

# THE “INFINITE BANKING CONCEPT” (AKA “BECOMING YOUR OWN BANKER”): ONE ACTUARY’S COMMENTARY



Advisors sometimes call LLIS because their clients have been approached by an insurance salesperson pitching a concept called “Infinite Banking” (aka “Be Your Own Banker”). Advisors want to know:

*What is this? Is it any good? Should my client consider doing this?*

## WHAT FOLLOWS IS A RESPONSE WRITTEN TO AN ADVISOR ABOUT A REAL PROPOSAL THE CLIENT WAS GIVEN.

### First, two background points must be made:

1. This is a sales concept; not an insurance policy. The concept is usually illustrated with whole Life policies and, more recently, with indexed universal life policies. The policies require large insurance face amounts and large premiums. The policyholder would buy the policy, be required to sock away large amounts of money every year, and wait for the cash values to grow to use them like a bank checking account.
2. The agent and the sales literature will tell their prospect that this is an “investment” because:
  - They can earn interest tax-deferred on the cash values; and
  - They can borrow money from the policy, and pay themselves interest on the loan instead of paying the big bad bank.

The biggest problem with this “investment” is that there is usually little or no cash surrender value in the first several years because of surrender charges. It’s many years before there are real accessible cash values and, in the interim, the policies require continued large premiums without flexibility.

*The information LLIS received along with the sales literature*  
The primary illustration presented included these details:

**Prospect:** Male (Mr. C), age 37, non-smoker, Preferred health

**Face amount:** \$10 million whole life (Remember, whole life means the premiums must be paid for the whole life of the policy. And the advisor said the client really needed \$2 million of 20-year term, not \$10 million of death benefit)

**Annual premium (years 1-5):** \$123,216 (guaranteed)

**Cash value (end of 1st year):** \$81,390 (commissions and other policy charges ate up \$41,826, reflected in the cash value)

**Annual premium (years 6-10):** \$123,522 (guaranteed)

**Paid in (after 6 years):** \$739,602

**Cash value (after 6 years):** \$716,226 (still under water)

Mr. C was told that he should funnel all the money he could into a participating whole life policy as quickly as possible. And then he could use that policy as his own private bank.

### *Our analysis of the biggest concerns about this plan*

Agents pitch the concept because the products have high commissions and large premiums. The advisor asked us to help him sort through the hype and give him our opinion.

1. Performance risk. Even if this idea was a sound one, what financial advisor would ever recommend that clients put all their savings in just one investment? Why would anyone want to put their investment dollars through the high commissions and other loads of life insurance . . . especially whole life or indexed universal life?
2. The Bank Comparison. We don’t agree that a whole life policy can be compared with a bank, but let’s take a closer look. When you put money into the bank, you expect it to actually make it to the vault. Would you want the banker to put 50% to 100% of your first deposit directly in his own pocket? That’s exactly what happens with any whole life policy. To find out how much the banker keeps, just compare the first year’s surrender value to the amount of premiums paid. The surrender value will be much less than premiums paid and it takes years for the cash values to equal the premiums paid.
3. The Cash. So where did the money go? To commissions, taxes, and policy administrative expenses. Not all the difference between the premium paid and the cash surrender value goes to the agent as commissions. Insurance companies must pay state premium tax and federal DAC tax, which average 2.5% to 3% on every premium paid. This tax is paid in addition to what the banker (the insurance agent) keeps the first year and receives on all renewal years.



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Policyholders, by law, have some regulatory protections because of the restrictions placed on how insurance companies can invest cash values. As most people know, bonds are the favored investment for most insurance companies. From the net after investment expense yield, the companies then charge from 1% to 1.5% on the spread between earnings and expenses as profit before crediting interest rates of return on a policyholder’s cash values.

With whole life insurance, the death benefit must be large enough to support the large premiums of this plan so the policy doesn’t become a modified endowment contract (MEC). A MEC policy would no longer be considered life insurance and would lose its tax advantages. The face amounts of insurance are not driven by need for life insurance, but on the amount of premium. This concept forces clients to buy more insurance than they really need. Why does this matter?

