Thinking Differently About The Purpose of Savings, Cash Flow, and Where You Store Your Money

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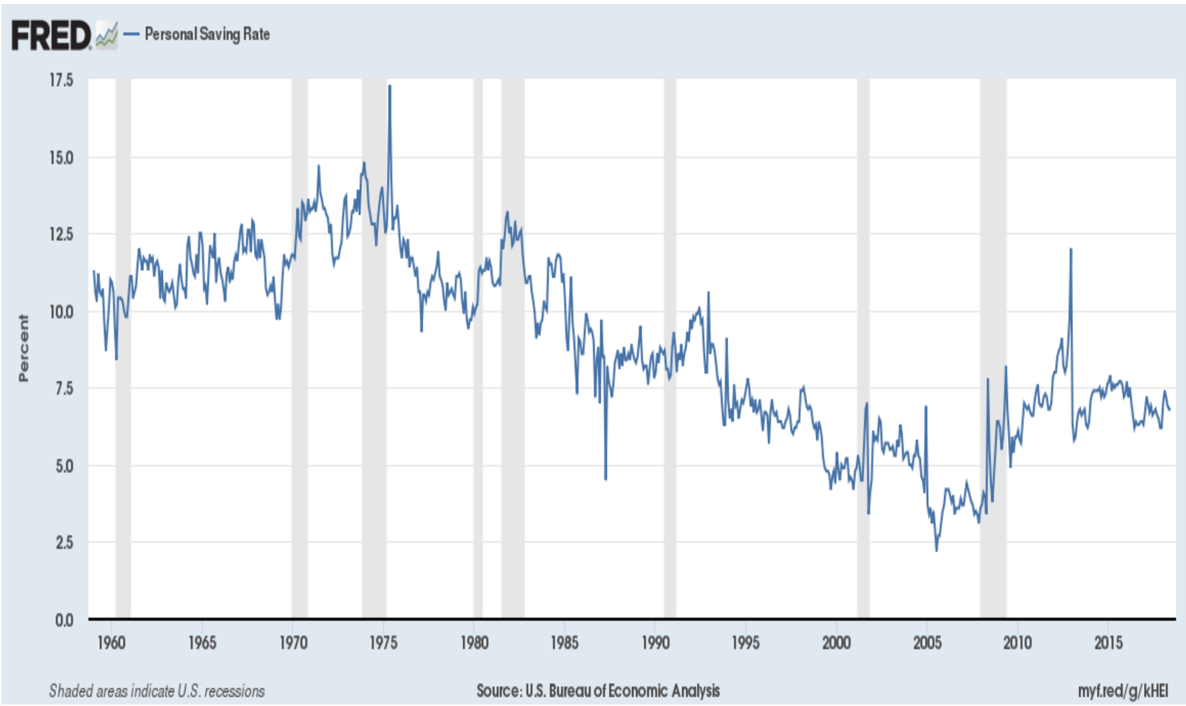
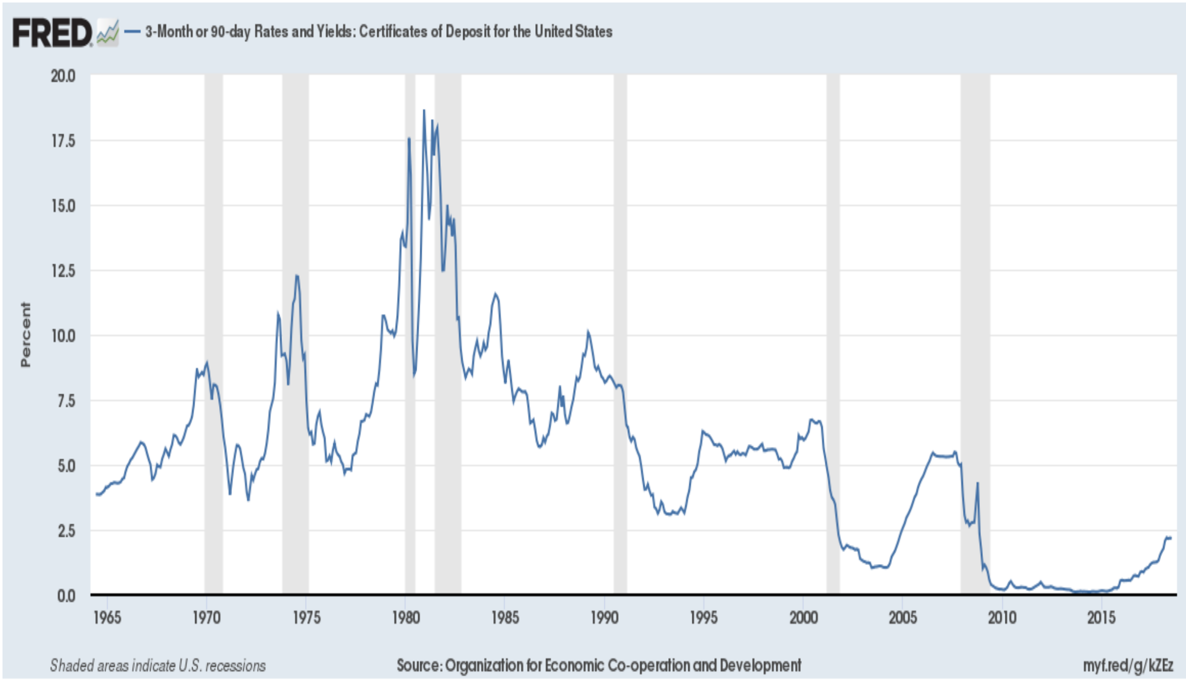
How We Got To This Point

