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AUGUST • 2017

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ABOUT LARA & MURPHY

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In 2010 he co-authored the highly acclaimed book, *How Privatized Banking Really Works* with economist Robert P. Murphy.

He is a co-creator of the IBC Practitioner Program for financial professionals and sits on the board of the Nelson Nash Institute.

ROBERT P. MURPHY is Research Assistant Professor with the Free Market Institute at Texas Tech University. He is co-author of *How Privatized Banking Really Works*. He is the author of *Choice: Cooperation, Enterprise, and Human Action* (Independent Institute 2015) and co-host with Tom Woods of the popular podcast Contra Krugman.

Murphy has a Ph.D. in economics from New York University. After spending three years teaching at Hillsdale College, he went into the financial sector working for Laffer Associates. With Nelson Nash, Carlos Lara, and David Stearns, Murphy is co-developer of the IBC Practitioner Program.

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> *"Judged from the old standpoint, property was sacred. Liberalism destroyed this nimbus, as it destroys all others."*
>
> *—From the book* Socialism *by Ludwig von Mises, 1922*

In the concluding chapter of his book, *Socialism,* Mises paints a picture of a world being turned upside down right before his eyes. Like it or not—and Mises himself was a skeptic—the old justifications for law and morality were crumbling with the influx of Enlightenment rationalism. As even Nietzsche acknowledged, when you tear down the pillars of society—even if you think those pillars had many things wrong with them—you need to be very concerned about what will fill the vacuum. As Jordan Peterson has observed, it is no coincidence that the worst tyrannies man has conceived filled the 20th century, when people were supposed to be living under scientific rule by experts, free from superstition and aristocracy.

In this final chapter of his great book, Mises notes that the discord that is tearing society apart *"works itself out in conflicts and errors, which we witness in horror."* It sounds much like 2017.

Once the philosophers had destroyed the public's awe of age-old institutions, Mises felt it was more important than ever for the economists to explain the social benefits of private property and money. For Mises, the great fight between Capitalism and Socialism involved nothing less than the fate of civilization itself. From our vantage point (as Christians), it does not surprise us that Mises can use his reason to understand the "utility" of the Biblical prohibitions. When God commands in His ancient law *"Thou Shall Not Steal"* and *"Thou Shall Not Covet"* these simple rules anticipate and refute all of the collectivist horrors of more recent history.

Mises seems to have known that the ideological battle was just beginning in 1922 and that it would grow into a fierce economic, social, and political opposition. According to Mises, to think that in this material world there could possibly be a "third way" was faulty reasoning. It is at this point in his book, on the very last page, that he makes perhaps his most widely quoted dictum:

"Everyone carries a part of society on his shoulders; none is relieved of his share of responsibility by others. And no one can find a safe way out for himself if society is sweeping towards destruction. Therefore everyone, in his own interests, must thrust himself vigorously into the intellectual battle. None can stand aside with unconcern; the interests of everyone hang on the result. Whether he chooses or not, every man is drawn into the great historical struggle, the decisive battle into which our epoch has plunged us. …And whoever desires that society should exist and develop must also accept, without limitation or reserve, private ownership in the means of production."

Thanks for helping us fight the good fight!

Yours truly,
Carlos and Bob

401K KO'D?

NELSON NASH'S WARNINGS VINDICATED

Those who've been in the world of the Infinite Banking Concept (IBC) know that one of the biggest hurdles for outsiders is the idea that a participant has to pay income tax *on the front end* before making premium payments into a properly designed dividend-paying Whole Life insurance policy. (Note: If this language is unfamiliar to you, then you absolutely must listen to Carlos and Bob's introductory podcasts—episodes 17 and 18 of the Lara-Murphy Show—available at www.lara-murphy.com/podcast.)

In contrast, the conventional wisdom put forth by financial gurus tells Americans that the "obvious" thing to do is to put your savings into a "tax-qualified" vehicle such as a 401(k) or a 403(b), so that you're contributing to your retirement account with "pre-tax" dollars. This is a supposed trump card that the "smart set" plays against IBC (or indeed, against anybody recommending deviation from the tax-qualified plans).

For starters, at a certain level of analysis the timing of the tax is a wash; if you pay it on the back end, then the total amount of money has grown, so the total amount you pay in tax is higher, offsetting the advantages of the deferral. (To be sure, the equivalence only holds if we keep everything else equal, including the tax brackets and your level of income. See the Murphy article "Framework for Tax Timing" in the November 2013 issue of the *LMR*.) So the whole premise of the people pushing for tax-qualified plans gets off on the wrong foot.

Yet beyond that—as Nelson Nash stresses in his writings and public talks—there was always the danger that the feds would tinker with the tax code. And lo and behold, a recent article by Jeff Spross in *The Week* explains that the "tax reform" plans include familiar possibilities such as removing the deductibility of corporate interest payments, but also to make 401(k) contributions taxable on the front end. (In other words, to make their tax treatment similar to a Roth IRA.)

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Spross explains that the whole thing is just a shell game in order to help with the politics: *"This wouldn't radically change the total amount of money coming into federal coffers — it would just look like it does, helping Republicans game the budget optics. All the plan would really do is take some of the money that the federal government would receive many years in the future, and deliver it now. Rather than change the bottom line, it would mainly just play with the budget windows that policymakers use to evaluate a law's effect on the deficit."*

To be clear, IBC is *not* a tax gimmick. As Nelson Nash says, he wants you to take control of the banking function in your household (or business). We are merely pointing out that one of the alleged downfalls of IBC—namely, the ostensible superiority of 401(k) tax treatment—is being seriously debated in Washington.

Government Shutdown?

TRUMP THREATENS SHUTDOWN TO GET WALL

Aiming to fire up the crowd, at a recent rally in Phoenix President Trump announced, "If we have to close down our government, we're building that wall."

We can't tell if Trump is serious about this threat, but then again he has never let conventional opinion stop him before. We can say that the typical fretting in the major media is misguided. Analysts talk about the supposed economic damages from previous shutdowns, but this is based on the faulty metric of treating all government spending as part of "Gross Domestic Product" (GDP). Yes, if Americans wanted to visit the Washington Monument or a national park, then a shutdown could legitimately reduce their consumption of "tourism services." But generally speaking, the federal government is a *drag* on the U.S. economy, meaning that a temporary lag in its activities is arguably good for growth.

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VINDICTIVE ON VENEZUELA

TRUMP SLAPS SANCTIONS ON MADURO

The president signed an executive order barring Americans from handling new debt issued by the Venezuelan government or state oil company. The official rationale is to punish strongman Maduro for his anti-democratic power grabs. This makes little sense, however, as Trump has no problem heaping praise on other thuggish world leaders (such as the Philippines' brutal Duterte).

Sanctions against Venezuela are both immoral and counterproductive. They will only hurt the impoverished people who are already suffering because of the socialist policies of first Hugo Chavez and now Maduro. Furthermore, U.S. sanctions provide political cover, giving Maduro a foreign scapegoat in the form of the "imperialist Yankees" who will distract the people from their true enemy, the Maduro regime.

Look, we had sanctions on Cuba for decades. Did they lead to Fidel Castro's downfall?

YELLEN YELLOW?

FED CHAIR TAKES SUBTLE SHOT AT TRUMP DEREGULATION EFFORTS

In her remarks at the recent Jackson Hole conference on monetary policy, Federal Reserve chair Janet Yellen praised the new financial regulations enacted during the Obama Administration. Most observers interpreted Yellen as repudiating the current efforts in the Trump Administration to roll back at least some of the new constraints on banks. Financial publications ran headlines suggesting that Janet Yellen had just torpedoed her chance of being reappointed chair when her current term expires (in February next year).

