The following excerpt has been taking from Roccy DeFrancesco's book Retiring Without Risk.

VARIABLE LOAN OPTION IN EIUL POLICIES

As I discussed previously in this chapter, after you build wealth/cash in a life insurance policy, the preferred way to remove the cash for use in retirement is through a policy loan (also referred to as tax-free retirement income).

While everyone in the industry thought "wash" loans were revolutionary as a way to allow clients to more conservatively pull larger amounts of cash out of their policies, when the new variable loans feature came out, that really excited those in the insurance industry.

As you'll recall, if you borrow money from the insurance company from your policy, the insurance company will charge you interest on the loan which is due every year. If the policy has a wash-loan feature, the crediting rate on the cash in your policy will mirror the interest rate on the money borrowed from the life insurance company; and it's a wash/neutral transaction for the insured.

A **variable loan** option allow the insureds to play the market a little by allowing the cash in their policy to grow with the equity markets and borrow money from the insurance company at whatever the fixed interest rates happen to be at the time of borrowing.

If the cash in your policy grows at a higher rate than the lending rate, you actually **make money on the money you borrowed** from your policy.

Let's say the lending rate today in your policy is 6%. Unlike a wash loan where the cash in the policy would be credited with a return of 6%, with a variable loan, in any given year, the insured has no idea what the investment return will be in the policy.

If you purchased an EIUL policy, the growth in the policy is pegged to the S&P 500. If S&P 500 returns 10% in a year when there is a loan on the policy with an interest rate of 6%, the insured

has a positive arbitrage (meaning the cash in the policy had a 4% positive return on the borrowed funds).

Conversely ─ if the S&P 500 goes negative (which in most EIUL policies will earn a return of 0-2% in that particular year), your policy is still charged with a loan where the rate is 6%. What that means is that in the year when the S&P 500 underperforms the interest rate on the loan, the principal cash in the policy will have to be invaded to pay that interest.

Better Potential for Growth

The reason you should consider using a life insurance policy with the option of using a variable loan is because IF borrowing rates and the S&P 500 perform as they have over the last many years, you should actually make money on the money borrowed from your life insurance policy.

How? As stated in the previous example, if the borrowing rate on a loan from your policy is 6% and the life policy which pegs the growth of the S&P 500 earns 10%, you have a 4% positive arbitrage on the cash in your policy.

Historically, the S&P 500 has returned in excess of 2% more per year than the borrowing rates used for loans. Will that trend continue? Most likely it will over the long term, although as you know: "Past performance is no guarantee of future performance."

A new twist to variable loans

I update this book periodically and since its first release in 2009, a company has rolled out an EIUL that removes the variability of variable loans.

What do I mean?

One company's policy contractually offers insureds participating variable loans with a **maximum lending rate of 5%**. This is a significant positive addition that will make buying an EIUL policy an even easier decision.

If lending rates in policies increase by 1-2-3% over the next 10-20-30 years, the increase will not affect the lending rate on loans in this newly released product.

In the next chapter I will illustrate the power of using an EIUL policy with a maximum lending rate of 5%.

It's tough to really get a feel for how a positive arbitrage on a loan can benefit you when you start borrowing from your policy. To help crystallize the benefit, I created a life insurance illustration with wash loans and variable loans to show you the difference.

Example:

Assume in my example that the client is male, 45-years old, and in good health. Assume he will fund $10,000 a year into an EIUL policy for each year until he turns 65 and then will borrow "tax-free" from his policy from ages 66-85. Assume the average S&P 500 returns over the life of the policy are 7.9%. How much could he remove from his policy with wash loans and how much from a variable loan where the interest rate spread is a positive 2%?

If the policy used wash loans where the interest rate is 4.25% and the crediting rate on the cash at the time of the loan is also 4.25%, the client could borrow **$38,724** "tax-free" from the policy every year from ages 66-85.

If the policy credited on average 7.9% a year as a credited amount on the cash value AND the interest rate is 6%, the client could borrow **$57,421** from the same policy from ages 66-85.

I'm not so sure that it is wise to assume there will be a 2% spread on average between what the S&P 500 returns and lending rates at the time loans are accessed from a life policy. I also do not believe that the S&P 500 over time will return less than what lending rates are when an insured borrows from his/her policy.

Typically, when I run illustrations like the majority you'll see in this book, I manually changed the interest rate on the loan to equal whatever the assumed crediting rate is. In this example, the assumed crediting rate is 7.9% annually. Therefore, if I used a 7.9% loan interest rate, how much could this same client borrow

from his life insurance policy? **$46,561** every year from ages 66-85.

I personally have no idea what the S&P 500 will do or what lending rates will be like in 10-20-30 years. What I simply want to do with my illustrations is come up with something that is not over-the-top aggressive and not pathetically conservative.

I also want to make sure readers understand how life insurance agents can manipulate illustrations to make them look very good based on the best of all worlds. I'll do more of this in an upcoming section when I show you an illustration at what many in the life insurance community think the S&P will return in an indexed life policy.

Further Protection

I alluded to an EIUL policy which credits 140% of what the S&P 500 returns every year. I like this policy when discussing the variable loan issue, and I think with an illustration you'll see why.

Assume the interest rate on a loan from a life insurance policy is 6%. In most policies, if the S&P 500 returns say 4.5%, the insured is going to go backwards by 1.5% in the policy due to the fact that the return is less than the interest rate (the client would have been better with a wash loan). If the insured had a policy that credited 140% of what the S&P 500 returns, the insured would have been credited with 6.3% in the policy and would have done slightly better than a wash loan.

Carrying that forward, what if the S&P 500 returned only 3%? The client would be upside down 3% if the interest rate on the loan were 6% in a normal policy but would only be upside down by 1.8% in a policy that credits 140% of what the S&P 500 returns.

My point is simply that the 140% crediting policy allows for more security for the client and better growth for clients who think the S&P 500 is going to be flat for a period of time.

Summary on variable loans

Variable loans are a good option to have in a policy. When buying a policy with a variable loan option, you can choose each year that you borrow from the policy whether to use the variable option or the fixed wash loan option. The more options the better. Also, if you want to protect yourself when purchasing cash value policies, it is recommended that you consider using the policy with a maximum lending rate of 5% which also allows you to move your money when in the borrowing phase to the 140% crediting method.