loan per se isn't necessary to make the additional PUA contributions, which are the real source of growth in the *BYOB* examples. Even if someone were to live up to Nash's theoretical ideal of devoting all income into premium payments, it still would not require frequent policy loans, because a large checking account could act as a buffer.

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