In Carlos' article last month (i.e. July 2017), he spelled out the possible connection between the Trump Administration's deregulation plans, and the Fed's need to unwind its balance sheet.

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This is purely speculation on our part, but it's possible that Janet Yellen sees the writing on the wall, and now thinks she can gracefully exit without being at the helm when the whole house of cards comes crashing down.

To reiterate our long-held position: Yellen was always the "regime change" Fed chair. She came in and replaced Bernanke, just as the Fed had implemented its "taper" strategy. Recall that the Fed has been holding a constant balance sheet since the fall of 2014, merely rolling over bonds as they mature. Yellen has always been telling markets that she intends to raise interest rates, as conditions permit.

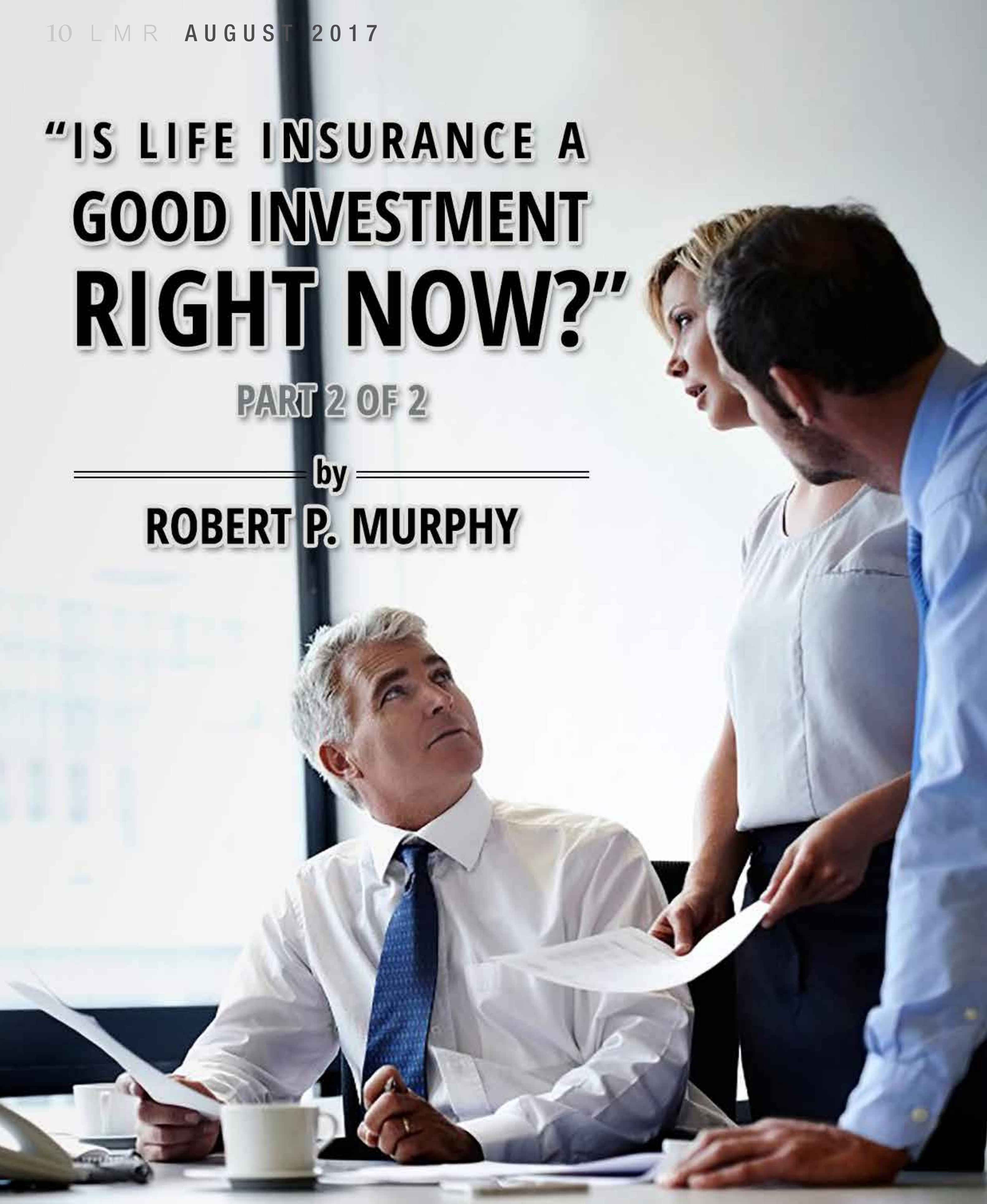
Whatever informal, behind the scenes meetings—with or without cigars—may have occurred before Janet Yellen was formally offered the job, she wouldn't have dreamed that she'd end up working side by side with a President Donald Trump. (Yellen was officially nominated in October 2013, and was sworn in as Bernanke's replacement in early 2014.) So even though she knew she was coming in to oversee a gradual tightening of policy, it's entirely possible that she's had enough and Yellen wants to get out while she still can.

"IS LIFE INSURANCE A GOOD INVESTMENT RIGHT NOW?"

PART 2 OF 2

by

ROBERT P. MURPHY



In the May 2017 issue of the *LMR*, I wrote the first part of this series. I began to tackle a common objection that Carlos and I get, when we talk to crowds familiar with Austrian economics. (Notice the quotation marks around the title of the article: These words are coming from the public, not from me.) Specifically, people wondered how Carlos and I could be in favor of the Infinite Banking Concept (IBC), after we had systematically explained that the Federal Reserve's actions since 2008 had set the U.S. economy up for another crash, and also threatened the U.S. dollar. In such an environment, why in the world would somebody want to load up on a dollar-denominated asset like life insurance?

> **People wondered how Carlos and I could be in favor of the Infinite Banking Concept (IBC), after we had systematically explained that the Federal Reserve's actions since 2008 had set the U.S. economy up for another crash, and also threatened the U.S. dollar.**

In that first article, I spent time *framing* the issue properly. It's important for our readers to understand exactly what Carlos and I are saying, and the very question—"Is life insurance a good investment right now?"—skews the discussion. In this, the second article, I'll review some of the main points regarding the framing.

After that, I will highlight the most recent statistics on the life insurance industry, to show why it is in relatively good shape (compared to many other sectors) and should be adequately prepared to serve its role in the broader plan that Carlos and I have explained to our readers.

Review from the First Article: Clarifying Our Perspective

First and most important: Nelson Nash's IBC is not about "investing in life insurance," the way other financial people might tell you to "invest in real estate" or "invest in Bitcoin." On the contrary, IBC is about "becoming your own banker." IBC is a *process*, and the *platform* by which you implement IBC is a dividend-paying Whole Life insurance policy. *That's* why we spend so much time discussing life insurance. You need to understand the basic mechanics of a Whole Life policy, and in particular how cash surrender values and policy loans work, just so you feel comfortable in using one or more of these devices as a major pillar in your financial plan.

If you're a typical reader, just about all of your dollar-denominated income and expenditures flow through the commercial banking system. Nelson Nash is simply recommending that you set up an *alternative* "warehouse" for your wealth. This is a great idea in general, but it's particularly urgent now, when Carlos and I think that our banking system is vulnerable to another crisis. (To be clear, Carlos and I are warning about the condition of the economy based on our own understanding of central banking and Austrian business cycle theory. Nelson Nash is not responsible for our views or strategy on this broader topic.)

