PARADIGM LIFE

GROWTH | INCOME | LEGACY

THE HISTORY OF THE POLICY LOAN

AND HOW BEST TO USE IT

TABLE OF CONTENTS

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INTRODUCTION

The Growth phase of *The Perpetual Wealth Strategy* is the combination of two distinct elements: the accumulation and utilization of wealth.

Accumulation - *The Wealth Maximization Account* is unlike any other financial vehicle. It is private, grows tax-free, and earns interest and a probable annual dividend. As a result, it has benefited the financial lives of millions for well over 100 years.

Utilization - The Policy Loan, when used under the guidelines of the strategy, provides access to credit without interrupting the growth of your wealth. The Policy Loan is also private, the insurance company guarantees it, and you can use it for almost any purpose. The terms of the loan are more flexible than most bank loans and give you optimal control to enhance your wealth.

This document reviews the extensive history of the Policy Loan, as well as important best practices to consider when using it.

HISTORY OF LIFE INSURANCE & CASH VALUE

The Wealth Maximization Account is a strategically designed permanent life insurance policy. Many Paradigm Life clients are surprised to learn that life insurance is one of the oldest assets. In fact, the concept of life insurance as we know it traces back to ancient Rome.

The more modern concept of an insurance "company" came into being in approximately 1688, as Edward Lloyd's Coffee House became a popular gathering spot for ship captains, ship owners, and merchants to talk business and, eventually, to buy marine insurance. In 1769, a group of professional underwriters broke off from the Coffee House and founded what ultimately became Lloyd's of London in 1769. In the United States, panic associated with the Financial Crisis of 1837 resulted in the concept of mutualization of life insurance companies. As a result, between 1838 and 1849, many of the most recognized names in private mutual life insurance companies – including New York Life, MassMutual, and Penn Mutual – were created.

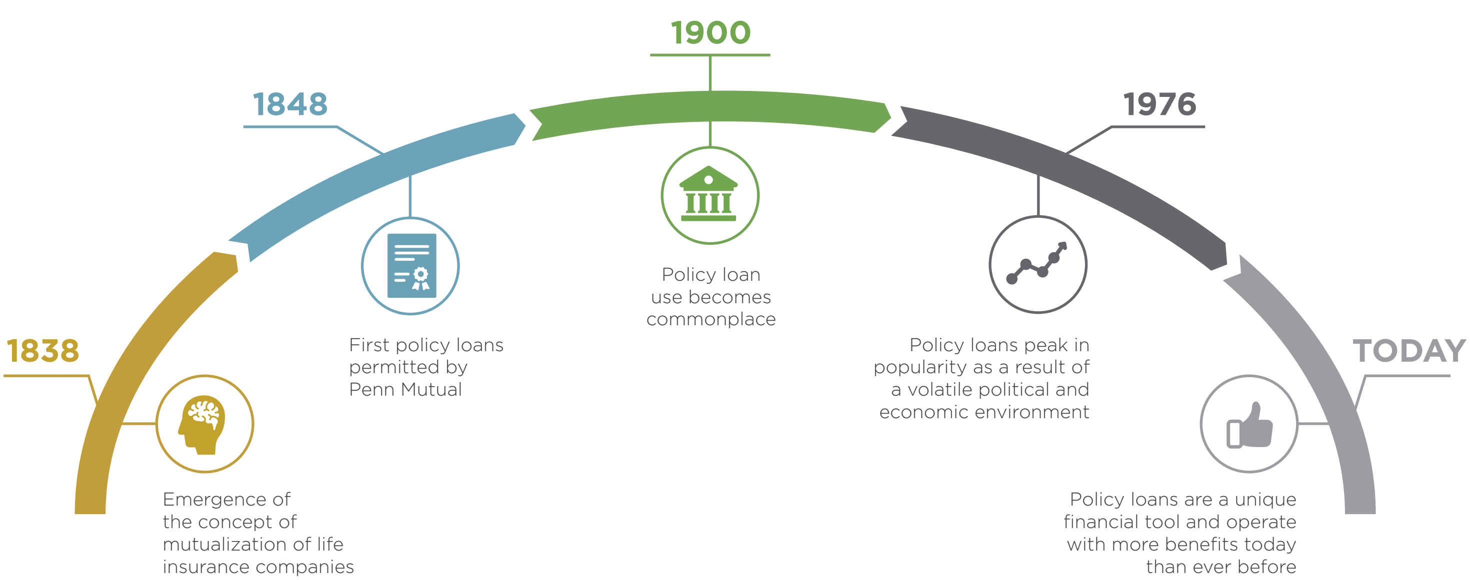
A whole life insurance policy is considered the "basic insurance contract." Policy premiums are level for the life of the individual and the policy builds "equity" or cash value which can be prematurely surrendered or used as collateral for a policy loan. The first insurance company to institute a policy loan was Penn Mutual in 1848. Penn granted policy owners access to the build up of cash value via loan. Shortly thereafter, other insurance companies adopted the practice with wide-spread acceptance by the end of the 19th century.