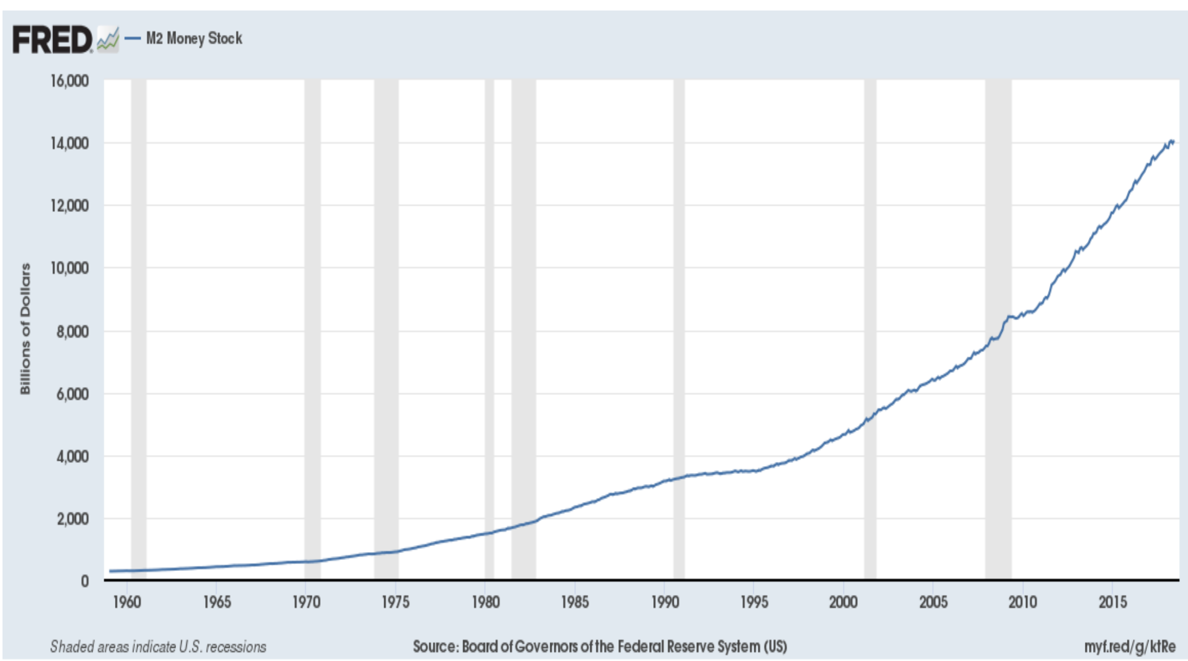
Good habits with money are normally the difference between people that worry about their future and individuals, families or entrepreneurs that consistently appear to define what someone else calls "being wealthy". It doesn't matter how much money you earn, save, inherit, or receive in a gift, if you don't learn the simple habits of *saving first and spending less money than you have available*, it is likely that your financial picture could be in jeopardy. Unfortunately, as the chart below illustrates, the rate at which Americans have saved money for the past 50+ years has been on a steady decline.



Whether you worry about money on a consistent basis or consider yourself wealthy, it would be prudent to educate yourself on how to get your money working for you by introducing different asset classes on to your balance sheet. This white paper is designed to help you realize that you actually have the ability to improve the safety, liquidity, and growth of one of the most important asset classes in your portfolio – CASH! Accomplishing this feat is necessary now more than ever because when your cash sits in the bank earning paltry rates of interest compared to decades before (see the chart below), savers are forced to choose between taking more risk or accepting the erosion of their capital to inflation and taxes.



Keeping more of what you make and earning more on your cash is the mindset our firm preaches to the public because our economy is not functioning on solid fundamentals. We believe people need to *think differently* today in order to take control of their financial picture. Conservative savers are being forced to deal with a financial future that involves *more risk, not less* while the amount of money in our economy continues to accumulate in cash and bank deposits (aka “M2” money supply). As the chart below shows, M2 just eclipsed $14 Trillion and the majority of those dollars are receiving less than 1% interest. Wow.



A Different Approach to Saving Money Starts with Education

So, how does one begin to think differently about their cash or *safe money*? Let's start by educating you on defining certain terms that most people get confused about when it comes to money and finance decisions.

