# Infinite Banking: Why Not Use Universal Life?

**8/10/10 Working Draft**

**A Brief History of Universal Life Insurance:**

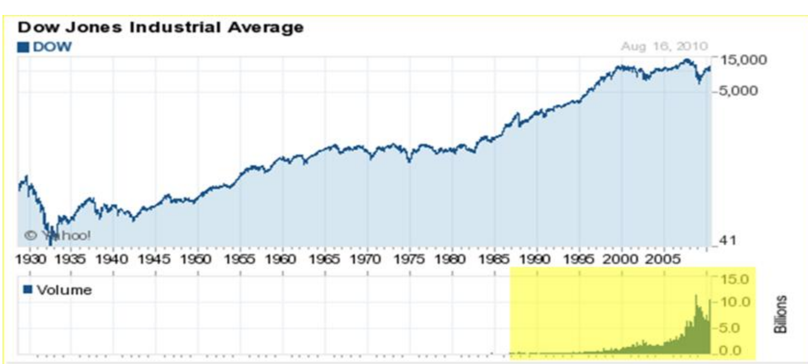
Universal Life was created by E.F. Hutton in the 1980s to compete against the 'buy term and invest the difference' mind set of the AL Williams Termites. The investment firm of E. F. Hutton is now part of the Citigroup family.

E. F. Hutton is still remembered for its catchy advertising slogan: "When E. F. speaks, people listen". Where is EF Hutton today and what are they saying? Well, it seems people stopped listening when E. F. Hutton; there were charges of check kiting and money laundering. Founded in 1904 it grew to become one of the most respected U.S. financial firms, and for many years was the second-largest brokerage in the United States. But in 1980 some Hutton branches began shifting funds from one account to another, effectively giving itself interest-free loans until the checks cleared (sounds like banking to me). Of course the scheme eventually came to light, and in 1985 Hutton pleaded guilty to 2,000 counts of mail and wire fraud. However, the SEC allowed Hutton to stay in business.

An internal investigation in 1987 uncovered that a Providence, Rhode Island, branch was laundering money for a crime family. Hutton voluntarily brought this matter to the SEC, but all signs suggested Hutton couldn't count on leniency a second time. However, this happened just before the stock market crash of 1987. With that, along with all the bad press, the firm's deep debt going back to 1985, and its star performers defecting to other firms, Hutton was on the verge of collapse by the end of the year, and so agreed to be acquired by Shearson Lehman Brothers. Several mergers later, what remains of the once proud firm is now part of Citigroup, Inc. (NYSE: C).

**Background:**

Universal life has been offered as an insurance option since the early 1980's, which coincidently, corresponds with the same time that employer sponsored guaranteed pension plans began to be replaced by 401ks which were heavily invested in the stock market. Pensions and 401ks were view primarily as recruitment and retention tools for employers seeking to entice and retain employees with 'velvet handcuffs'. In the 1980's the growth of the stock market and mutual fund investing with its increasing volumes of business was simply too great for the insurance industry to ignore. They wanted a way to capitalize on the securities industry.



Universal life is a flexible-premium, <u>adjustable-benefit</u> life policy with an account value that accumulates on a tax-deferred basis. This type of policy is specifically designed to give the policyholder <u>flexibility to change the premium and death benefit</u> of the policy while retaining the tax benefits of life insurance.

Universal life insurance products are designed to shift the mortality and investment risk to the policy owner with rate guaranteed during the first year but subject to maximum mortality rates guaranteed during the first year but subject to maximum mortality rates and minimum interest rates during subsequent years. The universal policies offer high yields near money market rates on the savings element—an element that 'resembles traditional cash surrender values in name only".

Universal life has three sets of guaranteed rates but, unlike whole life, the rates are **not** put into an actuarial formula to determine a **guaranteed premium**, **guaranteed cash value** and **guaranteed death benefit**.

Universal Life with a ***<u>no-lapse secondary guaranteed life benefit</u>*** has been sold to many insurance buyers as <u>a low-cost alternative to Whole Life</u>. All too frequently, a reduced premium and a guaranteed death benefit are the *only* policy features that consumers have considered in deciding which type of insurance to purchase. The emphasis with Universal Life as with Term is on reducing the <u>cost</u> of insurance rather than on maximizing the living and/or death benefits of Permanent Life Insurance.

However, a thorough comparison of all the **features, benefits** and **provisions** of Whole Life with no-lapse Universal Life demonstrates that the new <u>Universal Life</u> with secondary guarantees <u>is much less valuable and attractive than their buyers have been led to expect</u>.

**Infinite Banking:**

Universal Life, Variable Universal Life, and Equity Indexed Universal Life policies <u>may</u> in fact work as a 'holding accounts' from which one may conduct the Infinite Banking Concept. Likewise, a tin can may be used as a place to hold funds from which you may operate your banking system. HOWEVER…for the most efficient banking system, we recommend only <u>maximum funded, dividend paying whole life contracts</u> from stable mutual insurance companies with long, well established track records.

