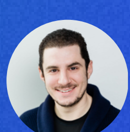
FORTUNE *or* FICTION

Why the ***'Be Your Own Banker'*** concept is flawed



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‘Recapture’ your interest and receive ongoing dividends for life. Sounds good, doesn’t it?

I get asked about Infinite Banking (IBC) and the Be Your Own Banker (BYOB) concepts on a weekly basis by prospective and existing clients. They’ve heard claims about receiving uninterrupted ‘infinite’ income by purchasing a life insurance policy, specifically, a Participating Life Insurance (PAR) policy. They have dreams of ‘becoming their own banker,’ and want to ‘get the bankers out of their lives.’ Ideally, they want to gain full control over their finances, retire early, and live the good life thanks to savvy planning.

As you can probably guess, it’s not that simple.

If it was easy to earn uninterrupted dividends, more people would be doing it. But the truth is, these claims of infinite income rarely stand up to scrutiny: data doesn't lie.

I'm not new to the insurance industry; I've been selling life insurance for more than a decade. More and more, I have clients coming in asking about PAR—they've seen an Instagram influencer or TikTok reel promising dividends for life and want to get in on the action. It's no wonder they feel like they've found the secret to a wealthy lifestyle. I have clients who heard a similar story (minus the social media) 20 - 40 years ago, and bought into the same industry claims. It's true what they say: history doesn't necessarily repeat itself, but it does rhyme.

Dave Ramsay, one of the most popular personal finance experts in the U.S., tailors his advice to the middle of the net worth spectrum, and calls whole life insurance the 'payday lender of the middle class.' After almost 15 years in this business, I'm starting to understand his perspective. Whole Life Insurance, specifically investment grade Participating Life Insurance, is a wonderful product when sold correctly. I'm happy I have it, and happy my kids have it, especially because it's a hands-off investment that can be leveraged. For the most part, insurance companies do pay dividends. When my daughter was born I purchased a $250k permanent PAR policy for $228/month. This year I received $700+ in dividends that were automatically reinvested; not a bad rate of return for doing absolutely nothing.

That being said, as great as these products are, let me be clear: a PAR policy should not be conflated with the 'becoming your own banker' and 'infinite banking' concepts — and I'll tell you why.

The theory is simple; take control of your banking needs and recapture the interest normally paid to banks, so you can pocket what the bank normally would.

> *"The essence of the process of Becoming Your Own Banker is YOU taking control of the entire banking function and creating a peaceful financial life for yourself, and generations to come."* (Becoming Your Own Banker, R. Nelson Nash)

The concept was created by R. Nelson Nash in the 1980s—the decade known for an economic boom before the inevitable crash. At the time, Nash was struggling to pay back high-interest loans he had received from commercial banks. In his 2009 book, Becoming Your Own Banker, Nash proposes 'Being Your Own Banker' (BYOB) and 'Infinite Banking' (IBC) as viable alternatives to traditional borrowing.

> *"The Infinite Banking Concept is all about recovering the interest that one normally pays to some banking institution and then lending it to others so that the policy owner makes what a banking institution does. It is like building an environment in the airplane world where you have a perpetual 'tailwind' instead of a perpetual 'headwind.'"* (Livingwealth.com, Summary of the book 'Becoming Your Own Banker' by R. Nelson Nash)

Nash's advice was to 'do what the wealthy do' and recapture your own interest, in turn creating your own banking system. The benefit seems obvious, and Nash's pitch appealed to people's insecurities about banking and financial institutions with simple rationale: when someone pays interest to a bank, that money is gone forever, and it shouldn't be that way.

The cost of using someone else's funds—in this case bank loans—is the interest you need to pay. Once you take out a loan, the interest you'll pay is gone forever, never to be "recaptured". With a PAR policy, using the "system" of life insurance, as the concept states, you can recapture the interest you pay to the bank (or any other financial services company) via the dividends that are paid out.

As the policy grows in value, you're building equity in your own "bank" via the annual compounding dividends you earn from your monthly premiums. As the plan is capitalized and grows over time, you can borrow against the increased value which, as is claimed, is the same as borrowing from yourself. With their simple pitch, interesting twist, and big promises, the BYOB and IBC concepts continue to gain popularity. After all, who doesn't want to 'be their own bank' and have 'infinite' money rolling in?