While accumulation strategies are definitely important in a saver's personal or business economy, proper utilization strategies allow people to control the flow of their money while it works for them. We call this phenomenon **uninterrupted compound growth.** To understand this concept, you also need to realize that there are two different *types of return* you can create with your money.

Internal return is what an asset generates through its performance (both income and appreciation over time). In most cases, this is calculated as the return on investment (ROI). Most retail, market-driven vehicles (stocks, mutual funds, and exchange-traded funds [ETFs]) use this return to measure their performance. They provide reports that show average returns over a specific period (one year, five years, ten years, and since inception). It's important to understand that your internal return is specific to your timeline of action and cannot be truly determined until after you've completed your investment horizon (e.g. if your investment horizon is 10 years, you cannot really analyze the performance of your investment until after the full 10 years has transpired).

And always remember that *past performance is no indication of future results*. You hear this all the time, but some financial professionals may disregard this principle when making investment recommendations. Internal return is **normally out of your control** because you have no way to know how much appreciation you'll earn from the market/asset class. Utilizing asset classes that generate growth through income first can assist you in creating a more stable internal return but there is always a level of uncertainty that exists when determining your internal return before you allocate capital.

External return is rarely considered, but entrepreneurs and institutions take advantage of this economic benefit all of the time. Think of it as your *return on cash flow*. When you properly utilize your money and leverage your internal return by getting more of your money to flow into your control, the results are magnified. You can do this by minimizing the opportunity costs that impact your daily life, such as:

- Interest costs from banks, credit cards, and mortgage companies
- Lack of control of your principal as you pay down debt
- Restricting the use of your money to one goal only
- Being held hostage by income taxes when you want to access your money
- Having to make a decision of whether to save money (build cash) OR investment money (put capital to work in your personal or business economy)

External return is *subjective* because everyone's financial picture is different. If you pay off your credit cards and free up money in your cash flow to now save, those "new found savings" are part of your external return in your personal economy. When an entrepreneur buys a business, its initial internal return is based on annual growth and business valuation. Now the buyer can add an external return by reducing expenses through operational synergies, improved employee morale with a better work environment, and visionary leadership. Add in some management expertise that can improve the trajectory of the company's future, and all of the sudden, the value of the business could improve.

Both internal and external return are important to changing the trajectory of your financial future but no matter what your comfort level is with different assets classes, you first need to realize that *cash flow is the foundation* to a strong financial picture. Managing your budget to keep spending on a realistic path while simultaneously building savings is extremely difficult. But if you can follow sound financial principles within your own financial home, generations of your family can enjoy the benefits. At this point, people start benefitting from what we call an **Eternal Return.** It is the culmination of your time, talent, and capital passed on to the next generation. It can be comprised of assets, the knowledge you impart to your family during your life, and the goodwill you have created for your family legacy, etc. This type of return includes a lot of intangibles and is sometimes difficult to grasp but make no mistake—it could be the most valuable return of all! If structured properly, the wealth you've created can improve your family's personal economy five, ten, twenty, even a hundred times over because its members are now working from a more robust, solid foundation that *you* built over time. Our organization believes in teaching our clients *generational planning exercises* that can assist people in optimizing their eternal return. With an uncertain economic outlook for America over the next thirty years, families that provide an eternal return to their next generations may be protecting not only their personal economies but their families' economic survival. We have a real sense of urgency to teach this type of information to you because we believe economic forces are working against savers.

One of the main things our firm has learned from studying behavioral finance is that most people with *good money habits* make financial decisions in certain ways. To understand this *decision-making paradigm*, you first need to understand what certain words mean to people with good money habits. Here are the subjective definitions we have given certain words based on tens of thousands of conversations with clients on the topics of money and finance.

Saving: To accumulate money in places where there is little to no risk of one's principal. By saving, the person is not concerned about the return ON their money but rather the focus is on the return OF their money. Saving is normally a conscious act by someone with good money habits and for decades it has resulted in people building up balances in various bank accounts (checking, savings, money market, and certificate of deposits).

