# Why EVERYONE Should Own an IUL

After talking to hundreds of people over the years, it has been my experience that most of them don't understand how money works. It's definitely not something they have been taught, and very few of them are going to learn it well on their own.

I would like to share some simple information with you to help those who are interested in becoming financially independent or at the very least learn the basics about how money works. The following are key money concepts you should know and be teaching your prospects and clients every chance you get!

1. **Average Versus Actual Rate of Return**

When money is making money, a key principle to know is the difference between an average rate of return and an actual rate of return. It is surprising how many people don't know the difference between the two.

Here is a quick example to teach you the difference. Say you start with $100. By the end of a year it grew by 100%; you would have $200 at the end of the year. The next year you lose 50% of your money. You $200 is now back down to $100. What was your actual rate of return? Zero, right?!

You started with $100 and you ended with $100. But what was your *average* rate of return? The first year you made 100%, the second year you lost 50%. Subtract 50% from 100% and you have 50%. Divide that by 2 (because of the two years), and your average rate of return is 25%. Did you earn 25%? No. You earned 0%. That is the difference between average and actual rate of return.

Knowing this fundamental is important. Knowing the difference between the actual rate of return on an investment, versus the average rate of return will better prepare you when you are planning how and where to grow your money in the future.

2. **Know the Rules of Money**

Financial institutions follow rules that make them profitable. It took them a long time to learn the rules, and the rules work extremely well if followed. Do you remember the first time you played Tic Tac Toe? You probably played it with a parent, a brother or sister, or a friend. Did you win the first time you played? Probably not. It wasn't until you caught on to the rules that you started to win. Handling money is no different. No matter how hard you try to get ahead, you will struggle until you follow the rules.

Here are the two Money rules you need to follow that will give you a fighting chance to win at the game of money:

#1 – Protect your capital
#2 – Always manage your cash flow

Sounds simple enough, and it is, but you need to know how to protect your capital and when to manage cash flow. For most of us, we need to keep it simple. We don't want to spend much time managing our money, and we don't want to spend any time worrying about it.

3. **Never interrupt compounding**

This one is a little more complex, but it doesn't have to be. Albert Einstein said compounding interest was the 8$^{th}$ wonder of the world. Those that understand it, earn it, and those that don't pay it. This rule, if mastered will surely make you financially independent. Tic Tac Toe, three in a row…

### 4. The Baking Soda of the Financial World

You need a place to put your money where it can do multiple things. It's kind of like baking soda. Do you know all the wonderful things baking soda can do? Add it to a little vinegar, and it will eat the corrosion off a car battery. Mix it with water and you can brush your teeth with it. Put it on a damp sponge and you can wipe the bugs off the front of your car and not damage the paint. Place an open box of it in the refrigerator and it will absorb all the bad food odors. Oh, and it works great for baking too!

What would be optimal for most American families is to have a single financial product that can do multiple things. The baking soda of the financial world, if you will, a financial product that simplifies everyone's lives and serves all the main purposes we need our money to serve but without complexity or constantly having to manage it.

I found this product. It wasn't at all what I was expecting to find. Most important, very few people understand just how powerful it is.

The product I'm talking about is a life insurance product, but it isn't what most would think of as a life insurance product. It is a specific life insurance policy called an Index Universal Life policy. The Life insurance industry has designed many different life insurance products over the past two hundred years; some have been better than others. Let me list the common types of policies available today:

#1 – Term Life
#2 – Whole Life
#3 – Guaranteed Universal Life
#4 – Variable Universal Life
#5 – Index Universal Life

Each one of these life insurance policies were designed with a specific purpose. I won't bore you with all the applications. However, here is something important to know about these contracts: four of the five life policies have a cash value. The exception is a Term life contract. There is no cash inside a term life policy. But here's the important point: all the money inside these other policies (the cash value) are tax favored. What does that mean? According to the IRS rules, you can grow money inside these policies and not be subject to income tax on the gains. You can also distribute this money for any reason you want, when you want, and not be taxed on the distribution.

Having the ability to grow money *tax free*, and distribute money when you want it *tax free* is a vast advantage when it comes to accumulating wealth.

Most people, and I mean just about everyone I've ever advised about managing their money, are dealing with two large detriments in their financial planning: 1) their current or future taxation has no predictability, and 2) the market risk they face also has no predictability.