Here for the agent or client who is convinced that investing is more productive than banking are a number of very important reasons ***<u>we do not</u>*** recommend Universal Life Policies ***<u>of any kind</u>*** for Infinite Banking:

1. **No guaranteed premium**: your premium payments (your 'deposits') may be higher or lower than you initially anticipated which add ***<u>uncertainty</u>*** to the foundation of your Personal Banking System. We believe you have more than enough uncertainty in your life already… why would want to add more uncertainty? When you could have guarantees? We don't get it.

2. **No guaranteed cash value**: cash values in whole life insurance policies create a new guaranteed minimum floor that is re-set every year…automatically. With cash value that is guaranteed, you don't risk the possibility of your cash values fluctuating every year like an 'investment' does. **<u>Certainty trumps risk</u>**.
3. While **interest rates may be guaranteed, cash values are not guaranteed**. Guaranteed interest rates mean nothing if your account has no money. Remember how insignificant 'interest rates' are to bankers? Are you setting up a bank you want to be there when you need it, or are you 'just buying term insurance' because you believe so heavily in 'the markets'?
4. **Death Benefits are NOT Guaranteed,** without an extra charge
5. **By contract, mortality assumptions and therefore mortality charges (cost of the insurance) can be changed at will by the insurance company and are very hard to understand.**
6. **Limited track record**: With limited longevity there is no proof that the assumptions made in the 'illustrations' will be accurate in the long run. Ask anyone who has had a Universal Life Policy for more than 15 years, what has happened to their costs and coverage. The <u>newest</u> member of the Universal Life family of policy types has been around all of maybe 10 years.
7. **Under-funding is generally promoted as a way to lessen the cost of the insurance** ... So, if the life insurance contract they promote is so good, helpful and beneficial to you, wouldn't they want you to put in as much as possible rather than trying to put in as little as possible? Most Uls, EIULs, and VULS are funded at the <u>'target premium' which benefits the agent</u>. Conversely, properly structured 'banking policies' are structured to give the maximum benefit to the policy holder, which means they are funded far beyond the target premium--funded right up the MEC limit.
8. **Borrowing from a Universal Life Policy can be deadly**. A lethal combination of <u>declining interest rates and increasing insurance costs</u> can spell disaster for UL policy owners. The situation can be <u>exacerbated even more if the policy owner has taken withdrawals or loans from the policy or has not paid the planned premiums</u> (used for banking!).
9. **Universal Life is a bundled version of 'buy term and invest the difference' a product <u>you</u> don't control.** BTID is based on the assumption that your investments will eventually replace your 'need' for life insurance. So, if that is the case, what happens to your investments when you decide to cancel the insurance? You give up the guarantees of most beneficial financial product ever created which gives your personal economy the most options possible, in exchange for the certain uncertainty of <u>investments</u> that can and do lose money.
10. **Universal Life, which is based on one year renewable term insurance is <u>guaranteed to get more expensive each and every year you keep the policy</u>.** Why would anyone buy ANY product that is **guaranteed to get more expensive each year you own it**? When the expense of owning an old car gets to the point where you can no longer afford it, you get rid of it. Whole Life from a mutual company has a fixed cost that actually decreases your out-of-pocket costs every year as it becomes more and more efficient the longer you own it. Add to that the guaranteed inflation we are now facing and you soon realize you are giving away your most valuable dollars today for inflated dollars of the future.

11. **Less than 1% of all term insurance policies ever pay a death claim**. Why? Ever increasing costs… because every year you are getting older, the closer you are to canceling the policy because of costs. How often do mature universal life polices pay a death claim? Although we are unaware of the exact statistics, compare to the pay of Paid Up Whole Life Insurance, we believe there is no comparison.
12. **Term Insurance is the most expensive insurance you can purchase:** The older you get the more expensive term life insurance becomes… so as you get closer and closer to mortality... the less likely you are to be able to afford the policy. Nelson Nash points out that "…most of the dying takes place after age 65." So, just when you need all the assets you can get to sustain you in your later 'passive income' years, you find that your tax free asset is now worthless! In your senior years is not when you want to be giving up assets, tax free or otherwise. A paid up whole life policy from a dividend paying company is an asset you can leverage in retirement. Unsuspecting UL owners seldom see their policies as anything but liabilities.
13. **The cost of insurance also affects the cash value accumulation in a UL policy**. The next chart titled "Table of the 2001 One Year Term Premiums" illustrates the increasing cost of life insurance protection. **Note: the annual cost of insurance increases more than three times from age 60 to 70.**

A Portion of the Table 2001 One-Year Term Premiums
for $1,000 of Life Insurance Protection – One Life

| Age | Premium |
|---|---|
| 60 | 6.51 |
| 61 | 7.11 |
| 62 | 7.96 |
| 63 | 9.08 |
| 64 | 10.41 |
| 65 | 11.90 |
| 66 | 13.51 |
| 67 | 15.20 |
| 68 | 16.92 |
| 69 | 18.70 |
| 70 | 20.62 |
| 71 | 22.72 |