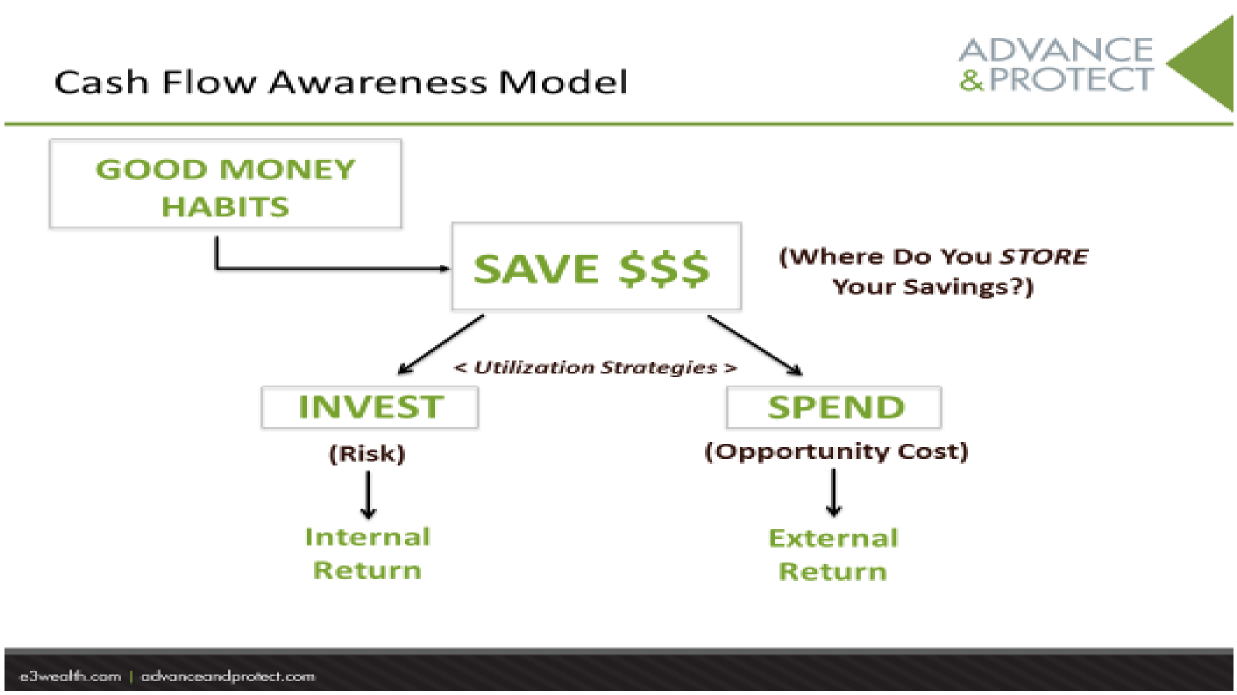
Investing: To put money to work in specific assets or financial vehicles that have the *potential* to generate a return on the principal. Your principal becomes your *initial investment* and you become an *investor.* If successful, you will receive a **return on investment (ROI)** or what we have described as an **internal return**. Note: the process of investing involves the risk of losing your principal and there are many different types of risk that investors face. Determining the appropriate amount of risk for each investment is a subjective process and needs to be measured based on an individual's personal/business economy.

When a person with good money habits *spends* their money, that principal is viewed as being *gone forever*. There is an **opportunity cost** present when this happens as their principal is no longer able to generate any type of return in the future. This is an **external return** because the money is no longer in your control. Our intention is to help someone choose to spend their money while reducing or eliminating certain opportunity costs over their lifetime. It's important to understand the dynamic between these three words – SAVE, INVEST, and SPEND – and why some people confuse their meaning.

For example, it is possible for someone to invest or spend money without actually saving it first. We would not consider this person to be a conservative saver because they are most likely taking on *more risk* with their investments and could be spending through the *use of debt.* Not all types of debt are bad but certain types of debt can add more risk to your personal or business economy.

On the other hand, there are many people who are not comfortable with the idea of risk and choose to save but never truly invest. This type of saver usually accumulates money in their bank accounts, works hard to pay off their debts as soon as possible, and struggle with the idea of spending their *hard earned money.* This occurs because they possess a fear about the unknown future and this person is constantly worried about *needing their money in case of an emergency.*

We want to help people realize their good money habits of *saving first* actually provide them with **more** flexibility, access, and control of their money. Whether they invest or spend those dollars is up to them; after all, **it's your money!** Here's how we help our clients visualize the process of taking control of their personal/business economies:



As the diagram above illustrates, the *act of saving* occurs prior to the decision to *invest or spend* for someone with good money habits. We call this process **Cash Flow Awareness.** Whether someone saves money on a monthly basis or accumulates money in big chunks due to financial windfalls (i.e. bonus, commissions earned, business distribution, inheritance, etc.), they are going to **store that money** some place safe until allocating it between investments or current spending needs & wants. The process of storing money in a safe place is called **accumulation** and the process of deciding whether to invest or spend your savings is called **utilization.**

Utilization strategies are not a topic that most financial professionals educate their clients about when discussing what to do with your money. Our industry is usually zeroed in on investment conversations and the majority of financial vehicles that exist in the marketplace today revolve around a risk/return mindset. The thinking is that in order to achieve higher returns, an investor must be prepared to take on more risk in their financial picture. Instead, our firm aims to teach our clients to simply **discover** what dollars are flowing into your control and what dollars are flowing out of your control. Then, **strategize** so more money flows into your control. The **end result** will be more money for you to retain and utilize during your lifetime and more money for future generations.