I equate these two detriments as two large holes in your bucket of money. You keep dumping money into a bucket, and these two holes just keep leaking it out, lost forever. Sometimes without you even realizing it.

I've talked with people who showed me their retirement plan's annual statement, and say they didn't lose any money that year because the balance was very close to the same from the previous year. What they fail to realize is they spent money funding their retirement account for the entire year, but the balance had not increased. They *lost* money. This happens way too often to good folks who are trying to prepare for retirement. (And this breaks rule #1 of the 2 money rules—protect your capital.)

## 5. Arbitrage

The word *arbitrage* is a funny sounding word; we don't hear it in our day to day conversations with others. Yet it is the most powerful financial concept we can use to build wealth. It is the number one concept used by banks and other financial institutions to create enormous wealth. I often wonder why this concept isn't taught to our kids in school. It's one of those rules about money that if you learn it and use it, your chances of becoming financially independent becomes almost a certainty.

The US banks have an advantage the average person doesn't. They can borrow money from the Federal Reserve at very lows rates, and then turn around and loan those dollars to ordinary working class folks at a higher rate. For example, the bank can borrow money at .50% on the dollar. They then loan it out at 4%, 5%, 6% or even 8% depending on your credit score. That means that they are making anywhere from 3.5% to 7.5% on the money they have loaned you after they pay the Federal Reserve the .50%.

Then, they have an additional advantage over us average folks. The US banks can borrow *ten times* the amount of money they have in holdings. If they have $1 million in holdings, they can borrow $10 million from the Fed. It's called fractional reserves. So, if you and I put our monthly pay checks in the bank, the bank can multiply our average balance by a factor of 10, borrow that amount from the Federal Reserves, and loan it out to customers. They do it all the time with credit cards, car loans, or lines of credit.

Borrowing at a lower rate and earning a higher rate on the borrowed funds is call *arbitrage*. And it is almost always done by using someone else's money, what we usually refer to as OPM – Other People's Money. OPM is a derogatory term, but in the case of the US Banks, OPM is *our* money, and the banks are leveraging *it* (not someone else's money) with the Federal Reserve Bank.

Why is all this so important? These are the known rules and concepts that are used every day by financial institutions. People who understand the rules to create wealth win in the game of money. If you don't learn and use the rules, you don't have a chance. Worse, you will be swallowed up by those that do.

## 6. The IUL Creates Arbitrage

The average American family owns a house, and (hopefully) puts a little bit of money away each month for retirement savings, or college funds for their children, or maybe a little in both.

I would guess around 50% of these American families are also paying for some type of life insurance policy. The typical life policy I see is a term life insurance product, and it has a death benefit of $100,000 to $500,000. It concerns me when I hear about couples with children, and the main bread winner doesn't have a life insurance policy to protect the family in case he or she dies prematurely. In most cases when there is a term-life policy in force, the death benefit could only sustain the family for two to three years before the family would be out of money. In our county half of our households have no life insurance, and the other half is basically under insured.

Here is the deal, you can have your cake and eat it too! The Index Universal life policy I spoke about earlier can do some amazing things when it is designed right. The good news is, it doesn't take a rocket scientist to design it right. It only takes a good life insurance agent with common sense and a client who wants a simple financial product that does just about everything you can imagine a financial product should do for the average American family.

I have spent a lot of time explaining all the benefits the Index UL life policy provides in various webinars and in my book, *My Family Financial Miracle*. I'm not going to go into the details, but it is important to recap the important things you can do with this product:

#1 – Grow money tax advantaged and distribute the funds tax free.

#2 – The cash in the policy participates in the upside of the market but doesn't participate in the down side.

#3 – The actual return, not the average return, of these policies has been 6% tax free over the last 15 years.

#4 – The cash in the policy is liquid; you don't have to wait until your 59 ½ to access the savings.

#5- The cash in the policy can be collateralized (meaning you can borrow against it), unlike an IRA, 401(k) or Stock or Bond or Mutual fund.

#6- The cash is creditor protected and can be used for whatever reason.

#7 – If you prematurely die, your financial plan is self-completing.

But my favorite thing about the Index Universal Life policy—it is a great side fund to be used to create an arbitrage. Remember the two money rules: protect your capital, and manage your cash flow. The IUL is the perfect financial product because it automatically helps you follow the rules.

7. **The Mortgage Master Move**

One of the most powerful ways I have used the arbitrage in my IUL is to manage my mortgage effectively.