1. Insurance companies won’t let applicants buy any amount of insurance they want. Financial justification is required.
2. Does the client really need/want a large amount of insurance? If not, then they are paying for coverage they don’t need. This is extra cost, which takes away from the bank’s “earnings.”
3. Is the insurance priced right for the individual or is there a less expensive way to provide this coverage? Guaranteed universal life could cost much less.
4. With a bank, you choose whether or not to make more deposits. And you can choose different amounts each time. With a whole life policy, premiums must be paid each year. After the initial death benefit has been determined, the premiums are fixed. If the second premium cannot be paid, the policy will lapse; and the “banker” does not return anything you gave him.

## THE NUTS AND BOLTS

Their recommendation is to use a participating whole life policy and, since there is no low-load participating whole life plan, it must be a front-end loaded policy. Other than the obvious loads, whole life policies require

more death coverage than universal life or variable universal life. Whole life has no flexibility because fixed premium amounts must be paid. Once the plan is in place, the policy owner is committed to future premium payments. Conversely, UL and VUL allow flexibility.

Where does this leave your client? With the wrong type of policy with too many loads for an “investment” idea. So why not use a variable UL for this “concept?” We don’t know any ethical broker-dealers who would allow this “concept” to be linked with a VUL product overseen by FINRA and the SEC.

Another key concept pushed by promoters of the “infinite banking concept” concerns policy loans. When your client takes out a policy loan, the pitch promises that the client would make the big profits the bank would have made. But will he? Most (if not all) whole life plans now have two different dividend payouts: one for those who don’t have policy loans (and probably the only one your client ever saw in projections), and one with a low dividend payout for policies with loans. Most insurance companies promote the idea that at some point in the future (usually after 10 or 15 years or at age 65+) the policy will credit the cash value account the same interest rate they are charging for the policy loan. But read the policy! This “wash loan provision” may only be current practice and not guaranteed in the policy.

The “concept” also makes the point that all earnings are tax-deferred. This is true. However, this is true for all permanent insurance policies, not just whole life and not just the ones that are over-funded.

Another frightening recommendation is that your client should “stop making contributions to his qualified plan, except for any amounts being matched by his employer,” and instead put the contribution amounts into his whole life policy. I disagree with this recommendation. Qualified plans also accrue on a tax-deferred basis. But the money going into qualified plans is pre-tax and, unlike insurance premiums, is not subject to commissions and other insurance costs. Earnings on both qualified plans and life insurance premiums are tax-deferred, but qualified plan contributions aren’t subject to premium taxes, commission loads, or monthly costs of insurance.



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The “private banking concept” also suggests purchasing a disability waiver of premium. This is one of the most expensive riders in the industry. The definition of disability is very strict, the cost per benefit dollar is very high,

and there are no residual benefits. Compare the cost of the rider to the price of an individual disability policy and you’ll see how truly expensive this recommendation is.

Finally, there are possible penalties. Unfortunately the “concept” has little disclosure about what will happen if the policy does not stay in force. If the policies have loans (and policyholders rarely pay back either the loans or the interest), they may eventually lapse with no values. When that occurs, all the taxes that were deferred in the policy will be due immediately. And there will be no cash values to help with this tax burden. If the policyholder wants to keep the policy in force in the later years, he will need to come up with cash and/or pay off large policy loans.

The story of the “infinite banking concept” is like that of the man who was floating in a hot-air balloon and came down from the clouds above a golfer:

**The man in the balloon yelled down:** “Where am I?”

The golfer yelled back: “You are in a hot air balloon.”

**Balloonist:** “Of course I’m in a hot air balloon, but where am I?”

**Golfer:** “You are 50 feet above me.”

**Balloonist:** “You must be an actuary.”

**Golfer:** “That is correct, but how did you know?”

**Balloonist:** “Because everything you told me is absolutely correct, but of no use in the real world.”

## ALTERNATIVES TO THE PRIVATE BANKING CONCEPT

An advisor might consider the value of some of the concepts without the downsides of the plan as it is proposed. If your client has maximized payments to all his retirement accounts, has a diversified, well-managed investment portfolio that should meet his retirement needs, and finds himself in need of some life insurance, you might look at some of the upside features of this plan without all the downsides.