Having an Entrepreneurial Mindset When It Comes to Cash

Over the past several years, our firm has assisted hundreds of entrepreneurial business owners with the task of *financing* the growth of their business. Because of our experiences in dealing with business owners when they are implementing various decisions related to money, we thought it would make sense to *dive deeper* into this process. Any competent saver in today's economy will be faced with similar scenarios, especially if you run your household finances *like a small business.*

In order to start a business, the first thing you need is **CAPITAL**. What are the main sources of capital for business owners?

Borrowing Money from a Bank, Another Financial Institution or Someone with Capital Already

Getting money from a bank is the normal method of raising capital for a business, assuming you qualify for a loan. Once the loan is approved, the bank will structure the terms of the loan for you. The bank structures an immediate repayment plan for you while controlling the amount of principal and interest paid back through the amortization schedule. That monthly payment is an expense most businesses prioritize, so that you don't default on the loan.

If you are not able to borrow money from a bank (ie. The bank declines to work with you), then you may need to borrow money from other types of lenders – private equity firms and private investors are two examples. They will still structure terms of the loan that protect their interests and limit your flexibility.

Building up Personal Assets or Raising Capital from Others

For some business owners, it's difficult to get a loan from any source. Sometimes it's because your credit isn't strong enough to qualify and other times your business type is just at the idea stage or service driven and until you are able to show a profit, no capital is available. In these instances, many business people would focus on saving money first in order to invest in opportunities with a greater return on investment (ROI) potential. Or, you may find other people who have already built up their savings and they are willing to invest in your business venture.

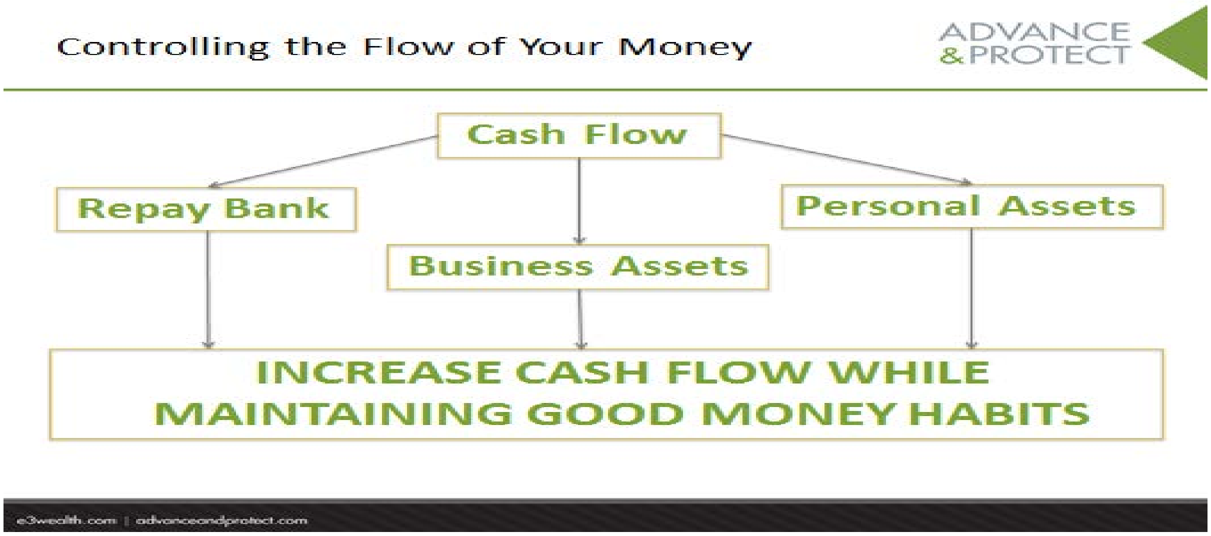
Why would someone take this type of risk with his or her hard-earned savings? Well, when you have good habits with saving money in the bank but realize your money could be working harder (or smarter) for you, controlling your future by opening a business or investing in a business may appears to be a good alternative.

