

BANKNOTES

THE NELSON NASH INSTITUTE
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JUNE 2021

Why IBC Works

By Dr. Robert Murphy

When people first hear about the advantages of the Infinite Banking Concept (IBC), a typical reaction is to say, “That’s too good to be true.”

For example, the IBC agent might tell his or her client that in order to take out a loan against the cash values in a whole life policy, the policyholder simply needs to call the insurance company up and tell them the amount and the address. The person on the phone won’t ask what the loan will be used for, what the income of the borrower (i.e. policyholder) is, what other assets the person might have to serve as collateral, and what timeframe the person intends to take in paying back the loan. Nope, the insurance company employee will simply take down the information and the check might literally go out in the next day’s mail.

In contrast, try pulling the same stunt with a commercial bank or credit union. Even when applying for a secured loan, with (say) a house with lots of equity serving as collateral, a borrower will need to jump through all sorts of hoops and fill out a few forms before getting approval. The process could be quite time consuming, even for someone with impeccable credit and sizable assets.

So are the IBC agents simply lying? And if not, what gives? Are the insurance companies staffed by magic elves while the banks are staffed by grumpy trolls?

No, the IBC agents are not lying. I personally have taken out several policy loans, and have seen firsthand just how easy the process is. At the same time, I have also tried at several points to obtain lines of credit from different commercial banks, and the process is a serious hassle. I can thus verify the amazing descriptions of IBC painted by its enthusiastic fans.

As an economist, I can also explain what’s going on. The difference in the treatment given clients by insurers versus conventional lending institutions is the nature of the underlying collateral on the loans. Once we understand how a whole life policy works, and what a policy loan really is, then it becomes obvious why the insurer doesn’t have the policyholder fill out paperwork to take out a loan.

Term Versus Whole Life Insurance

Term life insurance is “pure” insurance. The policyholder pays a certain

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amount of money as a premium, so that if he happens to die during the period in question (say, six months or a year), then and only then will the insurer cut a check to his estate. If the term of the policy runs out and the policyholder is still alive, then he gets nothing from the insurer. It's analogous to buying fire insurance on one's house. If there's no fire, then nothing happens, and the money spent on premiums is totally gone.

In contrast, a whole life policy (as the name suggests) is designed to last for a person's entire life. As long as the person keeps paying premiums, the policy stays in force; there is no predetermined expiration, as is the case with a term policy, which might be designed for (say) a 20- year term.

As the critics of whole life are quick to point out, the premiums needed to keep a whole life policy in force are much higher than those for a term policy with a comparable death benefit. Part of the difference is due to the continuation option described above. In other words, since the insurer is agreeing to a level premium for as long as the policyholder wants to keep a whole life policy in force, the insurer has to set the premium high enough to cover the additional expectation that the policyholder will die while the policy is in force. In contrast, the vast majority of term life policies expire without the person dying.

In fact, things are even bleaker for the insurance company. At a certain point, the owner of a whole life policy gets a huge check from the insurer even if he is still alive. Nowadays the cutoff age might be 121 years. For example, a person might sign up for a \$1 million death benefit whole life policy when he's 25. So long as that person continues to make his premium payments, he can go on paying the same premium, even as he ages and becomes a much higher risk. Ultimately, if and when the person reaches 121 years, the insurer company sends him a check for at least \$1 million. (In practice it may be more, since the person will have purchased more "death benefit" along the way.)

Now we see why whole life policies are so much more expensive than term policies with the same initial death benefit. A useful analogy is to real estate: The

policyholder of a term policy is like someone renting an apartment. He pays the rent month after month, and receives shelter in exchange. But after the term of the lease expires, and the landlord raises the rent, the person moves out of the apartment. He has nothing to show for the money he spent over the years, except the memories.

In contrast, someone might buy an apartment unit with a mortgage from a bank. This person's monthly mortgage payments will be higher than what the renter had to pay each month, assuming they live in comparable apartments. However, with each month's payment, the buyer acquires more and more equity in the property. After keeping up with his payments for (say) 30 years, the mortgage is paid off and the person owns the apartment outright.

The analogy with life insurance should be clear. The term policy in effect is just rented insurance. In contrast, the person who starts a whole life policy gains equity in the policy with each successive payment. Specifically, the cash surrender value grows over time. This is analogous to a homeowner calculating how much equity he has in his property, i.e. asking how much it's worth minus how much he still owes on it.