The use of life insurance to accumulate wealth along with policy loans to deploy it dates back 160 years, longer than any other financial strategy. This financial vehicle has valiantly stood the test of time and is available for use today.

HISTORICAL USE OF POLICY LOANS

By the early 1900's, the use of policy loans was commonplace. In 1922, Henry S. Nollen, then President of Equitable of Iowa (now a part of Voya Financial), articulated the most commonly stated reasons their policyholders requested loans. These reasons included: to pay premiums on policies; to purchase supplies, equipment, food, and clothing; to pay outstanding accounts to merchants for professional service; to pay rent on farms, and to invest the loan proceeds at a profit.

Fifty-five years later in 1976, other than the agricultural undertone, little had changed about policy loans and their most commonly stated uses. Policyholders used loans for short-term and long-term borrowing. With cash value so accessible at a competitive interest rate and confidential in nature, policy owners utilized it for short-term needs such as policy premiums, taxes, business inventories, vacations and a myriad of other uses. Short-term borrowing often turned into longer-term borrowing because there was no pressure to repay. Policy owners commonly used policy loans for long-term uses as well such as paying for a new home or starting a business. And, like their counterparts fifty-five years prior, they articulated a desire to borrow against cash value at the policy loan rate and invest elsewhere at a higher rate. Many Paradigm Life clients value the strategy for the very same reasons.



MODERN CONCEPT OF POLICY LOANS

As previously mentioned, policy loans and their many uses have changed very little over the past 100 years. Today, Paradigm Life clients still value:

- **Accessibility** – Cash values are easily accessible through policy loan (see below);
- **Guarantees** – Cash values (and therefore policy loans) are guaranteed to be there when needed;
- **Competitive Interest/Terms** – Policy loan payback rates are competitive with loan rates generally, but with more favorable terms (i.e. interest only, open-ended repayment term, etc.);
- **Privacy/Confidentiality** – You are not required to disclose the loan purpose. You use it how you choose to;
- **No Collateralization/Securitization** – Unlike traditional lenders, the insurance company does not collateralize or take a security interest in the item purchased even if the item is one which would otherwise be collateralized (i.e. real estate, cars, equipment, etc.);
- **Line of Credit** – As you repay the policy loan, the unencumbered cash value can immediately be re-used (similar to a line of credit).

The Policy Loan is an integral part of The Perpetual Wealth Strategy and Paradigm Life has simplified the process of requesting a loan to a few steps. To request a policy loan, our Client Relationship Specialists are there to assist you. You may also inquire directly with the insurance company or visit their online portal.

Historically, policy loan proceeds are sent to you by check within approximately 5-10 business days. Today, however, most insurance companies offer EFT of loan proceeds. With EFT capability, funds are available within a matter of a few business days.

BEST PRACTICES

The Perpetual Wealth Strategy is comprehensive. The first step is establishing *The Wealth Maximization Account* by structuring a whole life policy in a way that maximizes growth. The second step is utilizing The Policy Loan in two ways: (1) in place of usurious interest and fees charged by a bank; and (2) to acquire additional income-producing assets. The newly created income should be used to repay the policy loan.

The success of the strategy requires discipline and accountability. R. Nelson Nash, the author of *Becoming Your Own Banker,* used the analogy of a grocery store owner. If the store owner is in need of a can of peas, he is free to come in through the back door and take it off the shelf without paying for it. This , however, results in one less can of peas that could have been sold to a paying customer at full price. More cans of peas must be sold to make up for the lost income. The store owner must value and respect his inventory. The failure to do so results in long-term consequences to the profitability of the business. Although the policy holder owns the "store," it is detrimental to business to take a policy loan without repaying it.