Your Top Priority is Cash Flow

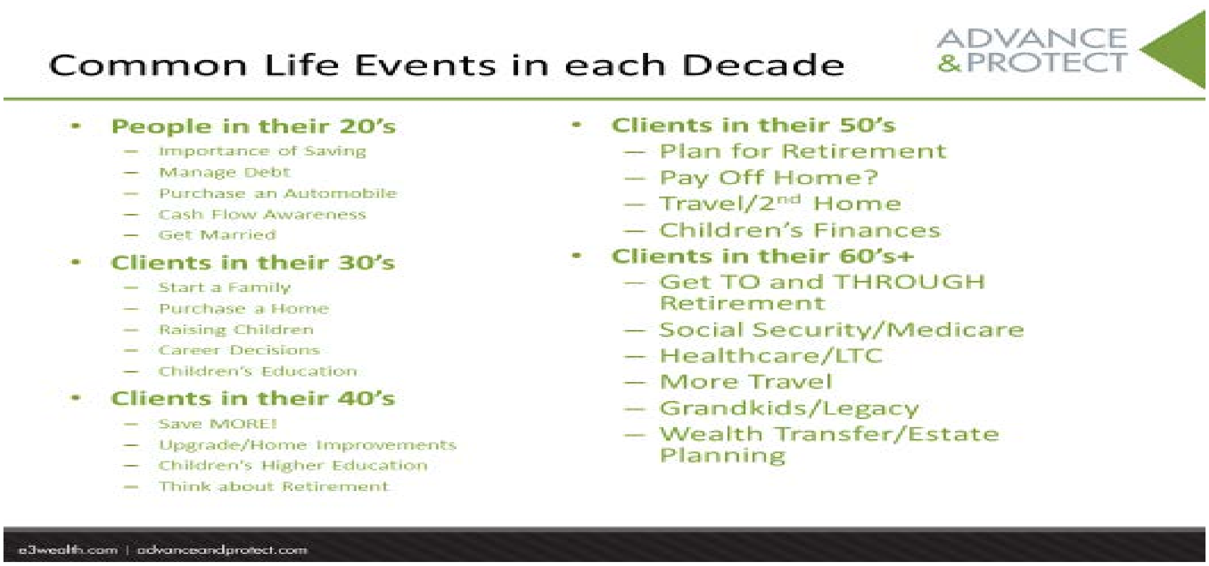
Once the *door is opened* to your business, the number one priority is to create strong cash flow as soon as possible. Positive cash flow will result from a good **awareness** between what expenses **need** to be paid on a month-to-month basis and those big ticket purchases that are the **wants** in your business plan. Those wants come at different levels. They may start out as purchasing items for day-to-day operations (buying furniture, small equipment, vehicles, advertising, etc.) and over time, the size of the wants expand as your business is growing (buy a new building, invest in larger equipment, acquire another competitor, etc.). The important thing to understand in this situation is that you **store** your cash flow in a place where it's safe, liquid, and achieving some level of growth.

Opportunity Costs

While improving the ROI of a business is a top priority for an owner, it's also important to minimize any opportunity costs that materialize from certain decisions. Most people don't understand the concept of opportunity costs. They can be described as something you give up or pay when you make a decision. When you use excess cash flow to repay a bank loan, the bank ends up controlling more of your principal. Re-investing money into personal assets means those assets are flowing into traditional asset classes and become susceptible to different risks, fees, and potential illiquidity. Even when you pay cash for big ticket purchases in a business, you face opportunity costs. This happens because that cash is now gone and it is no longer working for you earning interest.



The same decisions are made inside of one's personal economy as there are thousands of financial decisions made over your lifetime at different points along the way. These are just a few examples that involve decisions to save, invest, or spend money before someone considers retirement:



The other thing you need to realize is that before you put your money to work for you, those dollars will *sit* somewhere. Another way to look at this situation is to consider your savings as being *stored* somewhere at all times and ask yourself *"Is this storage facility providing me or my business any added value?"*

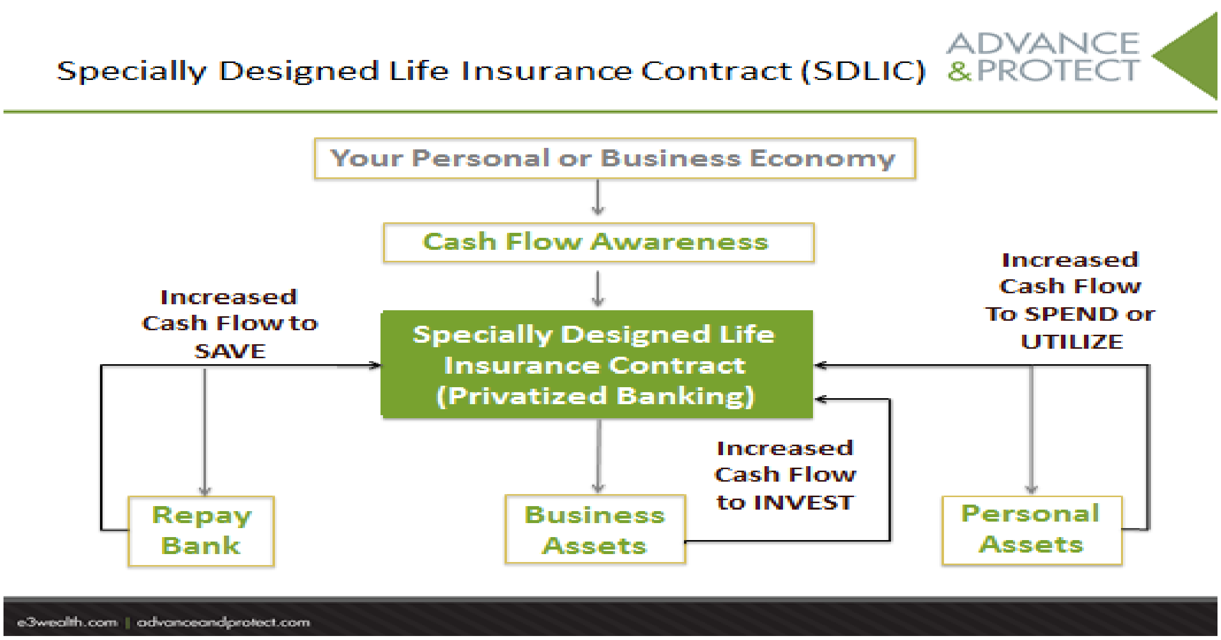
As you repay the bank, your payments go towards both interest (the bank's profit) and principal (replenishing the bank's loan capabilities). When dollars are re-allocated from your business to your personal accounts, that money is invested into different financial institutions (banks, brokerage firms, mutual funds, etc.) with a focus on **accumulation**, not utilization. And if you keep money in your business today, you're normally storing those dollars in some sort of bank account earning very low interest (less than one percent). These types of scenarios have individuals, families, and entrepreneurs very concerned because they continue to struggle to find a place to store their money. They want flexibility, access, and control of the flow of their money but traditional financial institutions are not providing adequate solutions. So, how does someone establish an alternative *safe money solution* for their personal and/or business economy instead of leaving money in their bank? Almost everyone has used a bank for three primary roles in your financial picture:

1. Pay Your Bills (Cash Flow Awareness)
2. Borrow Money (Financing Purchases)
3. Save Money (Accumulation and Utilization)

We believe it is possible to find another financial institution that will provide your better ways to borrow and save your money while experiencing an improved level of safety, liquidity, and growth.

A Better Way To Store and Utilize Cash

Our firm believes today's conservative saver with good money habits needs to consider utilizing a different financial institution to **store** their money while they are waiting to **use it**. In essence, you can create your own **Privatized Banking System** by implementing **Specially Designed Life Insurance Contracts (SDLIC)**



Through extensive research and a broad knowledge base on different financial institutions, we believe there are specific types of life insurance companies that offer specific types of life insurance contracts with certain beneficial features to a conservative saver. A properly trained financial professional can use these contracts to offer a conservative saver a tremendous alternative to traditional banking methods. *Please understand that we are not actually creating a real bank for our clients or* *communicating that life insurance companies are the same as a bank.* Rather we are attempting to design a financial vehicle that can mimic certain **banking functions** in one's personal/business economy – like financing big ticket purchases and controlling where your cash flow is stored.

Not all life insurance companies or products fit the SDLIC model. Certain components must be present for a SDLIC to be optimized:

- Become insured by a Mutual Insurance Company with strong financials
- Use a participating whole life contract with design flexibility
- The contract must allow for access to the policy cash value through policy loans while the policy is being capitalized with new premiums
- Your access to policy cash value needs to be immediate and substantial enough to differentiate SDLIC from most life insurance contracts: 50-60% in 30 Days, 80-90% in 3 years, 90+% in 5 years and 100% by years 6-7
- Use a contract that allows for policy loans that do not interrupt the compounding of the guaranteed interest and dividends within the policy (These are called **non-direct recognition loans**)

Very few life insurance companies have all of these components. It is important to work with a firm who truly understands and continues to educate themselves on the nuances of this strategy. Several of our advisors have received advanced education on this strategy through the Nelson Nash Institute (NNI). To learn more about this organization, you can visit their website www.infinitebanking.org.

Why Use Life Insurance?

Life Insurance is an **"AND Asset."** What does this exactly mean? Most assets generate a return when you leave your capital invested. For example, when you buy a stock, you earn a return while you own the stock. If you sell that stock, you stop earning a return unless you reinvest those funds elsewhere. In this instance, most assets are **"OR assets."** You either earn a return in one asset OR the other. To implement the "AND" strategy with an asset, you need to be able to utilize one important financial concept – **leverage**. Utilizing leverage means you are able to borrow against an asset so that your capital is working for you in more than one place! This is not a new concept. Entrepreneurs have been implementing leverage strategies inside of their businesses for hundreds of years. Real Estate investors accomplish this feat all of the time. And you can even use leverage when investing in the stock market (through a margin loan).

The key to all uses of leverage is measuring the amount of **risk** you are taking in the underlying asset and what are the **terms of the loan** that the financial institution sets up for you. These components coupled with the conservative nature of mutual insurance companies make the use of specially designed life insurance contracts (SDLIC) very appealing when you understand the power of your own privatized banking system.

Utilization strategies can be consistently optimized in your financial picture when a SDLIC is a cash flow tool made available to you. Accessing your cash value through policy loans is a very powerful and often misunderstood tool at your disposal. We have found that educating our clients about the ways traditional loans from a bank work and comparing that process to a SDLIC can demystify this strategy. Making 3-4% tax free over your lifetime on capital inside of your private banking system may not sound like that big of a deal. But, what if that return was **on top of** the returns you generate in your business, or in your real estate investments, or in other areas of your financial picture? All of the sudden, this strategy can make a huge difference after 10-20-30 years of utilizing your capital! Earning a rate of return in two places is your uninterrupted compound growth at work.