For whole life, the cash surrender value is defined as the (present discounted value) of the expected death benefit payout minus the flow of future premium payments. As time passes, the looming death benefit becomes more and more certain, because the person will either die or attain age 121. On the other hand, with each successive premium payment, the remaining number of such payments dwindles, meaning that the policyholder has a freer and freer claim on the death benefit. This is why the cash value of a policy grows over time.

When critics declare that whole life is "obviously" a terrible financial product, because one can get "the same" insurance from a term policy at a much cheaper rate, this is akin to someone saying that buying a house is "obviously" a dumb move because one can rent the same living space for much lower monthly payments. The famous "buy term and invest the

difference” strategy ignores other differences too, but in the present article I want to focus on policy loans.

Policy Loans

In order to fulfill its contractual obligations to a whole life policyholder, the insurer must take a portion of each premium payment and invest it conservatively. As a whole life policy ages, the insurer had better have a growing stockpile of financial assets earmarked for the policyholder, so that if and when he reaches age 121, the insurer can hand over the assets now worth (say) \$1 million.

From the insurer’s perspective, then, there are numerous streams of income every month flowing from the various policyholders. Some of them actually die, and thus payments must be made in accordance with the contractual death benefits. Beyond that, there are salaries and other overhead expenses to be paid. After these expenses, what’s left can be plowed into investments so that the total assets of the insurer grow over time, just as the policyholders all think that their cash values are growing.

When a whole life policyholder applies for a loan, the insurer does not “take it out” of the policy. Rather, the insurance company takes some of the money that it otherwise would have invested in outside assets, and instead loans it to the policyholder. Strictly speaking, in terms of the cash flow a policy loan doesn’t “touch” the whole life policy at all. Rather, the insurer makes a loan on the side to the policyholder.

The insurance company is quite happy to make such a loan, because the policyholder pledges the cash value of his own whole life policy as collateral. To repeat, strictly speaking the policy loan doesn’t “suck out” the cash value of a policy, but rather the outstanding loan (depending on its size) offsets some of the cash value. In the same way, if a homeowner applies for a home equity loan, he doesn’t literally sell off the guest bedroom to the bank. Rather, he takes out a loan from the bank and pledges the equity in his house as collateral.

A Matter of Liquidity

Now we see why insurers are so free-wheeling

when it comes to policy loans, whereas commercial banks and credit unions are much more uptight: the collateral on policy loans is much more liquid than on conventional secured loans.

Consider what happens if a whole life policyholder has taken out a \$10,000 loan at 5% interest. Suppose he never makes any payments on it, so that the outstanding loan balance has grown to \$10,500 a year later. Then the policyholder is hit by a bus and dies.

Does the insurance company care? Not at all (unless the employees knew the policyholder personally!). Because the man owned a whole life policy, the company now owes his estate a check for the death benefit. Suppose the death benefit originally would have been \$500,000. Now, because of the outstanding policy loan, the insurer subtracts the balance and only sends the man’s widow a check for \$489,500.

In contrast, suppose the man had gone to a commercial bank, asking for a secured loan of \$10,000 with his new boat serving as collateral. If the man missed his payment on the loan, the bank would start to worry. As the loan rolled over at interest, it might eventually grow to be more than the underlying collateral was worth. (This isn’t likely to happen with a well-structured whole life policy loan, because the underlying cash value grows predictably over time too.)

Another problem for the commercial bank is that if the man defaults and the bank seizes his boat, the bank might discover that the man didn’t take good care of the asset, especially when he saw the default coming. (Again in contrast, there’s nothing that the policyholder can do to ruin the cash value in his policy. The insurer doesn’t allow him to borrow more against it, than the cash value at any given time. There is no need for the policyholder to do anything “responsible” to keep the collateral in good shape.)

Finally, even if the boat has been kept in good condition, such that its market value is more than the balance on the loan, the bank still has to go through the hassle of selling it. This can be a major problem, especially in our current situation where banks are the reluctant owners of millions of foreclosed homes. (Again in contrast, the insurer doesn’t have to do

anything to “seize” the collateral of the policyholder who defaults on a policy loan. It simply subtracts the relevant amount from the check it otherwise would have sent.)

Conclusion

Once we understand the nature of a whole life policy and how policy loans actually work, it becomes clear why insurers offer loans at such attractive interest rates and almost unbelievable terms. The explanation is that the underlying collateral—the cash value of the policy itself—makes such loans the safest investments imaginable for the insurer. No matter what, they are going to be repaid, because they are already contractually obligated to pay a death benefit to the policyholder. The outstanding loan balance, if any, can just be subtracted before the check is sent out.

