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An Unfortunate Life Insurance Policy Loan Conversation

What your client doesn't know certainly can hurt him.

Bill Boersma | Feb 13, 2020

Life insurance policy loans trip up more people than I thought could ever be possible. It's not because they're so complicated but because they aren't properly explained to most policy owners. Worse yet, many policy owners don't even know they have loans on a policy and when they do, don't understand how they got there. This sounds so ridiculous it defies belief.

Consider this: A policy owner recently called me after his attorney sent him a copy of something I'd written about policy loans. "This story could be about me," he exclaimed. I asked him to send me what he had and explain what he was trying to accomplish. Included was a list of questions he had for his agent, of which the agent answered the simple and inconsequential ones and ignored the balance. It was easy to understand why, as the balance of the questions had no answer that any agent would want to share with a client.

Here was one of the questions: "When I first talked to you years ago, you indicated that I could borrow my own funds at a 1% to 1.5% interest rate, so how did the loan get to over \$700,000 when I only borrowed about \$175,000 and paid back \$225,000 at one point." I imagine that would be a good question.

It's fortunate but sad that I knew the answer before I opened the attachments because this isn't the first or last time I'll see this. I'll recreate the conversation:

A Conversation

Me: *Hey Doc, thanks for the info. So you want to know why the policy loans you started taking in only 2006 have grown to such a huge number?*

Him: *That would be nice to know.*

Me: *Did you know that when you "first" took your loan in 2006, you already had a hundred grand of loans on the policy?*

Him: *Excuse me?*

Me: *Oh yeah, your policy was already taking "secret" loans for years before you ever knew it.*

Him: *Please explain.*

Me: Your policy was set up to automatically loan you the premiums when you didn't pay out of pocket. That can fundamentally be a good thing but only if you're aware and understand how it works.

Him: I thought the premiums were coming out of cash value.

Me: If only it were so. In a way they are, but in another very important way they aren't. The premiums have been loaned to you for years and accumulating interest.

Him: You're kidding me!

Me: I kid you not.

Him: Even so, how on earth did they grow to such a level?

Me: 8% is a pretty steep borrowing rate.

Him: 8%? I was told I was borrowing at ridiculously low rates, that I was borrowing my own money and given the crediting, taking advantage of a very low spread.

Me: I think I'm honing in on the problem.

Him: What problem?

Me: You really want me to say it?

Him: Yes

Me: You was snookered. That's not even close to how this thing works. Your agent is either an idiot or he outright lied to you. By the way, I see that you just took out another \$66,000 in loans this past year.

Him: I most certainly did not!

Me: You most certainly did too!

Him: Ok... explain.

Me: Your policy auto-loaned you another \$32,000 in premium plus accrued another \$34,000 in loan interest. In just 10 years, your loan will break \$2 million. What do you think about that?

Him: THIS IS A FAMILY FRIENDLY FORUM SO THIS PART HAS BEEN REDACTED. SORRY, IT WAS VERY COLORFUL.

It doesn't have to be this way. The issue of life insurance and policy loans is very complicated in some ways but exceedingly simple in others. It's a matter of whether one understands how they really work or not. Unfortunately, not understanding can have murderous consequences. While sales and marketing is built to sell, it's not always built to explain, and therein lies the value of objective counsel.

Bill Boersma is a CLU, AEP and LIC. More information can be found at www.oc-lic.com, www.BillBoersmaOnLifeInsurance.info, www.LifeLoanRefi.com and www.XpertLifeInsAdvice.com or email at bill@oc-lic.com.