At this time, I think it is important to address one of the most common concerns with this strategy that involves borrowing from a life insurance policy because we hear this question all of the time:

Why is it a good idea to borrow my own money and pay interest on my own money?

This question is asked by the public a lot and creates confusion because the reality is very different from question! The answer to this question is rooted in both the tax code and the structure of a life insurance company.

First, you want to borrow from a life insurance company using a policy because policy loans have preferential treatment in the Internal Revenue Code (see IRC Section 7702). Technically, you are borrowing from the life insurance company's general portfolio while they are holding your cash surrender value and death benefit as collateral. So, you never touch the cash value in your policy. Through a policy loan you can access internal growth and principal without being taxed as long as the policy remains inforce. The second thing to understand is the **terms of the loan** offered by a Mutual Insurance Company. They determined the rate of interest charged on a loan and the amount of money you have access to at any one time. The policy owner controls all of the other terms related to paying back (or not paying back) the loan balance. The policy owner decides if they want to pay back the loan, how much to pay back at any one time, for how long the pay back will continue, etc. Controlling the cash flow portion of a loan is a powerful financial tool that banks and most other financial institutions do not allow savers to be in charge of!

Also, you need to realize the difference between **PAYING** interest on a loan and being **CHARGED** interest on a loan. Paying interest means the interest is already built into the amortization of your loan payment. With a policy loan, the insurance company **CHARGES** you interest and that interest is paid after your principal is prioritized. So, if an insurance company applies 100% of your loan payment to the principal balance that means your loan principal gets paid off first and the interest is the last thing to be eliminated. Whether the loan is direct recognition or non-direct recognition, the loan interest will not improve the internal return on the policy if it is paid off. So, the interest may be left to accumulate against the death benefit, so as not to interrupt access to the policy utilization while the insured is still alive.

Most Americans have been conditioned to focus on the interest rate itself versus when you are paying interest and how much over time (Rate of Interest versus Volume of Interest). The benefit of the SDLIC is that the actual interest charged does not impact the compound growth of your policy cash value. The loan balance does affect the amount of cash value you have access to at any one time but cycling your positive cash flow back through your banking system alleviates the concern about access to capital. Paying off the loan balance is not the focus each time you borrow money. Access to enough capital for proper utilization is the key!

After all, which kind of asset would you want on your balance sheet to store your safe money?

An asset that grows 3.5%-5% Tax Free but you can never really access the capital without disturbing the compound growth.

OR

An asset that grows 3-4% Tax Free and you have access to the capital almost immediately and over your lifetime.

Both assets are examples of whole life insurance contracts. The first one is a policy with no policy loans or utilization of the policy cash value. The second one is a policy that is structured like a SDLIC and is utilized in your privatized banking system. The difference in the rate of return is the opportunity cost of policy loans. The "cost" of a policy loan may lower the net return on the cash value but remember, if you hold the policy until you die, the beneficiaries recoup the opportunity cost of any outstanding policy loans. The only concern you have while you are alive is **"Am I implementing proper cash flow strategies within my privatized banking system?"**

In order to optimize your own privatized banking, it is imperative that you customize its design to fit your cash flow, available assets, income tax situation and your utilization needs. Luckily for you, the reader, our perspective on this topic is based on tens of thousands of knee-to-knee appointments with individuals, families, and business owners. We will not give you our *opinion* on this topic blindly with no consideration for your actual financial situation. Instead, we provide both concepts and strategies that demystify cash value life insurance as a financial vehicle that has tremendous potential to provide you flexibility, access, and control of your money. If **designed properly** and **monitored frequently** by a financial professional who is **properly trained** in cash flow strategies and alternative asset classes, your opinion of cash value life insurance may change significantly.

The purpose for writing this white paper was to help you achieve a better understanding of certain key topics that can substantially improve your personal or business economy. We believe everyone who has positive cash flow and good habits with money deserves to hear about how a specially designed life insurance contract (SDLIC) can be utilized as both an alternative asset class and a cash flow tool. If you believe in minimizing your risk in your portfolio and want to pay cash for big ticket items in your personal and/or business economy, then we urge you to reach out to us and learn more.

Thank you for reading.

About The Author…

John E. Moriarty, ChFC is the founder and president of e3 ConsulantsGROUP, e3 Wealth, and e3 Tax. e3 operates a *family office model* that serves individuals, families and entrepreneurs **based on their mindset**, not based on the size of their net worth. If you desire to learn more about the organization's services, please visit their website at www.e3wealth.com or email at info@e3wealth.com so you can receive an electronic copy of their book *Building Your Own Privatized Banking System* can be obtained.

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