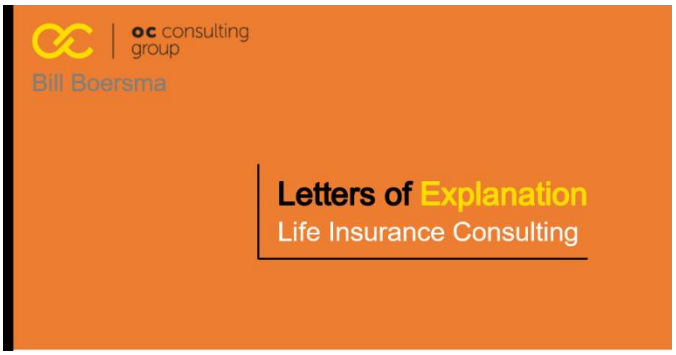
Dear Mrs. Client:

Last week I promised you some numbers to put into perspective my thoughts that premium financed Indexed Universal Life isn't what you think it might be.

The spreadsheet you showed me some time ago assumes an annual loan of $700,000 for 13 years. This is used to purchase a policy that assumed roughly a 7% annual crediting. This may sound conservative for an S&P 500 Index return but it isn't if you understand how Index funds work. A significant issue is that the dividends aren't included in the return and historically dividends make up at least a couple hundred basis points of the return and sometime 500 basis points. There are entire decades where the dividends are greater than 50% of the return of the S&P 500.

When you take dividends out, a reasonable return is much lower. There is independent modeling that suggests that to credit 7% on an Indexed policy the Index would have to actually return 10%-12%. Also, the insurance ledger assumes level returns year in and year out. We know that isn't going to happen and the inevitable variability in returns may dramatically affect the performance of a policy.



Finally, we're now at the tail end of the longest bull market in history. Is this when you really want to go into an equities based contract? If we model a policy with a few years of down or flat numbers, the policy performance will look dramatically different.

Finally, to put some numbers to it, the ledger you were provided shows a return on premiums to cash value at negative 2.34% after year 5. It's 3.65% at year 10 and 4.88% at year 13 when premiums are scheduled to terminate. This is all assuming the policy is actually crediting at 6.96% every year from year one. This shows how steep the early expenses are.

Per the ledger, if everything works out perfectly, which it won't, in 20 years the cash value will be $21,395,000 and this will be used to pay back the loan of $20,156,000. That is a pretty tight margin. Furthermore, the commercial loan is paid back by a $20,000,000+ loan from the policy so you still have a loan but it is from a different place. And it keeps accumulating at interest. 10 years later the policy loan has grown to $32,833,000. If the policy didn't perform as projected and it collapsed with that loan on it, which is a possibility, you would own ordinary income tax on $23,733,000 of phantom gain. This is money (forgiven debt) you would have to pay income tax on when the policy has $0 of net cash, hence the term "phantom gain".

If everything doesn't pan out as expected, your interest expenses and collateral requirements could increase as well.

~~This is what I promised to relate and I'll move forward on some other ideas now.~~

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