The Faith of Entrepreneurs

By Llewellyn H. Rockwell, Jr.

Ludwig von Mises didn't like references to the “miracle” of the marketplace or the “magic” of production or other terms that suggest that economic systems depend on some force that is beyond human comprehension. In his view, we are better off coming to a rational understanding of why markets are responsible for astounding levels of productivity that can support exponential increases in population and ever higher living standards.

There was no German miracle after World War II, he used to say; the glorious recovery was a result of economic logic working itself out through market forces. Once we understand the relationship between property rights, market prices, the time structure of production, and the division of labor, the mystery evaporates and we observe the science of human action making great things happen.

He is right that understanding economics does not require faith, but there are actions undertaken by market actors themselves that require faith (and Mises would not disagree with this)—immense faith, faith that moves mountains and raises up civilizations. If

we accept the interesting description of faith by St. Paul (“evidence of things unseen”) we can understand entrepreneurship and capitalist investment as acts of faith.

Everyone who is in business understands this. It requires a thousand daily acts of seeing the unseen future to be in business. The reality of the marketplace is that the consuming public can shut you down tomorrow. All they need to do is to fail to show up and buy.

This is true for the smallest business to the largest. There is no certainty in any business. Nothing is a sure thing. Every business in a market economy is only a short step from bankruptcy. No business possesses the power to make people buy what they do not want. All success is potentially fleeting.

Success does yield a profit, but that provides no comfort. Every bit of profit you take for yourself comes out of what might otherwise be an investment in the development of the business. But neither is this investment a sure thing. Today's smash hit could be tomorrow's flop. What you perceive to be a solid investment could turn out to be a short-term craze. What you see, based on past sales, as having a potential mass appeal could actually be a market segment that was quickly saturated.

Emperors can rest on their laurels but capitalists never can.

Sales history provides nothing but a look backwards. The future is never seen with clarity but only through a glass, darkly. Past performance is not only not a guarantee of future success; it is no more or less than a data set of history that can tell us nothing about the future. If the future turns out to look like the past, the probabilities still do not change, any more than the probability of the next coin toss landed on heads increases because it happened previously five times in a row.

Despite the utter absence of a road map, the entrepreneur-investor must act as if some future is mapped out. He or she must still hire employees and pay them long before the products of their labor come

to market, and even longer before those marketable products are sold and turn a profit. The equipment must be purchased, upgraded, serviced, and replaced, which means that the entrepreneur must think about today's costs and tomorrow's and the next day's saecula saeculorum.

Especially now, the costs can be mind boggling. A retailer must consider an amazing array of options concerning suppliers and web services. There must be some means of alerting the world to your existence, and despite a century of attempts to employ scientific methods for finding out what makes the consumer tick, advertising remains high art, not positive science. But it also an art with high expense. Are you throwing money down a rathole or really getting the message out? There is no way to know in advance.

The heck of it too is that there are no testable causes of success because there is no way to perfectly control for all important factors. Sometimes not even the most successful business is clued into what it is, precisely, that makes its products sell more as compared with its competitors. Is it price, quality, status, geography, promotion, psychological associations people make with the product, or what?

Back into the 1980s, for example, Coca Cola decided to change its formula and advertise it as New Coke. The result was a catastrophe as consumers fled, even though the taste tests said that people liked the new better than the old.

If the historical data are so difficult to interpret, think how much more difficult it is to discern probable outcomes in the future. You can hire accountants, marketing agencies, financial wizards, and designers. They are technicians, but there are no such things as reliable experts in overcoming uncertainty. An analogy might be a man in a pitch-black room who hires people to help him put one foot in front of the other. His steps can be steady and sure but neither him nor his helpers can know for sure what is in front of him.

“What distinguishes the successful entrepreneur and promoter from other people,” writes Mises, “is precisely the fact that he does not let himself be

guided by what was and is, but arranges his affairs on the ground of his opinion about the future. He sees the past and the present as other people do; but he judges the future in a different way.”

It is for this reason that an entrepreneurial habit of mind cannot be implanted through training or education. It is something possessed and cultivated by an individual. There are no entrepreneurial committees, much less entrepreneurial planning boards.