Here is a possible scenario:

1. Determine how much insurance your client needs and for how long. Then determine the most efficient way to purchase that insurance. Usually, we recommend term for a fixed period of time and low-load guaranteed universal life (GUL) insurance for lifetime needs. Ask for full disclosure of expenses; especially for any non-guaranteed products.
2. What are your client’s investment needs and risk tolerance? While I do not pretend to be an investment advisor, most advisors we work with recommend diversification. So while the cash values in a low-load UL can be -- and should be -- considered part of their investment portfolio, an insurance policy should not be your client’s only investment.
3. If your client wants to “invest” inside a life insurance policy (and thus have the ability to take policy loans, etc.) consider a low-load variable UL contract with the minimum death benefit. Within a VUL, your client could have a fixed guaranteed account just like in a UL or WL. And you could manage the sub-account choices for your client to minimize expenses. We suggest your clients maximize -- not minimize -- their contributions to qualified plans.

## THE REAL ILLUSTRATION

The advisor supplied me with “as sold” sales illustrations. The following remarks address those key documents that prompted the client to purchase:

While you provided more than one policy, I will use the primary mutual company illustration for the numbers below, unless otherwise mentioned. However, the same logic and number relationships would apply to all the whole life illustrations you provided. This illustration has the guaranteed values, and current and reduced dividend projections. I will use in my comments their best shot with current expenses and costs of insurance projected forever unless I specifically comment on the guarantees. Remember the banker and the vault mentioned earlier? In this case, the first year premium is \$123,216. However, by the end of the first year, Mr. C would have only \$81,390, which certainly doesn’t sound like a good investment.



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He continues to pay the \$123,216 for five years, at which point the illustration shows an increased premium of \$123,522 for the next five years. After six years, he has paid in \$739,602, but the best projection shown illustrates that he still has only \$716,226 (in the hole by \$23,376).

I mentioned the lifetime commitment of paying premiums. As the illustration shows, a premium is due and must be paid until age 100. However, it shows that under the company’s projections, the premiums beginning at age 65 (year 28) do not need to be paid by cash; they are paid by surrendering future dividends. Included in the fine print is: *“The premium payment amount is assumed to be paid through the use of dividend values in the years marked. This does NOT make the policy paid-up, make the policy a guaranteed limited premium payment policy, nor reduce the number of premiums that must be paid. Future dividends may be less than those illustrated which may result in the need to continue premium payments or to resume premium payments after the suspension of such premium payments. In the guaranteed example, dividends are not available to pay the premiums.”*

This is also important to keep in mind because the “concept” makes it seem as if your client could take money out and pay it back later. What it does not mention is that, even though he may take money out, he is still required to pay the premiums due.

The “concept” encourages taking loans from these policies. However, it fails to show any policy loans in the projections. That may be due to the fact that most companies have a much lower dividend scale when there is an outstanding loan. So if your client does take advantage of this concept and takes out a policy loan, the future projections of values would be less than shown “as sold.”

Concerning the purchase of waiver of premium (WOP), this policy does not illustrate a waiver. So I will move from the primary illustration to the second mutual company one because it has the waiver broken out. He is paying \$1,110 extra every year until age 65. Without a copy of Mr. C’s actual policy, I believe you’ll find this rider will start paying only after your client is totally and continually disabled for six months. This means no residual payments . . . ever! It also means that if he is disabled for a short time, say four months, then goes back to work for a month or two but

finds it necessary to go back on disability, he will be required to begin the six month waiting period all over again.

The key take-away: as a small disability policy, WOP has poor definitions and limited benefits. As a comparison, he could get the same amount of benefit but with residual and without the need for “continuous” disability for about \$860 per year. And that’s on just one of his policies. His savings would be substantially more by adding all his waivers into one good disability insurance policy.

## THE CONCLUSION

As I mentioned in Alternative #2 above, I would never recommend putting all of a client’s investment dollars into an insurance policy.

Year	Cash Surrender Values Low-load VUL	Cash Surrender Values WL
1	\$126,781	\$81,390
5	\$686,198	\$558,671
10	\$1,598,880	\$1,430,304
20	\$4,177,849	\$3,623,725
27	\$7,145,346	\$6,056,222

My comments in this white paper were true when I wrote it and remain true today. This sales pitch comes around every year or two. The name and numbers may change, but the concepts remain the same. The most important thing to remember: The only things guaranteed are stated as guarantees; everything else is based on projections. The “devil is in the details” so make sure your clients fully understand what they are considering and request full disclosure.

*As my father used to say: “Trust everyone but cut the cards.”*  
by: Keith Maurer, CLU, FLMI



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