If you have not yet implemented IBC in your personal life, we urge you to investigate sooner rather than later. Start by listening to episodes 17 and 18 of the Lara-Murphy Show (exact links provided in the endnotes to this article).[1]

Carlos and Bob's Three-Pronged Strategy

To continue with my review from last time, recall that Carlos and I produced a video in September 2016 entitled, "How to Weather the Coming Financial Storms." If you didn't watch it, you can still find it featured at our main page: www.Lara-Murphy.com. (If you are reading this article long after its original publication, check the endnotes for a permanent location for the video.[2])

You need to understand the basic mechanics of a Whole Life policy, and in particular how cash surrender values and policy loans work, just so you feel comfortable in using one or more of these devices as a major pillar in your financial plan.

After explaining our economic views, we recommended a three-pronged strategy:

1. Obtain a month's worth (meaning how much you would have to spend to maintain your basic emergency needs) in actual currency on hand, in case the commercial banking system seizes up and you can't use the ATM or write checks.

2. Obtain many months' worth of physical gold and/or silver, in case the dollar crashes and you need an inflation-proof hedge to tide you over until your sources of income can at least partially adjust to the new reality.

3. Start an IBC policy, so that your dollar-denominated cashflows are segregated from the conventional banking system.

To be sure, there are many nuances to fully appreciate our simple recommendations, but the above list is a good summary. My point in reviewing the three prongs for this article is to remind you that *we handle the threat of (price) inflation by encouraging an accumulation of the precious metals.* So it's not an adequate rejection of IBC to say, "Well gee whiz, I thought you Austrian types were warning about a dollar crash?"

Even if the dollar takes a beating and (say) falls 50 percent against other major currencies, Americans are still going to use dollars when they go to Walmart or when they log into their online bank account to pay their electric bill. You are still going to want your own cashflow management system in the vehicle of an IBC-structured Whole Life insurance policy.

We handle the threat of (price) inflation by encouraging an accumulation of the precious metals. So it's not an adequate rejection of IBC to say, "Well gee whiz, I thought you Austrian types were warning about a dollar crash?"

Now that I've reviewed the role that an IBC policy (or policies) plays in the overall strategy that Carlos and I developed, let's analyze the underlying strength of the life insurance sector. After all, it does no good to be holding life insurance policies with hundreds of thousands of dollars in "cash surrender value," if the insurer goes belly up and can't make good on its liabilities.

So how confident should we be, that the life insurers will stay standing if another economic crisis hits? That's the question I seek to answer in the remainder of this article.

Exter's Pyramid

In Figure 1, I reproduce the pyramid made famous by John Exter.

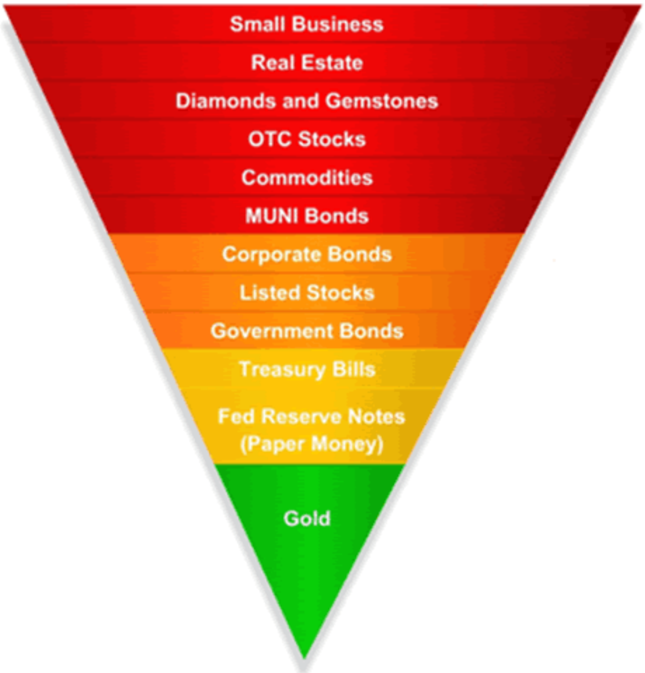


Figure 1. Exter's Pyramid of Collapsing Values

During his career, Exter worked for the Federal Reserve and also for commercial banks. He studied historical financial panics and concluded that during a crisis, investors rush to *liquidity.*

In Figure 1, the top of the pyramid represents the assets—such as real estate and municipal bonds—that have low liquidity and hence high risk, in the event of a crisis. If there is major uncertainty, investors will try to unload these assets and move down the pyramid.

Generally speaking, actual currency (Federal Reserve notes in the U.S.) is the most liquid of all assets. However, in the event of a currency collapse—and we are probably witnessing such an event in real-time in Venezuela—people no longer want to hold even the "money" as issued by the government. In such terrible circumstances, people flock to the *market's* money—gold—as the ultimate safe haven and asset of last resort.

Look again at Figure 1, but this time have in mind the three-pronged strategy that Carlos and I recommended. Notice that the tip of the pyramid is gold, which is one component of our plan. Moving up to the yellow region, we see actual currency—another component of our plan.

Finally, moving up another segment into the orange region, we see government bonds and corporate bonds. This is the third com-

So how confident should we be, that the life insurers will stay standing if another economic crisis hits? That's the question I seek to answer in the remainder of this article.

ponent of our strategy, because holding a large Whole Life insurance policy is effectively holding indirect claims on a portfolio of government and (investment-grade) corporate bonds, as I detail in the next section.

The Relative Strength of the Insurance Sector

In this section, I will summarize the most recent report on the life insurance sector's financial position, according to the American Council of Life Insurers (ACLI) 2016 Fact Book. (This report is available online,[3] and note that the data in this report only go up through 2015.)

Although the data won't be as recent, those interested in this topic should read previous ***LMR*** articles analyzing various indicators of the insurance industry's reliability. For example, consult the April 2012, August 2012, January 2013, April 2013, May 2014, October 2014, May 2016, and May 2017 issues of the ***LMR*** to see articles from either Carlos or me, on this topic.

In the event of a currency collapse—and we are probably witnessing such an event in real-time in Venezuela—people no longer want to hold even the "money" as issued by the government. In such terrible circumstances, people flock to the market's money—gold—as the ultimate safe haven and asset of last resort.

The "General Account" vs. the "Separate Account"

With all of the preliminaries out of the way, let's proceed to document some of the key facts concerning the financial position of the life insurers. Note that throughout this article, I will be focusing on what's called their general account, which refers to the assets the life insurers hold in order to "back up" their in-force policies. The assets held in the *general account* are the means by which the insurance companies can afford to pay out death benefit claims when insured people die.

In contrast, the *separate account* holds the assets related to special products that serve as investment pass-through vehicles, such as variable annuities or Variable Universal Life (VUL) insurance policies.

Nelson Nash *strongly* insists that it only makes sense to implement IBC using a dividend-paying **Whole Life** insurance policy, ideally issued by a mutual company (rather than a stock company). Since a life insurer's general account holds the assets that "back up" the traditional life insurance products (including Whole Life), that's the relevant metric for our purposes in this article. For someone practicing IBC, it doesn't matter if the stocks held by a life insurance company in the separate account crash, because that will simply affect the returns to the owners of VUL policies and the like. The people practicing IBC will be unaffected, because the assets "backing up" their cash values are kept distinct, both in the internal accounting and also quite literally in terms of regulatory requirements.

Nelson Nash strongly insists that it only makes sense to implement IBC using a dividend-paying Whole Life insurance policy, ideally issued by a mutual company (rather than a stock company).