Below are actual scenarios and recommended best practices:

ONE The Policy Loan as an alternative to Cash/Credit Replacement

Use – Saving for vacations, larger purchases, college, emergencies, home repairs, etc., results in an opportunity cost. You earn no return on the cash you save and dipping into credit can be expensive. A policy loan, however, allows you to take the vacation, pay for college and make repairs or purchases while at the same time earning a competitive return on the accumulating cash value. A policy loan eliminates the opportunity cost associated with cash or credit.

Best Practice – When used as a cash/credit replacement, a policy loan should be repaid at the same rate and on the same terms as the alternative. For example, if a vacation was charged to a credit card at 15% and repaid over ten months, the policy loan is likewise repaid with the excess payments added to the PUA rider or another policy. Choosing not to repay the policy loan in this context is inconsistent with principles of The Perpetual Wealth Strategy.

TWO Investment Capital

Use – Leveraging the policy loan against the accumulating cash value for investment purposes is known as velocity. Velocity is the growth of your Wealth Maximization Account and the growth of the investment.

Best Practice – When used for an investment purpose, the policy loan is repaid using the return generated by the investment. For example, if a policy loan is used to acquire a rental property that generates income, after expenses, of $500 per month, that amount is directed to pay off the policy loan. The result is the growth of the cash value during this period as well as the return generated by the asset. As the policy loan is repaid, the newly unencumbered cash value is used for future opportunities.

THREE Family Use

Use – In a family setting, the strategy can be a unique and effective way to teach financial principles to children. The Wealth Maximization Account in this scenario is the "family bank," a source of capital used to replace cash/credit.

Best Practice – As with capital obtained from a traditional lender or other source, funds from the "family bank" are valued, respected and repaid accordingly. Before approving a policy loan for family use, the objective of the loan is discussed, vetted, and a repayment strategy determined. The loan is properly documented with a loan summary and amortization schedule and tracked for teaching and accountability purposes. Remember, do not steal peas.

FOUR **Business Use**

Use – In a business setting, a policy loan can be used as a substitute (partially or entirely) for third-party financing. With competitive rates, far more favorable repayment terms and equally favorable tax benefits, a policy loan made to a business can be used as a replacement for cash/credit or for investment purposes.

Best Practice – Policy loan proceeds should be valued and respected as though they were obtained from a traditional third-party lender. The loan should be properly documented and terms made clear through a promissory note (and trust deed, if necessary). An amortization schedule should be created to track repayment and can provide additional evidence of the existence of the loan if necessary. Flexibility of repayment is a tremendous benefit; however, again, do not steal the can of peas.

Regardless of the loan strategy employed – cash/credit replacement or investment capital for family or business use – the system should be properly organized and each policy loan tracked. Insurance companies allow policy holders tremendous latitude with respect to policy loans. This freedom makes accountability to the system even more critical. The following are vital ways we can organize, track, and maintain accountability:

ONE **Clearing Account** – A Clearing Account is a separate checking/savings account. For organizational, tracking, and accountability purposes, policy loan proceeds should not be comingled with personal funds. Rather, when a loan is requested, proceeds should flow into the Clearing Account first. Once there, loan proceeds can be deployed directly for investment, or transferred to personal accounts as necessary. Loan repayments should pass through the Clearing Account first and then back into the policy. Passing loan proceeds and repayments through the Clearing Account keeps transactions clean and organized; and, it provides a paper-trail should proof of repayment be necessary.

TWO **Loan Summary** – Because insurance carriers do not separately document or track each policy loan, a summary of each loan should be kept by the policy holder. The Loan Summary form (which can be found at www.paradigmlife.net) allows the policy holder to describe the purpose of the loan, the amount, when it was obtained, and how it is intended to be repaid. A separate file (physical or electronic) should be kept for each policy loan along with the Loan Summary.

THREE **Promissory Note & Amortization Schedule** – A Promissory Note describes the terms of a loan made between individuals or business entities. If a loan is made to a business for a business purpose, the Promissory Note is critical for legitimizing the loan should proof ever be necessary. An Amortization Schedule provides structure and organization relative to repayment of a policy loan. In addition, where a policy loan is made to a business, the Amortization Schedule can provide additional evidence of the repayment terms outlined in the Promissory Note should it become necessary.