Here's what happens (I will use round numbers so it is easy to follow the concept):

My primary home is financed using an interest only loan. The rate for the loan is adjusted monthly, and it is tied to an index called the LIBOR. This month, the LIBOR index is at .50% and the bank's spread on the index is 1.50%. The bank adds the 1.50% spread to whatever the LIBOR index is at the end of each month. Whatever the LIBOR index is, the bank adds the spread of 1.50% to the index value each month.

My current rate is the LIBOR .50% plus the 1.50%. That equals 2%. The index changes monthly, the spread is constant.

The rate has been as low as 1.50% when the LIBOR was at 0%, and as high as the current 2% rate. I've used this loan for the past ten years. We can talk about the risk and reward of this concept later. Just believe me when I say, if you want to pay off your house quickly, this is the best way to do it using the same amount of cash flow. After I share how this works, you may not ever want to pay off your home.

I will use a $250,000 loan to demonstrate how using the Interest Only loan and the Index Universal Life policy creates an arbitrage and grows wealth. In other words, you can take advantage of this concept just like the US banks do.

10 years ago, a 30-year fixed mortgage had a rate of 5.25% and a monthly payment of $1,380 on a $250,000 loan.

The Interest Only payment average monthly payment was $300. Subtract that $300 from $1,380 and you have a difference of $1,080 per month.

$12,960 is the annual difference between the 30-year fixed mortgage payment and the annual Interest Only payment.

By putting this $12,960 difference in an Index Universal Life policy, I would have enough cash ($250,000) in the policy in year 13 to write a check to pay off the interest only loan. Keep in mind I am simply managing my cash flow; the annual cost is the same. The amortized loan is reducing the debt, the Interest Only loan is not.

Let's look at this another way. If I had a 30-year loan, in year 13, I would have a balance of $180,000 on the loan but no money in an IUL. If I use an Interest Only loan, I would owe $250,000 to the bank by the thirteenth year on the Interest Only loan, ***but*** I have $250,000 in cash in the Index UL policy making 6%.

So, let's look at year 13. I owe the bank 2% every year to use their $250,000 to live in my house. However, that 2% is offset by the money I have accumulated ($250,000) in my IUL policy. It's making 6%. It gets better. My real cost for the year to use the bank's money is $2,750, which is less than 2% of the $250,000. This is because mortgage interest is tax deductible. Because I'm in a 39.60% federal tax bracket and a 6% state, I can write off 45% of the cost of the mortgage interest.

Meanwhile, my earnings on the $250,000 in the IUL are 6% or $15,000 income-tax free for the year. The arbitrage is $12,250, the difference between what I have to pay and what I earn. And because this money is growing in a compounding environment that is never interrupted, it will just continue to increase each year. Five years from now the cost on the Interest Only loan will be close the same, but my *earnings* will jump to $19,000.

Now at what point would I want to take the $250,000 out of the IUL side fund and pay off the house? The smart answer is probably never. I would just use the interest earned to pay the bank the cost of using their money and continue to get the tax-deductible expense. Let me rephrase that. If I never pay off my mortgage and continue to build this side fund, I will be able to enjoy the mortgage tax deduction while at the same time continuing to make money on my money. Who wouldn't want to do that?

This is why I say you can create true wealth when you understand the rules. This one strategy over a 30-year period would create about $1.2 million dollars' worth of cash for retirement. I didn't have to do *anything* different than what I was normally doing—spending the same amount of money that I would be spending on a mortgage. The only difference: I followed all the rules. I never interrupted compounding and I am protecting my capital. That capital isn't in the brick and mortar of my house; rather it is liquid in my cash account. I am managing my cash flow optimally, and I've created a productive arbitrage.

The Index Universal Life policy really is the Baking Soda of the financial industry. Managing mortgages is just one of many different applications this financial product can be used for. The beautiful thing about it is, it's simple. You can have one product to put money in that can be used for:

College planning
Retirement planning
Capital Investing
Building a business
Estate planning
Asset protection
Collateralization
Arbitrage
Second Home or Large purchases like a boat or RV
Oh, and it's a great life insurance policy too! It self-completes with the death benefit.

What you can do with an IUL is practically unlimited and I believe it should be the financial foundation of the average American household. I hope this was helpful to give you some ideas on how you can better manage your money and become financially independent. It is my way of saying "Happy New Year!" and may 2017 be your most prosperous.

Merle Gilley