The inability of governments to engage in the entrepreneurial act of faith is one of many reasons why socialism cannot work. Even if a bureaucrat can look at history and claim that his agency could have made a car, dry wall, or a microchip, that same person is at a loss to figure out how innovations in the future can take place. His only guide is technology: he can speculate about what might work better than what is presently available. But that is not the economic issue: the real issue concerns what is the best means given all the alternative uses of resources to satisfy the most urgent wants of consumers in light of an infinity of possible wants.

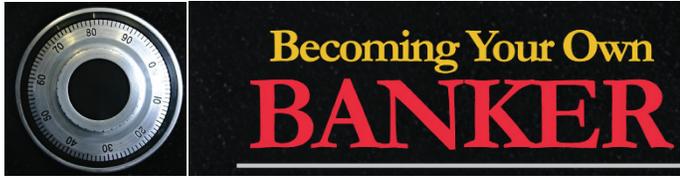
This is impossible for governments to do.

There are thousands of reasons why entrepreneurship should never take place but only one good one for why it does: these individuals have superior speculative judgment and are willing to take the leap of faith that is required to test their speculation against the facts of an uncertain future. And yet it is this leap of faith that drives forward our standards of living and improves life for millions and billions of people. We are surrounded by faith. Growing economies are infused with it.

Mises forgive me: this is a miracle.

Llewellyn H. Rockwell, Jr., former editorial assistant to Ludwig von Mises and congressional chief of staff to Ron Paul, is founder and chairman of the Mises Institute, executor for the estate of Murray N. Rothbard, and editor of LewRockwell.com. He is the author of *Against the State and Against the Left*.

This article was originally published on www.lewrockwell.com. Read the original article.



Twenty Sixth in a monthly series of Nelson Nash's personally written Becoming Your Own Banker® lessons. We will continue these lessons until we have gone through the entire book.

PART III Lesson 2 To Start Building Your Own Banking System

Content: Page 42, Becoming Your Own Banker Fifth Edition

Having just completed Methods, A, B, and C, we continue our study of the five methods of financing the use of an automobile. Do you realize that, thus far, we have covered the methods used by at least 95% of the American public? And by looking at the graph isn't it evident that there is not a great deal of difference in the results of them? None of these methods has addressed the need for capitalization – the creation of a pool of money from which to make the purchases and also large enough to accommodate the needs of some other people, too. It is true that Method C is building a pool from which to make car purchases – but it is not big enough!

Remember the grocery store described in Part One. If it is only large enough to serve your own needs, you won't have much of a successful business. A number of years ago in an article in FORTUNE magazine, Professor James Bryan Quinn of Dartmouth estimated that it takes a corporation seven years to show a profit on a new product. This may take some people by surprise and think that he is overstating the case. But we foresters would counter that he is understating it – it's more like 25 years! Taking a clue from Quinn's observation, why not accumulate money over a seven-year period of time and at a somewhat higher annual amount, say \$5,000.

In covering these last two methods, D & E, let's imagine that the two are twin sisters – one chooses method D and the other method E. The first one –

we'll call her "C/D Sister" – accumulates money on a monthly basis in a savings account and buys a Certificate of Deposit (at someone else's bank) in the amount of \$5,000 each year with a yield of 5.5% interest. Show me someone who does this for seven years – just to build a banking system – and I will show you someone who has whipped Parkinson's Law. She will win by default in comparison with her peers, because they can't discipline themselves to do so.

This young lady will also attract the Willie Sutton types – the Internal Revenue Service – and they will take 30% of the earnings. The net effect is that she will earn 4% after taxes. Table (1) on page 45 will show the results of this procedure. The C/D account now has an after-tax accumulation of \$41,071.13 at the end of seven years.

Now it's time to start the self-financing of car purchases from the system. A word of caution is in order – if she is dull enough to let the salesman at the auto dealership know that she has over \$40,000 in her C/D account the salesman will most assuredly say, "Lady, you don't need to be looking at a Taurus – let me show you this BMW!" But this young lady has done some studying and recognizes that if she jumps through that hoop she will end up with the same results as Method C, except on a grand scale.

So, she withdraws \$10,550 from the C/D account – takes it plus her trade-in car and purchases the Taurus. She continues to fund the monthly savings account and annually withdraws \$3,030.00 from it to purchase a new C/D. She is playing "honest banker" with herself – but she is using someone else's bank to do it. She has no ownership of that bank and is earning only the interest that the bank is paying her.

