Chapter 19
Common Objections to IBC

[T]he probability of the college-educated person ever learning the benefits of 'banking' through the use of whole life insurance is not very good. He will be exposed to some professor teaching him that 'whole life insurance is a very poor place to put money.' It will take a lot of effort to get this notion out of his head, because 'unlearning' is more difficult than learning.

—R. Nelson Nash[1]

The overarching theme of this book is to show the connection between Nelson Nash's IBC and the Sound Money Solution. However, there are many fierce critics of IBC on a purely financial level. Were we to ignore these typical objections, the reader could not concentrate on the final chapter, which spells out the connection. In this chapter, therefore, we will first present the standard case for whole life insurance, and then defuse some of

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the most common critiques of IBC.

The Case for Whole Life Insurance

A standard way to motivate the purchase of a dividend-paying whole life insurance policy, is to first ask the prospective client about the attributes of a theoretically perfect investment. These would include things such as safety (meaning the asset's price would not likely drop), liquidity (meaning the owner could turn the asset into its "fair" market value quickly if needed), high rate of return, tax advantages, a source of income (i.e. not merely appreciation in price), uncorrelation with the stock market, a hedge against price inflation, and protection from creditors in the event of bankruptcy.

The most popular investment vehicles are strong on some criteria but very weak on others. For example, gold is an excellent inflation hedge, but it does not provide a flow of income, its appreciation can be taxed as a capital gain, and the government has confiscated gold in the past. Real estate too is an inflation hedge, but it can be very illiquid and its value too can be quite volatile. And the stock market, though promising a high rate of return, also comes with the risk of massive short-term losses.

The standard case for whole life insurance is that it is remarkably strong on several of the above criteria, and even its weak points are not as bad as the critics think. In reality there is no such thing as the perfect investment, but the case for middle- to upper-income families including whole life as part of their conservative financial plan is quite compelling. When we supplement the standard case with Nelson Nash's insights, and in particular the relationship of insurance and fractional reserve banking (as we spell out in the next chapter), the case for practicing IBC becomes stronger still.

In our experience, most people reject IBC out of hand, because they have one or two "devastating" objections to the use of a whole life insurance policy. In the remainder of this chapter, we defuse these common criticisms.

"Everyone knows you do better to buy term and invest the difference!"

It is "common knowledge" among many people that the internal rate of return on a whole life policy—even if dividends are reinvested—is much lower than could be achieved on alternative investments. In particular, many financial advisors will quite confidently state that only a fool would buy permanent life insurance, since it is so much better to "buy term and invest the difference." In other words, they claim that an individual should separate the two decisions: First, he can buy whatever death benefit he wants in the cheapest manner possible (i.e. by acquiring a term life insurance policy). Second, he can then use the savings on premium payments to invest in a mutual fund, which historically will yield a higher rate of return than the cash value of a whole life policy.

There are several problems with this glib dismissal of whole life as a "terrible investment." For one thing, so long as the policyowner sticks with a particular policy for many years, the average annualized rate of return—even on a plain vanilla whole life policy with no fancy IBC maneuvering—is probably much better than many critics realize. When we consider the dangers attendant with other potential investments, the case for putting one's genuine *savings* into a whole life policy becomes stronger.

For a concrete illustration, the website Insure.com offered an analysis[2] that took

> …a look at buying…a New York Life whole life insurance policy compared to buying term life insurance in the same face amount and investing the premium difference in a "side fund" such as a bank or mutual fund. This comparison comes courtesy of James Hunt, an actuary for the Consumer Federation of America (CFA) and former insurance commissioner of Vermont. His analysis estimates the "real" interest rate earned on savings within a cash value policy.

Here are the results:

> In this comparison, Hunt shows that if you buy a comparable term life insurance policy you need to earn 4.6 percent in your investment vehicle in order for your side fund to equal this whole life's cash value after 20 years. If your term life insurance side fund is invested in a bank CD or bond fund, you may not be able to net 4.6 percent after taxes.

Although Hunt was looking at the cash values for a particular New York Life whole life policy, his results are typical for policies issued in this period. For example, a presenter at the IBC Think Tank in early 2010 showed a standard table of projected cash values for a whole life policy, in which the (average annualized) internal rate of return eventually rose to 4.24 percent by the thirtieth year of the policy.[3]

At first such a rate of return may seem underwhelming, but we should keep in mind that at a 35 percent tax bracket, someone would need to earn 6.52 percent on an alternative investment, in order to match the return illustrated for whole life. Already we see that whole life insurance is not nearly the "bonehead" investment that so many people allege.

Moreover, we need to consider safety. In order to earn 6.5 percent annually over a 30-year period, someone would have had to put his money in investments that were riskier than a whole life insurance policy, with its guaranteed cash values. (It's true, in reality nothing is "guaranteed," but a whole life policy is still quite safer than most other investments.) To earn a tax-adjusted 6.5 percent on an extremely safe and fairly liquid investment, is definitely an attractive option that most households should consider in their overall portfolio.

Yet there is one more thing to consider, in the comparison of whole life versus a cheaper term insurance policy. Suppose Will and Tom are identical twins who are 30 years old. Will opts to buy a whole life policy with a million dollar face value, while Tom decides to buy a 20-year term policy carrying the same death benefit. It's true, Will's premiums will be much higher than Tom's, and it's also true that Will's accumulating cash values will be quite modest the first few years of the policy. If Will and Tom compare notes at age 35, Tom would feel that he made the clearly superior choice in opting for term insurance.