Basic Facts of the Life Insurers' Financial Position, for 2015

At the end of 2015, the U.S. life insurance industry had 616 stock companies, 110 mutuals (and hybrids such as mutual holding companies), and 81 fraternal organizations. There was a total of $20.8 trillion in face value coverage in force, with $649 billion in total premiums paid. (Stock companies had issued $14.0 trillion of this coverage, while mutuals were responsible for $6.2 trillion.) Stock companies held total assets of $4.8 trillion, while mutuals held $1.5 trillion.[4]

(For newcomers, note that in any given year, only a small portion of the outstanding death benefit coverage will be claimed, since most people who have life insurance aren't going to die in that particular year. So it is not alarming that the total market value of life insurer assets is only a fraction of the total outstanding face value of their policies. In fact, the life insurers actually hold a substantial cushion to cover their actuarially expected death benefit claims, and then some.)

Table 1. Distribution of Life Insurer Assets in General Account, 2015 (millions)

Asset Type	Market Value (year end)	% of Total Assets
BONDS		
U.S. government securities	$349,507	8.7%
Foreign gov. securities	77,432	1.9
Corporate bonds	1,957,032	48.4
Mortgage-backed securities	449,748	11.1
Total long-term bonds	2,833,719	70.1
STOCKS	90,452	2.2
MORTGAGES		
Farm	17,947	0.4
Residential	13,632	0.3
Commercial	383,275	9.5
Total mortgages	414,854	10.3
POLICY LOANS	129,688	3.2
Short-term investments	60,043	1.5
Cash and equivalents	46,285	1.1
TOTAL	**$4,039,968**	**100%**

SOURCE: ACLI, 2016 Fact Book, Table 2.1 (p. 11)

As the data in Table 1 reveal, at this level of granularity the life insurance industry is in a fairly defensible position, vis-à-vis Exter's pyramid. Fully 48.4 percent of the general account assets consist of corporate bonds, an additional 8.7 percent are U.S. government bonds, 3.2 percent are policy loans (which are literally the safest investment possible for a life insurance company, since it guarantees the collateral itself), and another 2.6 percent are short-term assets including cash. Thus I would say some 63 percent of the general account assets would be classified as very liquid, possessing moderate to low risk in the event of another financial crisis.[5]

To be sure, a major crisis could knock out even Fortune 500 companies, causing them to default on their bonds, and if tax receipts collapse while requests for food stamps and other assistance skyrocket, even Uncle Sam might default. Even so, in terms of holding a collection of assets that will likely yield a modest return with as little risk as possible, the life insurers' general account is pretty balanced.

What About Interest Rate Risk?

An obvious concern in our present environment is that a rapid rise in interest rates might cause devastating losses to institutional bondholders. Remember that if interest rates go up, the market value of a bond goes down, and the longer the maturity of the bond (or the higher the "duration"), the more sensitive it is to this interest rate risk.

> **Strictly speaking, a life insurance company is not a "bond fund" of the type managed by a conservative mutual fund.**

Strictly speaking, a life insurance company is *not* a "bond fund" of the type managed by a conservative mutual fund. Remember, the ultimate purpose of a life insurance company is to pay death benefit claims when an insured party dies. If its actuaries and investment officers do their jobs properly, the life insurance company will choose its fixed-income assets in order to *match its liabilities.*

For example, suppose the Acme Life Co. knew for certain that in the year 2025, it would pay out a total of $100 million in death benefit claims. In order to cover itself, Acme would want to be holding right now bonds that would mature into $100 million by 2025. So long as the issuer of these bonds didn't default, and assuming Acme could meet its cashflow needs over time and thus hold the bonds to maturity, *it wouldn't matter* what happened to interest rates in the interim.

To be sure, if interest rates spiked in this scenario, then the market value of Acme's bonds would go down. But at the same time, the "present value" of the actuarially expected death benefit claims for 2025 would *also* go down, when the accountants plugged in the higher interest rates into the formulas. Therefore the fall in the market value of Acme's Assets would be matched by a fall in its Liabilities, leaving the equity in the company unchanged. In particular, Acme would still be able to meet its contractual obligations to the beneficiaries named in its policies, because (by construction) the bonds it holds will mature into at least $100 million, in time to pay the death benefit claims.

Thus we see that *if the life insurers engage in perfect maturity matching*, then they have nothing to fear from rising interest rates. However, we might worry that in practice the life insurers can't be *completely* matched in terms of asset-liability maturities. In that context, it's reassuring to see the following data in Table 2.

Table 2. Distribution by Remaining Maturities of Life Insurer Bonds in General Account, Year's End 2015

	1 year or less	1-5 years	5-10 years	10-20 years	> 20 years
Government	10.2%	19.1	18.2	24.8	27.7
Corporate	7.7%	26.2	34.4	13.0	18.7
Combined	8.3%	24.5	30.6	15.8	20.8

SOURCE: ACLI, 2016 Fact Book, Table 2.4 (p. 15)

As Table 2 demonstrates, the life insurers have a smooth mix of bond durations. If short-term rates spike, about a third of their total bond portfolio matures within five years, so they should be able to roll over into the higher yields without too much pain. It's true that the roughly 21 percent of very long maturities would take a beating, but again I remind the reader that these were acquired in order to fund the long-term liabilities represented by outstanding policies. By its very nature, a life insurance company needs to have long-lived assets so that it can confidently make promises to its clients.

While I'm discussing the bond portfolio, it's also worth noting that in 2015, 48 percent of general account private bonds were classified as "Class 1," while another 42 percent were "Class 2." These two classes together constitute "investment grade" bonds. So earlier, when we pointed out that almost *half* of the life insurers' general account consisted of corporate bonds, it's important to realize that 90 percent of these are *high-quality* corporate bonds.

A Trouble Spot

To show that I'm not merely doing a whitewash or suffering from confirmation bias, let me disclose one area of concern. As many of you probably noticed when you looked at Table 1, the life insurers hold some $450 billion—a bit more than 11 percent—of their general account assets in the form of mortgage-backed securities. Now for context, remember that the amount of corporate bonds is more than *four times* this amount, but even so, it troubles me that the life insurers have such a large exposure to these derivative assets.

In fairness, not all mortgage-backed securities (MBS) are created equal. In *theory*, a properly designed mortgage-backed security is safer than a conventional mortgage, because it ostensibly spreads the risk of default out among hundreds or thousands of mortgages, covering a wide range of locations.

Yet as we know all too well, the alleged safety of mortgage-backed securities did not hold up in 2007 and 2008. Since Carlos and I think the American financial markets have repeated the same types of mistakes that led to the 2008 crisis, we cannot ignore the MBS sitting on life insurer balance sheets.

> **Yet as we know all too well, the alleged safety of mortgage-backed securities did not hold up in 2007 and 2008.**

In particular, in just last month's issue, Carlos wrote an article talking about the Fed's desires to unload its MBS, and the possible regulatory means by which the feds would induce private institutions to absorb more of these assets than they really want to hold.

Conclusion

Naturally, someone practicing IBC is first and foremost concerned with the financial health of the *specific company* that has issued the policy or policies. Use the list of previous ***LMR*** articles (which I gave earlier in this article) to learn how you can go about researching companies for the maximum amount of due diligence.

Yet if we look at the life insurance industry as a whole, in general it has behaved fairly conservatively. As part of the three-pronged strategy that Carlos and I outlined in our 2016 video, "How to Weather the Coming Financial Storms," the IBC component—which addresses your need to manage cash-flows denominated in dollars—should hold up in all but the most extreme scenarios.