While the allure is undeniable, these concepts hurt the insurance industry, damage the reputation of life insurance, and create unrealistic client expectations.

For years, some advisors have been overselling Participating Life Insurance policies while ignoring the long-term realities of the clients they're meant to be helping.

It's time we changed things.

WHAT IS PARTICIPATING LIFE INSURANCE?

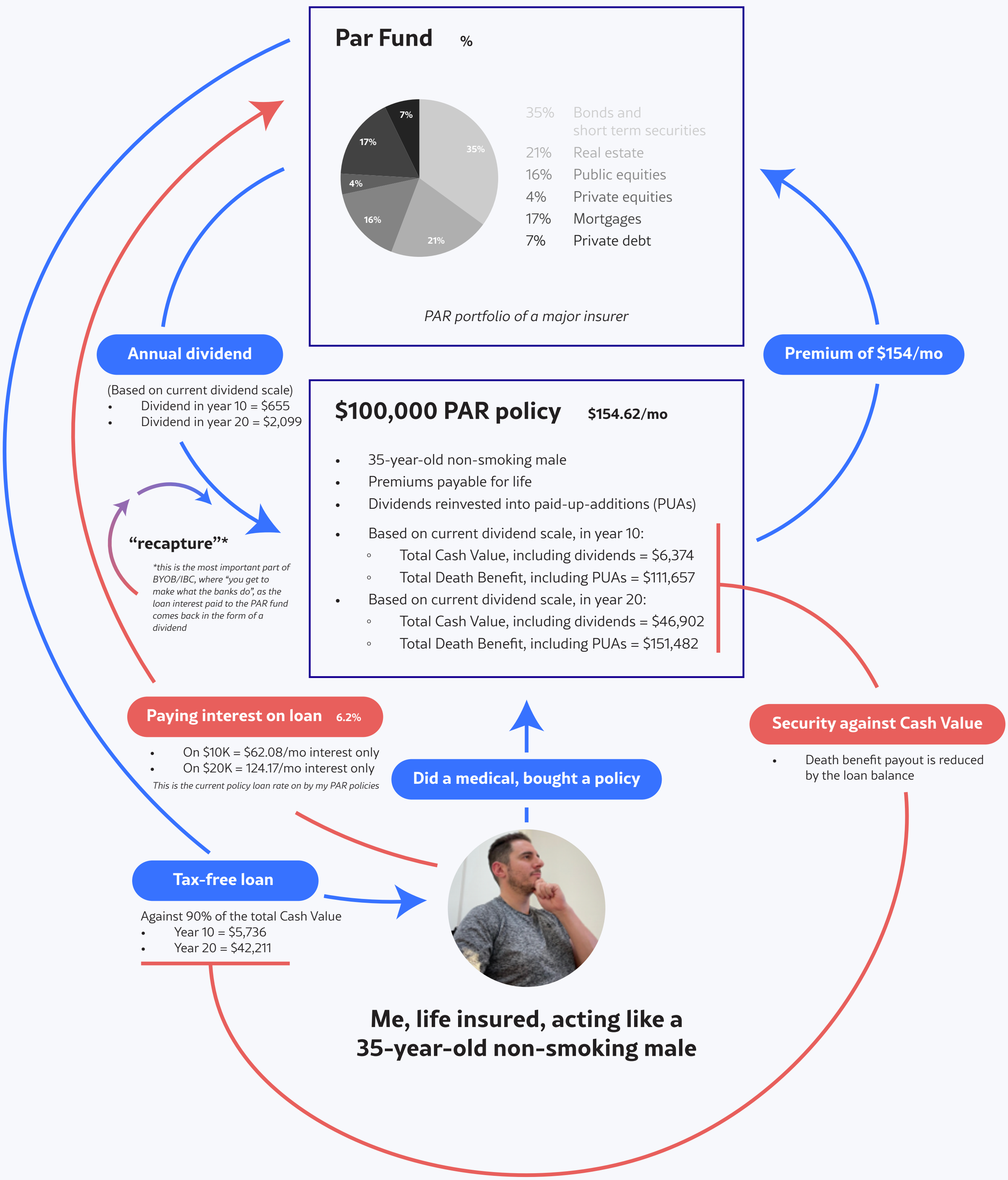
Let's back up.