However, let's jump ahead to age 50. At this point, the accumulated wealth of the twins (we'll suppose) is roughly the same; Will's whole life policy has become much more efficient as it matured, while Tom was able to use the savings on his cheaper premiums in order to build an investment portfolio that appreciated (after taxes) about the same as Will's cash values.

But there is one major difference between the two brothers now that they have used their respective strategies for two decades: Will can continue paying his level premium—the same one he began paying at age 30—and keep his life insurance policy in force, until the day he dies. Tom, on the other hand, will probably *not* renew his expiring term policy. Particularly if he has had any health problems, at age 50 Tom would find it very expensive to obtain a new term life insurance policy. So even if Tom happened to have more wealth to his name at age 50, that alone wouldn't be decisive, because Will could easily maintain his insurance coverage while Tom could not. For example, if both brothers died in a car accident at age 51, clearly Will's widow will be *much* better off than Tom's widow.

We are not trying to argue from a narrow financial planning perspective, whole life insurance is necessarily the best option for every household. What we are pointing out, however, is that the glib advice of "buy term and invest the difference" overlooks many important real-world considerations. Think again of the difference of buying a house versus renting: Yes, the cheaper rental payments (for a comparable living area) may make the most sense for some people, especially if they are young. But building up equity in a house makes a lot more sense for a stable household with a long-term financial plan, *especially* if landlords practiced age discrimination and charged higher rates the older a renter became.

As a final point, we repeat an observation made to one of the authors by an actuary, who pointed out that whole life *is* "buying term and investing the difference." That is, when the insurance company takes in premiums on whole life policies, it must conceptually isolate the component of each payment dedicated to the provision of the death benefit, while the remainder is used to fund overhead and accumulate assets to satisfy the cash value targets.

In a sense, the whole life insurer is acting as both a term provider (where the term is the entire life of the client) *and* as a very conservative investment fund manager. It is of course important for individuals to exercise due diligence to see if it makes sense to go to a single provider of these dual services (i.e. an insurer offering a whole life policy), but the comparison should be apples to apples. Someone who opts for a 20-year term policy and invests the difference in a mutual fund composed of stocks and bonds may accumulate wealth at a faster rate, but he is taking on far more risk than the person building up a whole life policy.

"There are other tax-qualified plans, such as my 401(k)."

It is true that whole life insurance is not the only investment vehicle to enjoy tax advantages. However, other vehicles such as a

401(k) carry numerous restrictions, making these assets far less liquid than the cash values of a whole life policy. For example, except in specified cases of extreme hardship, a person has strict rules on when he can withdraw his money from a 401(k) or similar tax-qualified plan, and also when he *must* begin withdrawing (to avoid penalties).

There is also the problem of confiscation. Simply put, many analysts expect the federal government to "raid the 401(k)s." There have already been trial balloons (quickly withdrawn) suggesting that Americans would be better off if the government assumed their volatile stock portfolios and instead guaranteed them retirement benefits down the road.[4] Nelson Nash in fact has written on precisely this topic,[5] imploring the reader to be suspicious when the government offers a "solution" (i.e. tax-qualified plans) to a problem that the government itself created (i.e. high tax rates).

Finally, we point out that even diversified mutual funds took a brutal beating in the 2000s. Depending on the composition of their funds, many households were lucky if they broke even during the entire decade. It's all well and good to tell someone, "Buy and hold," but many breadwinners with 401(k)s and other comparable plans had to delay their retirement after the bloodbath in 2008. As of this writing in spring 2010, the U.S. equity markets are swinging by up to 3 percent *daily*.

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"Won't I get ripped off by the huge agent commission?"

It is true that a large portion of a new policy's initial premium payment funds the commission that the insurance company pays to the agent who brings in the client. This is the main reason that the internal rates of return on the cash values of a whole life policy are abysmal in the first few years.

Unfortunately, part of the explanation for high commissions is government intervention (at the state level). As anyone who has applied for a state license to become an insurance "producer" knows, the cardinal sin in this industry is giving a "kickback" to the customer for buying a policy. If an agent is caught sharing his commission fees with anyone who doesn't also have a license (including the customer whose initial premium payments are funding the entire commission), then the offending agent will lose his license. In this way, the state government enforces a cartel and keeps the price of commission-based insurance higher than it otherwise would be.

Notwithstanding the intervention by state governments, it is entirely reasonable that agents earn a commission on whole life and other permanent insurance products. After all, as the discussion in this very book attests, a whole life insurance policy is complex, and requires far more guidance than a standard term insurance policy. The insurance agent who explains the mechanics of a whole life policy to a prospective client needs to be compensated for his or her time, and the industry has adopted the commission approach that is common for many types of salespeople. (Keep in mind that all of the performance results we have thus far presented *include* the commission fees.)

It is important to note that a whole life policy configured according to Nelson Nash's philosophy actually *minimizes* the proportion of the initial premium payments going to the agent's commission. This is why it is important to obtain a whole life policy from an agent who truly understands and believes in the IBC mindset; other agents would have a natural incentive to steer the client away from the proper configuration, and into a policy where the cash value's growth is stunted in the beginning. In fact, were it not for state laws we would expect IBC salespeople to offer the greatest commission cuts to their clients, because someone who has a good experience with IBC will ultimately acquire many policies.

Finally, we point out that the insurance agent "cartel" actually has relatively low barriers to entry. The requirements differ from state to state, but a person with no background in insurance can typically obtain a license after two days of classroom instruction, a short test that is quite easy, and a few hundred dollars in various fees.