For maximum protection, of course, people following our guidelines would also obtain holdings of actual currency as well as physical possession of gold and/or silver.

Carlos and I are both Christians, meaning that our ultimate security does not rest on material things. But to the extent that you want to be a wise steward of the resources entrusted to you, we recommend that you review our very defensive strategy to help ensure that you don't get financially wiped out by the coming storms.

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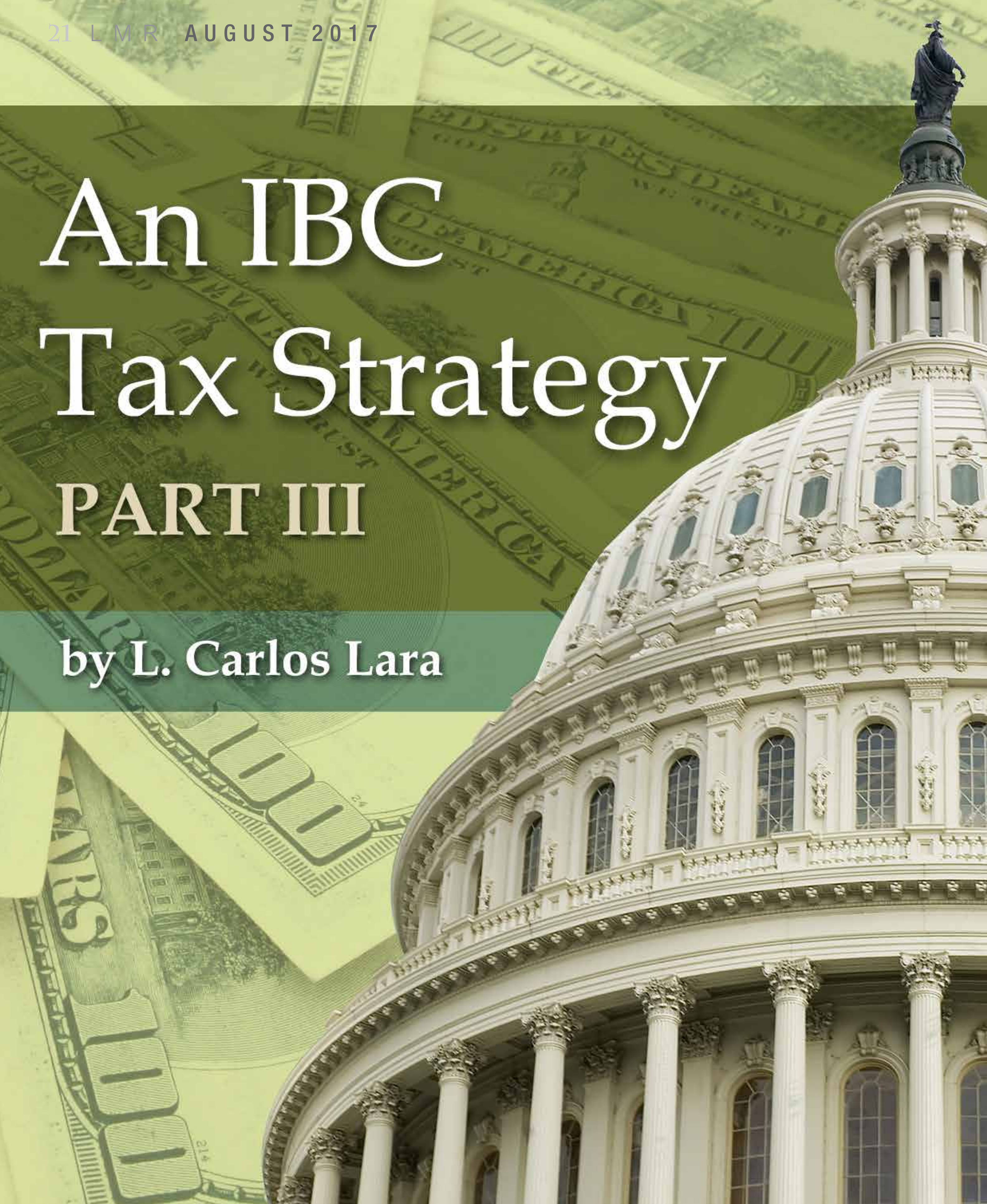
References

1. If you're new to IBC, listen to episodes 17 and 18 of our podcast, available at: https://lara-murphy.com/podcast/episode-17-guide-starting-ibc-part-1/ and https://lara-murphy.com/podcast/episode-18-guide-starting-ibc-part-2/.
2. Our video, "How to Weather the Coming Financial Storms" is available at: https://lara-murphy.com/video0916/.
3. Data obtained from ACLI's Life Insurers Fact Book: 2016, available at: https://www.acli.com/-/media/ACLI/Files/Fact-Books-Public/2016LIFactBook.ashx?la=en.
4. ACLI, pp. 2-3.
5. A purist might insist that we include "listed stocks" in our list of moderate-risk assets according to the Exter pyramid, and this is correct, if we are just using pure liquidity as our guide. However, since Carlos and I think that the stock market has been blown up by the various rounds of QE, it would be inconsistent for me to praise the life insurers' holdings of corporate equities as a moderately safe investment.



An IBC Tax Strategy

PART III

by L. Carlos Lara

In this third and concluding article about an IBC Tax Strategy, a strategy that I personally use, I would like to shift gears and steer our thoughts in the direction of some very important rules that govern life insurance policy loans. As individuals that practice IBC these discretionary guidelines with regards to policy loans should be fully understood, whether we are members of the general public, or financial professionals. This is the main reason that I reiterated several times in the preceding two articles that this particular tax strategy was not for novices, or those new to IBC.

To clarify, let me put it to you this way. We must never forget that beyond all of the outstanding attributes of a properly designed dividend-paying Whole Life insurance contract and how it works, policy loans are a completely separate undertaking and are a central feature of the *Infinite Banking Concept*. In other words, IBC is never really being fully practiced without policy loans being utilized at some point in the process. Consequently, knowing all the ins and outs of how policy loans work is crucial to getting the most out of practicing IBC. The good news is that there are only a few critically important best practice guidelines that we must know and understand. These few principles are the subject matter of this final article of this three-part series.

If you are new to IBC I encourage you to continue to broaden your education about IBC using our podcast and our website, especially with regards to policy loans. Robert and I have written quite a number of articles specifically about this subject ever since 2010 when we first launched the *Lara-Murphy Report (LMR)* and they are all available in the ***LMR*** archives for subscribers. But whether you are an ***LMR*** subscriber or not,

If you are new to IBC I encourage you to continue to broaden your education about IBC using our podcast and our website, especially with regards to policy loans.

I would at least like to recommend that you read "The Policy Loan Debate Explained," which I wrote in the September 2014 issue of the ***LMR*** as a starter article. You can find a *free* copy of it here: https://lara-murphy.com/lmr-greatest-hits/ Many other free articles on policy loans are also located on this same page and I recommend that you read as many of them as you can before you begin to use IBC in your own economic affairs.

The Ideal Strategy for Business Owners

Before launching into the most critical rules on policy loans, let's briefly review the main reason that I wrote this series in the first place and why I believe this is the ideal tax strategy for a business owner primarily.

Once the workings of IBC and policy loans are fully understood, the business owner has no difficulty choosing the superior stress-free option.

It all started with an attempt to answer a typical objection that I would often hear being expressed by business people once it dawned on them that practicing IBC would in fact allow them to eventually wean themselves from their dependency on commercial banks and in particular from the clutches of a commercial bank's overt collateral requirements. As a prerequisite the collateral that commercial banks demand include the assets of the business and the personal guarantee of the business owner. This is why once the workings of IBC and policy loans are fully understood, the business owner has no difficulty choosing the superior stress-free option.