(These premiums are for illustration purposes and are not representative of any specific UL, VUL or EIUL policy. A UL policy will have its own specific insurance costs or mortality charges that should be

14. **Universal Life relies on the underlying investments of the stock market (as Variable Universal Life or Indexed Universal Life) to offset the guaranteed yearly increases in its annual renewal term insurance costs.** The underlying assumption is that the only way to create wealth is through 'investing'... an assumption that runs 180 degrees counter to the values of 'banking'. The 4,000 year old principles of banking require bankers to minimize all their risks. Learning how to create value by essentially eliminating market risk is one of the most important financially lessons you can learn.
15. **Universal Life shifts risk from the insurance company to the policy holder in the same way the 401k has shifted the risk to the employee from the employer.** What

happened to guaranteed pension plans? Starting in the 1980s, employer sponsored guaranteed pension plans have largely been replaced by 401ks heavily invested in the stock market. Likewise, Universal Life shifts the risk from the insurance company to the policy holder.

## *Comparison of Two Key Policy Features*

### *Accessibility of Policy Values*

Cash value life insurance policies offer the ability of the insured to access cash values while the policy is in force. Depending upon the type of policy, cash value may be withdrawn, surrendered or borrowed from a policy. (Loans from a policy will result in an interest charge.)

**Whole Life**

- The cash value of the life policy may be borrowed against by the policy owner.
- Participating whole life policies may have paid-up-additional insurance (PUA) that has been purchased by dividends. PUAs provide additional guaranteed cash value and guaranteed death benefit.
- PUAs may be surrendered or borrowed against in order to access their cash value.
- Neither the surrender of dividends nor loans against a whole life policy will change the
- Guaranteed death benefit or the cash value features of a whole life policy.

**Traditional Universal Life**

- Universal life cash values can either be withdrawn from the policy or borrowed using the loan feature of the policy.
- Traditional universal life may lapse if there is inadequate policy cash value and premium paid into the policy to pay the mortality and expense charges.

**Universal Life With Secondary Guarantees**
The cash value of universal life with secondary guarantees can also be withdrawn or borrowed from the policy. However, these types of contracts often have provisions, stipulating that the guaranteed death benefit of the policy may be forfeited if either a withdrawal of cash value or a loan is made against the policy.

### The Universal 'Gotchas'. Conditions That Must Be Complied With to Maintain the Secondary Guaranteed Death Benefit

Any one of a number of changes or events during the life of a policy can result in either the loss of no-lapse guaranteed coverage provided by a secondary guaranteed death benefit or in a shortening of the guarantee period. These changes and events could include:

- A late premium,
- A skipped premium,

- A policy loan,
- A withdrawal,
- A non-scheduled change in the face amount,
- A change in the death benefit option, or
- The addition of a rider or other benefit after the policy has been issued.

Universal life has been offered as an insurance option since the early 1980's. The major concern for the policyholder is that the policy will lapse if the cash surrender value falls to zero. This may happen if one or more of the following conditions prevail:

- The policy was inadequately funded with premiums;
- The actual interest credited over the life of the policy was inadequate; or
- The mortality and expense charges were increased, thus dissipating the policy account value.

A typical plan might involve one like the following:

$$CV_t = [C_t^* - (F_t/(1+i)^{1/12} - C_t^*)\, q_t - E_t](1+r_t) \qquad (1)$$

where $CV_t$ = the cash value at the end of month t.

$C_t^*$ = $CV_{t-1} + (1-\alpha)C_t$ . $C_t$ is a premium contribution made to the plan at the beginning of month t and $\alpha$ is a loading charge between .05 and .08. $C_t^*$ is referred to as an intermediate value.

$F_t$ = The death benefit available during the period. It may be one of two options: (1) a specified amount or (2) a specified amount plus the intermediate value. The insured can switch freely between the two options, and the specific sum can be increased with evidence of insurability.

$i$ = a guaranteed annual accumulation investment rate.

$q_t$ = the applicable mortality rate for month t and the attained age of the insured.

$E_t$ = an expense loading, usually zero after the first year, equal to a policy constant plus a percentage of the specified death benefit.

$r_t$ = the applicable investment rate for month t.

(The Effects of Risk Reduction Inherent in Universal Life Insurance: Author's Reply William C. Scheel, *The Journal of Risk and Insurance*, Vol. 48, No. 4 (Dec., 1981), pp. 690-693. Published by: American Risk and Insurance Association, Stable URL: http://www.jstor.org/stable/252831)

**In short…**"Don't trust any financial products or strategies that have been invented or created since the great depression. They are all designed to increase the government's and/or the financing institution's balance sheet, at your expense." --Jesse Wheeler