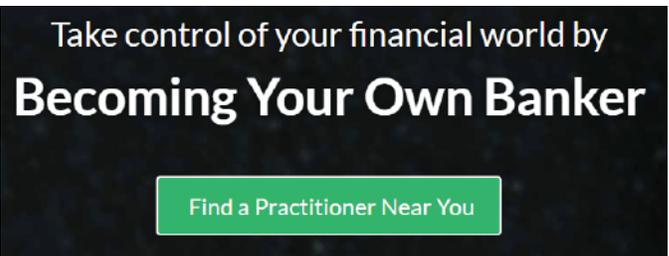
There are several "characters in the play" that must be considered:

- The Stockholders or Owners of the bank – earn dividends.
- The C/D holder – earns interest.
- The Administrators at the bank – earn salaries.
- The Borrower of money – Pays interest – an

absolute necessity in the whole scene. Nothing happens without him. He pays for the whole works listed above.

Table (1) on page 45 shows the results of this procedure over the same 44 years as compared with the previous three methods. Figure (1) on page 41 is the graphical depiction of the data in Table (1). There is a significant difference between the results of Method C and Method D. It is the result of three additional years of accumulation and all seven years are at an additional amount, in this case it is \$5,000. She is taking the necessity of capitalization seriously. The results speak for themselves.

In Lesson 27 we will look at the results of her twin sister who builds her banking system with the identical cash outlay through dividend-paying whole life insurance.



The following financial professionals joined or renewed their membership to our ***Authorized Infinite Banking Concepts Practitioners*** team this month:

- [David Befort, Minneapolis, Minnesota](#)
- [Mark Mappa, Northbrook, Illinois](#)
- [Isis Palicio, Coral Gables, Florida](#)
- [Bryan Nelson, Laguna Niguel, California](#)
- [Wayne Durksen, Warman, Saskatchewan](#)
- [Ken Johnson, Lexington, South Carolina](#)
- [Mary Jo Irmien, Bismarck, North Dakota](#)
- [Susan Mancho, Columbia, Maryland](#)
- [Jim Buzhardt, Nashville, Tennessee](#)
- [Gina Wells, Fenton, Michigan](#)
- [Jake Chesney, Chicago, Illinois](#)
- [Nancy Versoza, Union City, California](#)
- [Vernon McCarty, Calgary, Alberta](#)
- [Mike Ross, Dartmouth, Nova Scotia](#)
- [Colton McGriff, Birmingham, Alabama](#)
- [Jim Oliver, Estero, Florida](#)
- [Vivien Adao, Glendale, California](#)

You can view the entire practitioner listing on our website using the Practitioner Finder.

IBC Practitioner's have completed the *IBC Practitioner's Program* and have passed the program exam to ensure that they possess a solid foundation in the theory and implementation of IBC, as well as an understanding of Austrian economics and its unique insights into our monetary and banking institutions.

The *IBC Practitioner* has a broad base of knowledge to ensure a minimal level of competency in all of the areas a financial professional needs, in order to adequately discuss IBC with his or her clients.



THE FOUNDATIONS OF IBC

We are excited to announce the launch of our online **video series** for the general public. The videos provide a comprehensive introduction to the *Infinite Banking Concept*.

The first four modules are free, you can view them here: infinitebanking.org/foundations
The remaining eight modules are subscription-based, costing \$49.95 for all eight.

*Or contact an **Authorized IBC Practitioner** and ask for a coupon code that will enable you to watch all twelve modules FREE.*

Module 1: [Introduction to the Nelson Nash Institute](#)

Module 2: [What the Infinite Banking Concept Is](#)

Module 3, Part 1: [How IBC Works](#)

Module 3, Part 2: [Policy Loans & The Nature of Collateral](#)

Module 3, Part 3: [How to Read a Policy Illustration](#)

Module 4: [Why Nelson Calls It The Infinite Banking Concept](#)

Module 5: [The Life Insurance Industry](#)

Module 6: [Why Not Buy Term and Invest the Difference?](#)

Module 7: [Using IBC to Pass Wealth to Future Generations](#)

Module 8: [The MEC Rule and Policy Design](#)

Module 9: [Does IBC Work for Older People?](#)

Module 10, Part 1: [IBC for the Business Owner](#)

Module 10, Part 2: [IBC for the Business Owner](#)

Module 11: [Using Your IBC Policy: Premiums, Dividends, and Policy Loans](#)

[Release June 2021](#)

Module 12: [IBC as a Way of Life](#) [Release June 2021](#)