Still, the limiting factor for many business owners to be able to obtain an IBC-type policy was that all of their excess cash flow was tied up elsewhere. They had enough business savvy to know that in order to obtain an IBC banking policy large enough to accommodate the required needs of their business a significant amount of ready capital would be required to fund such a policy. So I simply suggested that the business owner could take cash flows that were already earmarked for paying taxes to the IRS and re-route them through a correctly designed IBC policy that would have the capacity to adjust to the business owner's particular situation.

By using this particular strategy the business owner would in effect be making use of the same money that was already set aside to pay the government and wind up accomplishing two things with it instead of just one. All he had to do was to first direct these monies to set up his IBC policy then turn around and pay them to the IRS using a policy loan. He would do this again the following year and continue this same procedure for several years until he had built up a sizable IBC infrastructure with a huge death benefit. My illustrations (in Part 2 of this article) showed ten consecutive years of policy loans as an example, although one of them was a real life case study. Building the large death benefit was the initial goal of this strategy and then later, at some time in the future, the business owner would repay these loans with *"windfalls"* or the sale of business assets.

I want to stress again that there is nothing magic going on here; we are not conjuring up wealth out of thin air. This is why I included actual illustrations provided by a life insurance company to show exactly what I meant. Furthermore, when I talk about the IBC "tax strategy" *I am not talking about reducing your tax liability.* You are still payng your normal tax bill to the IRS. I am simply showing the business owner how to use the same cashflow to build up an IBC infrastructure in addition to satisfying the tax man.

I focus on the business person because he has large cashflows. This is not to say that an employee on a fixed income does not ever have a windfall or that such an individual never sells an asset and then needs a place to store the proceeds from that sale. I simply mean that this idea resonates most strongly with business owners because they can *create* windfalls by generating additional business profits and, as a rule, they strive to build up business assets in order to sell them later for a profit.

What really makes this IBC tax strategy work as efficiently as it does boils down to the way the life insurance contract is initially designed, combined with the following three important attributes of a dividend-paying Whole Life insurance policy. We have already discussed all three of these in detail in the previous articles, but it is well worth listing them once more for emphasis.

I want to stress again that there is nothing magic going on here; we are not conjuring up wealth out of thin air.

1. Access and Control Over Your Money: If you have cash value in your policy you have a contractual right to *policy loans.*

2. Flexibility of Repayment Terms: Although an outstanding policy loan rolls over at interest, you can pay it back on your own schedule, or even not at all, if you wish.

3. Uninterrupted Compounding Of Your Money: Whatever amount you borrow—that same amount continues to earn money in the form of interest, dividends, and equity in your policy as long as you live and as long as your policy remains in force.

The Important Discretionary Guidelines of Policy Loans

Notice that I refer to the policy loan rules as *"discretionary guidelines."* This is because in the final analysis these rules are up to you, the policy owner, to exercise or not. For example, with regards to point number 2 above—in reference to the flexibility of the repayment terms of policy loans, I clearly state that you can pay back the policy loan *"on your own schedule, or even not at all, if you wish."*

That statement is not a misprint. It is absolutely true of policy loans. But in the context of my discussion of an IBC tax strategy, it would be contrary to the true practice of IBC if you did not pay back your loans at all. This important point has been repeatedly stressed throughout this series and I am restating here again. In other words, it is absolutely in the best interest of the policy owner who is practicing IBC to repay his policy loans.

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Repayment of policy loans is what releases the collateral and replenishes your line of credit with the insurance company so that you can re-use the cash values again.

The reason for this insistence is that we must not forget our primary purpose for practicing IBC in the first place. IBC is first and foremost a cash flow and financing system that allows you to borrow from the insurance company using your cash values in your policy as the collateral. Repayment of policy loans is what releases the collateral and replenishes your line of credit with the insurance company so that you can re-use the cash values again for either emergency expenditures, investments and/or for purchasing big-ticket business assets.

The true IBC practitioner realizes and accepts that this *process* of using the Whole Life policy as its *platform* is the *"alternate"* cash flow and financing mechanism he has been looking for to replace the commercial banking system, which he was previously using with all the duress that came with it. This alternate system now becomes his main (so called) *privatized* bank and the primary place where the bulk of his "dollars" should ultimately reside. So naturally there is a very strong economic incentive to pay off policy loans with windfalls and proceeds from the sale of business assets.

In effect, the entire IBC process involves *"overfunding"* the policy without *"MEC-ing"* it in the initial capitalization phase and then *"re-funding"* it again when policy loans are paid off, thereby replenishing the business owner's capital base. Practicing both phases of this process is representative of sound money management and the best use of *time* as an ally.

Years later, once the business owner is ready to retire with his substantial cash values and the huge death benefit in his policy, he can now re-direct the dividends, which by now will also be huge, into a tax-free income stream to sustain him in old age. Then at his death it all culminates with the beneficiary, or beneficiaries, or his estate receiving that large death benefit income tax free. All this to say that by practicing IBC correctly and responsibly there will never be the worry of a 1099 surprise or the worry of the IBC policy ever being underwater.

Avoid Surrendering The Policy… Until Death

There is one complication. This error can potentially trigger a taxable event especially if you have had the policy for a number of years, have surpassed the cost basis of the policy (the premiums paid in) and have been taking out tax free dividends and withdrawals and still have sizable unpaid loans too close to the cash values on the books. I do, however, want to underscore the word *potential* because the way to keep that potential taxable event from ever occurring is to never *surrender* the policy. Quite frankly, there is absolutely no need to do such a thing unless the entire U.S. economic system derails. Short of this type of catastrophe there is no need to surrender it when practicing this

There is one complication. This error can potentially trigger a taxable event.

strategy. The surrender is what makes the potentiality of the tax event more certain.

Specifically, what can happen is this: If you surrender a life insurance policy, then at that point the IRS will look at its history. If, during the life of the policy, you have "taken more out of it" (in the sense of dividends, withdrawals and policy loans) than you "put into it" (in the form of premium payments and loan repayments), then the IRS is going to treat the *net* wealth you extracted from the policy as taxable income.

Because of this possibility, you want to make sure you handle your IBC policy such that you never find yourself in a position where you want to surrender it. The policy must be allowed to continue to chug along utilizing

You want to make sure you handle your IBC policy such that you never find yourself in a position where you want to surrender it.

its uninterrupted compounding mechanism on its credited interest rate and its dividend payments to build up equity in the policy as described in point number 3 above. In spite of sizable policy loans outstanding, the policy's earnings will stay ahead of them. Recall that due to the design and structure of the policy, you, the policy owner can never be obligated for a loan that's greater than the available cash value. The policy will stay ahead of your loans as long as you live and ***as long as your policy stays in force.***

To further reinforce the value of practicing IBC in general and this strategy in particular is the IRS's ruling under Title 26 Section 7702 (a) thru (g)[1] and again in Title 26 Section 101(a)[2], which together state that any and all cash value growth in the policy is not taxable in any year and any distributions taken out of the policy including its gains are not taxable in any year, plus if the policy is held until death the taxation of any gains are avoided altogether. On top of that, the beneficiary of the death benefit receives it income tax free.

To repeat, the type of error I'm warning about is made when a policy owner mistakenly surrenders a policy to pay for an outstanding policy loan. That transaction can potentially create a taxable event, not because the loan is taxable, but because the surrender of the policy itself *may* be taxable. This is because the policy surrender while you are still alive causes the entire principal and all the gains to become revealed as though they were withdrawn all at once at the time of the surrender, thus triggering the tax.