FOUR **Financial Statement** – For many, the only time they take an assessment of their income relative to expenditures and their assets relative to their liabilities is once a year at tax time. Do not fall into this habit. Keep accurate and up-to-date family financials. Know your income and track your spending. Stay organized financially. As policy loans are properly organized and tracked, they can easily be incorporated into your Financial Statement.

There is power and wisdom in the statement, "When you track your money, you control it." Now that your policy is approved and funded, create the proper framework so that your money can be organized, tracked and, most importantly, controlled.

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Life is not always easy, predictable or fair. As a result, we may experience financial setbacks. Sometimes a financial setback is temporary – maybe we are between jobs, experiencing a temporary reduction in income or are faced with an unexpected expense. In these cases, the policy, as the keystone of our overarching financial system, provides us with options to overcome temporary setbacks.

Policy Loan – if a policy loan is outstanding and the policy holder is no longer able to meet the terms of the loan previously agreed upon in the Promissory Note, the policy holder has options.

a. "Refinance" Policy Loan – Although not required by the insurance carrier, the policy holder's "system" could permit a loan to be refinanced to more favorable terms. The term of the loan could be extended, for instance, to reduce the repayment amount. This "refinance" could be temporary or permanent depending on need.

b. Interest Only – Although not required by the insurance carrier, the "system" could permit the policy holder to make interest only payments towards the loan. This should be viewed as a more aggressive temporary solution and should only last long enough to permit the temporary financial setback to resolve itself.

c. Temporarily Stop Loan Payments – Although not required by the insurance carrier, the "system" could permit the policy holder to stop making loan repayments altogether. Payments previously being made towards the loan could be used instead to help cover more critical financial needs until the financial setback is resolved. Stopping repayment results in interest accruing against the outstanding loan balance, but can buy some much needed time for the policy holder to get back on his/her feet. This is the most aggressive temporary solution and should only last as long as absolutely necessary.

Policy Premiums – a temporary setback may result in the policy holder being unable to meet their policy premiums. Here, again, the policy holder has options.

a. Pay Base Only + Minimum PUA – Most policies we build include flexible PUA riders. If the entire premium cannot be made, the policy holder can in most cases reduce their premium pay-in to include only the base premium. Generally, most of the total policy premium is PUA. Therefore, reducing to base premium only will minimize the amount of premium paid into the policy thereby providing some temporary relief.

b. Change to Monthly Premium Mode – Most insurance carriers will allow the premium mode to be changed. A policy holder on an annual premium mode and faced with the prospect of paying the entire annual premium can find relief by adjusting to a monthly pay-in. The monthly premium mode does not impact the coverage amount, but can spread the base premium obligation out resulting in smaller, extended pay-ins.

c. Use Cash Value to Pay Base Premium – Accumulated (non-leveraged) cash value can be used to meet base premium obligations. To avoid a reduction in cash value and coverage amount, a policy loan should be used to cover base premium rather than a partial surrender. This is an aggressive temporary solution and should be used only until the financial setback is resolved.

The unfortunate reality is that sometimes temporary financial setbacks can become longer-term or even permanent setbacks. Even in these more extreme and much less-likely scenarios, the policy holder may have options.

Explore Temporary Solutions First – In situations involving long-term or permanent financial setbacks, the policy holder should explore all relevant temporary solutions first. Temporary adjustments relative to policy loan payback or premium payment mode do not permanently modify the policy.

Explore Modification Options w/Carrier – In some cases, insurance carriers may be able to adjust policy coverage amounts. Reducing coverage, if possible, results in a reduction in policy premium. This should be viewed as an aggressive permanent solution to be used as an alternative to policy surrender.

Policy Surrender – Surrender of the policy should be viewed as the last resort in a worst case scenario. In the event of surrender, any unencumbered cash value is refunded to the policy holder. Surrender of the policy may result in a tax consequence (on any gains) and will eliminate death benefit coverage.

CONCLUSION

At Paradigm Life, we are committed to providing value to our policy holders long after the policy is issued and funded. If you have any questions regarding the Best Practices described here or if there is anything else we can do for you, please do not hesitate to contact us.

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