This action by the policy owner signals the insurance company to pay itself out from the

The other common mistake is made when a policy owner believes he can no longer make the premium payments on the policy to keep it in force, therefore allowing the policy to lapse.

remaining cash values (not the death benefit) leaving the policy owner to pay the tax on all the gains with the remaining money, which may or not be there if you stripped all of your capital base by never paying off any policy loans. Of course, if you surrender the policy at a time when you know you have not surpassed the cost basis there will be no tax due. Additionally, if you surrender the policy with a hefty capital base enough to pay off the policy loans and still have enough cash value left over to pay the tax then it's pretty much a wash.

The other common mistake is made when a policy owner believes he can no longer make the premium payments on the policy to keep it in force, therefore allowing the policy to lapse. If you are having problems making the premium payments all you have to do is ***restructure*** the policy so that some of the policy's working parts, such as PUAs, death benefit, or dividends are partially surrendered or directed in such a way to make sure the premium payments are continuously made and this will keep the policy in force until your death, which is the main goal of this strategy.

Everyone who practices IBC must know about the potential tax problems caused by policy surrenders and the available *premium payment restructures* available in all dividend-paying Whole Life insurance polices obtained from a mutual or a mutual holding company. This knowledge is a must. But as I've stressed, so long as you are playing "honest banker with yourself" and paying down your outstanding policy loans according to a schedule, then you will never get into dangerous waters.

Practicing IBC and especially the IBC Tax Strategy that we have been discussing here requires monitoring of your policy or policies.

Annual Policy Reviews and In-Force Illustrations

There is one final piece of advice. Practicing IBC and especially the IBC Tax Strategy that we have been discussing here requires monitoring of your policy or policies. Remember, this is a cash flow and financing system you are managing. Consequently, you should do a review of your policy with the help of your *Authorized IBC Practitioner* each year. Your insurance company will provide you an annual snapshot of your policy each year at the end of your policy's anniversary date. This is an excellent time to do your policy review. Ask questions and become familiar with all of the terminology in the policy's annual statement and especially how to read the policy's progress.

Since you, the policy owner, are ultimately in charge of taking out and paying off policy loans with windfalls and proceeds from the sale of business assets, learn how to request an *"in-force illustration"* from the insurance company. These in-force illustrations can project for you several years into the future to see how the policy is expected to perform from the day of your request.

These projections take into account current crediting interest rates, current loan rates, and premium payments to help guide the cost and consequences of future loans and pay offs. I know that we are currently in a prolonged low interest rate environment, but the reality is that we live in a volatile interest rate world where the values of assets can change overnight. These projections will help you see down the corridor of the future to help guide you in making important business decisions to steer away from potential future problems.

For example, these in-force projections may show you that say five years down the road you may need to make adjustments, like pay the interest each year for a few years to slow up the compounding interest on loans if you don't have enough to reduce the principal at the present time. Or, you may need to restructure the policy much earlier than you first thought. The point is that the entire IBC process is flexible and you have options when you are monitoring your IBC policy sensibly.

Learn how to request an "in-force illustration" from the insurance company.

Once you know and understand these few important discretionary guidelines to the successful practice of IBC, including policy loans, you can do the IBC type tax strategy with *any* recurring expense you may have, not just your taxes. If you will always practice IBC correctly and responsibly, as these three articles have made clear, you can do this strategy with complete confidence.

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THEORY AND PRACTICE:

The Origins of the Nelson Nash Institute

INTERVIEW WITH DAVID STEARNS

DAVID STEARNS IS ON THE BOARD of the Nelson Nash Institute, and is one of the creators of the IBC Practitioner Program. He is the President of Infinite Banking Concepts (IBC), LLC, formed to distribute "Becoming Your Own Banker" trademarked and copyrighted educational material. He graduated from the State University of New York College at Buffalo in 1975, and holds a degree in Master of Public Administration from Auburn University Montgomery. He served twenty-seven years in the U.S. Army, retiring in 2004 as a Lieutenant Colonel. Stearns served in a variety of assignments, initially as a Field Artillery officer before attending the Army Rotary Wing Course leading to future assignments as an Army Aviator. Stearns began his second career in 2004 working with Nelson Nash in IBC. He is married to Kimberly Nash Stearns, and has four adult children and six grandchildren.

LARA-MURPHY REPORT: How did you become interested in Austrian economics?

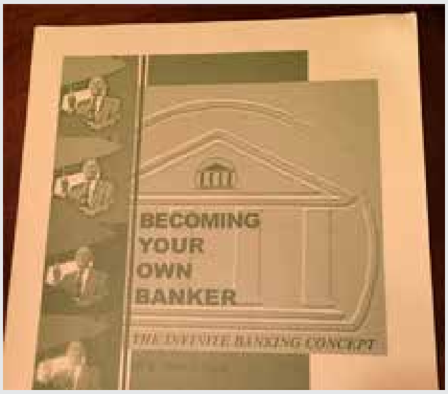
DAVID STEARNS: I was slowly immersed in the principles by [my father-in-law] Nelson [Nash]—something similar to Nelson's boiling frog analogy. I didn't know what Austrian economics was really all about or how to label it, I just grew into it.

He introduced me to Dr. Clarence Carson in the early nineties, and made it a point to give Clarence's textbooks to all my children. My first formal exposure to the Austrians was when my wife and I attended a "Mises Circle" event in Atlanta, GA in 1999.

"My first formal exposure to the Austrians was when my wife and I attended a 'Mises Circle' event in Atlanta, GA in 1999."

As you know, Nelson lives by Austrian fundamentals, and brilliantly weaves the Austrian ethos in everything financial. A personal example of mine is the use of the first (of many) whole life policy I bought from Nelson in 1979 (the day before I married his daughter). Under Nelson's guidance we used that policy to finance many things over the past thirty-three years. We have not had a conventional car loan in over 20 years. Using this policy in conjunction with several more for privatized banking allowed us to eliminate our home mortgage.

LMR: Your direct connection to the Infinite Banking Concept (IBC) is that your father-in-law is Nelson Nash. But can you tell our readers a little bit of the background of how you became involved with IBC professionally?



"Nelson lives in Birmingham, so he and I started to spend a lot of time together. He published the first edition of Becoming Your Own Banker in 2000, and started to ramp-up his seminar series around the same time."

DS: In 2000, while still on active duty with the U.S. Army, I accepted an assignment working as an advisor/trainer for a U.S. Army Reserve unit stationed in Birmingham. Of course, Nelson lives in Birmingham, so he and I started to spend a lot of time together. He published the first edition of *Becoming Your Own Banker* in 2000, and started to ramp-up his seminar series around the same time.

One of the benefits of an Army career is having to be a jack-of-many-trades, one of which is expertise in briefing and conducting presentations using PowerPoint. After attending an early seminar with Nelson, I saw that he needed some help modernizing, and digitizing his presentation. He used a box of view graph overhead slides that he would rifle through looking for the correct slide when talking. I talked Nelson into buying a laptop and then transformed his presentation from overhead slide format to PowerPoint.

Starting around 2002, Nelson asked me to provide more administrative support to his efforts, and encouraged me to retire and help him full-time. However, with the fallout of 9/11, I was committed to the Army for several more years. Fast forward to 2004; I retired from the Army, and finally started to work with Nelson full-time.

Initially, I handled book orders, instituted a client management tracking system, and coordinated the IBC Think Tank, our (at that time) semi-annual conference. The Think Tank was built around Nelson's 10-hour seminar, where attendees heard Nelson and other presenters on IBC-specific topics. Well, over the next six years the event grew from 6 attendees to more than 200. In 2009, I took control of the entire Becoming Your Own Banker operation, and formed Infinite Banking Concepts, LLC.

"The Think Tank was built around Nelson's 10-hour seminar, where attendees heard Nelson and other presenters on IBC-specific topics. Well, over the next six years the event grew from 6 attendees to more than 200."

LMR: You wear several different hats in your connection to IBC. Can you explain, for the record, the different roles of the Nelson Nash Institute, the IBC Practitioner's Program, and the IBC Think Tank?

DS: The Nelson Nash Institute was formed by Nelson, Carlos Lara, Robert Murphy and me to provide the public a platform of educational resources related to privatized banking. We saw that there was a critical need to clarify the IBC message that had become bastardized over the past 10 years by a combination of factors. Greed, misinformation, and marketing hype contributed to giving IBC a mixed reception by both the public and the financial services industry. We also wanted to honor Nelson and create an entity that would cement his legacy and pay honor to his invaluable contribution to "personal economics."

Because the four of us were committed to providing the public with quality information with the intent to separate IBC-fact from IBC-fiction, we quickly saw that there was also a need for trained, vetted financial professions whom the public could trust when implementing IBC. This was the genesis of the IBC Practitioner's Program.

In a nutshell, the Nelson Nash Institute exists for our primary customer, the public. The Practitioner's program is a subset of the Institute with the mission to train financial professionals in the importance of economics. Without a sound foundation in economics, we believe that financial advisors are missing a critical piece when advising their clients.

In 2012, several major mutual insurance companies approached us requesting an IBC training program to be used for their agents that were interested in implementing IBC in their practices. These companies embraced the idea of IBC but were concerned that the concept was out of control. This was perfect timing, because it coincided with our decision to develop the program. Fortunately, two of the requesting companies agreed to help us by providing actuarial support and legal review. This relationship contributed to the Practitioner's Program becom-

"We quickly saw that there was also a need for trained, vetted financial professions whom the public could trust when implementing IBC. This was the genesis of the IBC Practitioner's Program."

ing sound, both from an economic and insurance actuarial standpoint.

The Think Tank is our annual meeting of IBC Practitioners. We believe that it is important for our group to meet to share their experiences with the challenging task of *implementing* IBC. An education, no matter how good, by itself does not mean that an agent can pique the interest of a prospect or provide quality support to an actual client. Experienced mentors are needed to coach and demonstrate this interaction; this is a critical aspect of the IBC Think Tank.

LMR: Since you've been around it for a long time, can you describe the growth in interest in IBC?

DS: I believe that interest has grown exponentially over the last ten years. The reasons for this are two-fold. One, the public is still uneasy about our economic environment, regardless of the impressive performance of the stock market, but cannot quite put their finger on where the problem lies. And two, the simplicity and logic of IBC resonates with them.

Generally, I feel that the public is more comfortable with the concept than ever before. A major contributing factor could be the availability of actual IBC history. With over 17 years of IBC in-force policy performance on the books, since the publication of *Becoming Your Own Banker,* an interested individual only has to ask to see the actual performance of a properly designed and managed policy. By managed policy I mean properly funded and loans treated responsibly.

LMR: Are you optimistic that more Americans are realizing the wisdom of Nelson's advice to "take control of the banking function"? Or do you think economic uncertainty and miseducation will drive more of them into the arms of political figures promising them security?

"With over 17 years of IBC in-force policy performance on the books, since the publication of Becoming Your Own Banker, an interested individual only has to ask to see the actual performance of a properly designed and managed policy."

DS: The millennial demographic will soon be the largest population segment in America, displacing the Baby Boomers. It stands to reason that they will have the greatest financial impact on our economy. I've read that for the most part the typical millennial doesn't trust institutions (read the government), and that they are not concerned with joining organizations. They do their own research before purchasing something or investing their funds. My hope is that these characteristics will lead them to the realization that the government cannot provide financial security for them, and that the commercial banking sector is not their friend. The NNI will stand ready to support this enormous group with our educational resources that are developed to help them recognize that the best solution is privatized banking, or as Nelson says: "putting the banking equation at the you-and-me level, where it belongs."

EVENTS & ENGAGEMENTS

NOTE: MANY OF THESE EVENTS ARE OPEN TO THE PUBLIC. CONTACT US FOR FURTHER DETAILS.

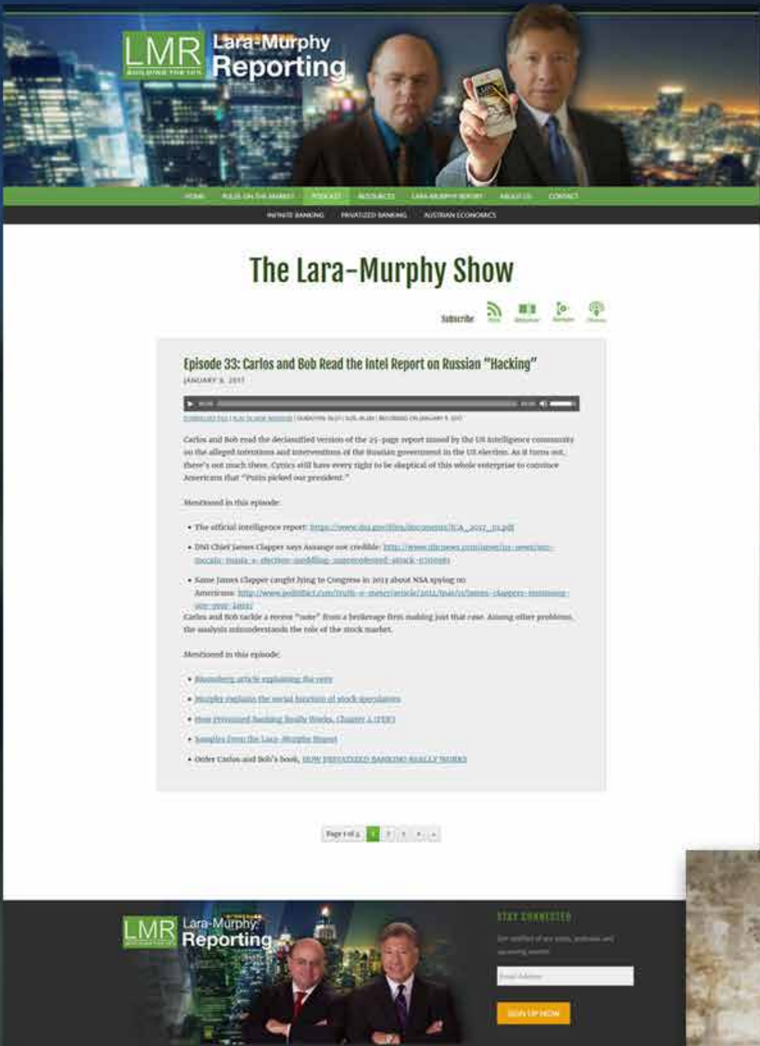
OCTOBER 7, 2017
NEW YORK CITY, NY

Murphy speaks at 35th Anniversary Gala for Mises Institute.

OCTOBER 15-22, 2017
THE CARIBBEAN

Murphy and Tom Woods host the “Contra Cruise.”

SOME EVENTS MAY BE CLOSED TO GENERAL PUBLIC.
FOR MORE INFORMATION: LMREVENTS@USATRUSTONLINE.COM



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