Put simply, life insurance can be summed up into two general categories: term and permanent. Term insurance lasts for a predetermined period, usually 10 to 30 years. It's often purchased by people who have dependents and likely have large financial obligations, like mortgages, student loans, or families to take care of. They're expecting to have different needs by the time the term runs out and provides incredible short-term value; low premiums with a high benefit. Permanent insurance, on the other hand, is guaranteed to pay out a death benefit whenever the person passes, whether that's 10, 20, or 100 years from now. As long as the premium is paid, the benefit remains throughout the person's entire life; incredible long-term value. Participating Life Insurance—a form of permanent insurance— has a potentially fantastic investment component built right in.

If you're unfamiliar, Participating Life Insurance, better known as PAR, is a hybrid investment/whole life insurance policy where you're contributing more than the actual cost of the insurance—via your monthly premiums—into a designated fund; in this case, the insurance company's Participating (PAR) fund. Together with other participants, your money is invested by the insurance company within that fund —they choose where and how much to invest. In return, the insurance company pays annual returns in the form of a dividend, called a Dividend Scale Interest Rate (DSIR). Clients can choose to accept the dividend in cash, or reinvest them into the policy (known as paid-up additions, where the dividends buy more dividend earning life insurance) to continue increasing the policy's value on a tax-deferred basis. Top line, it sounds promising. Many people love the appeal of a fully hands-off, 'set it and forget it' opportunity.

My concerns have less to do with the realities of the product; I believe the root of the problem is the way the BYOB/IBC concept, and to an extent PAR life insurance, is marketed and sold. I consider it one of the most subtle financial misrepresentations today due to the complete lack of transparency surrounding the dividends. As a result, advisors have been given carte blanche to over-promise and under-perform. Sadly, it may take decades to know something isn't right, and by then, you're stuck.

PAR/BYOB FLOW



WHO SHOULD OWN PARTICIPATING LIFE INSURANCE?

At this point, I've shared that PAR isn't all bad, and can be a wise insurance product with investment advantages.

Before looking into PAR, it's wise to utilize registered investment accounts like Registered Retirement Savings Plans (RRSPs) and Tax-Free Savings Accounts (TFSAs). PAR should primarily be considered when someone needs (or wants) permanent insurance, is in a position to diversify their assets, has extra money, or has a higher net worth.

Even though dividends aren't guaranteed, one of the big five insurance companies claim they've been paying dividends, "every year for the last 110 years." This implies the policyholders will always get something, so there's seemingly nothing to worry about. Few are aware there's a possibility of not seeing any dividends, but they rarely consider that could be the case.

Canadians have approximately $100 billion worth of assets managed within PAR funds, without a strong understanding of how dividends are paid.

For the average investor, volatility can be worrisome, and patience can be hard to come by during a market downturn. However, the stock market has returned an average of 10% per year for the last 100 years, demonstrating that losses are temporary and growth is almost a guarantee—at least, for those willing to be patient. For a long-term client with a bit of money who prefers stability, or a wealthy individual looking for something ‘different,’ PAR policies can be an easy sell.

CASE STUDY

Where it all started

Client goal

Purchase term insurance after buying a home

Background

- Existing PAR policy from 1979, purchased for her by her grandfather from a now-deceased advisor
- $14,000 in loans

PAR dividends

- $8,500 in dividends accumulated purchased an additional $55,000 of life insurance (paid-up additions)

The real story

One year after signing over the PAR policy and closing the term deal, I was cc'd on this client's annual statement. The dividends? Zero.

I had attended an industry event just a week prior, and heard this same company's pitch: "We've paid out dividends every year for the last 110 years." So why was my client receiving nothing? I'd never seen this happen before, and didn't even know it was possible. I have many policies on the books from the 80s, 90s, and 2000s where dividends are a fraction of what was illustrated, but this was a first. How can a long-term fund with consistent annual positive returns not pay a dividend?

I sent off an email to the company in question.

The initial reply

> *"The dividend scale, and therefore the dividends being declared in any year, is made up of many components; mortality, expenses, and investments being the largest. Policyowner dividends may be distributed whenever there is an overall positive net difference between the expected and actual experiences with regards to these components. The positive net difference is the participating account earnings and part of those earnings may be distributed yearly as policyowner dividends.*
>
> *However, as a participating account block ages, the investment component takes on a larger role and has a larger influence on the dividend scale. The interest rate environment dictates the success of the investment component. This policy is in the situation where the investment component is the largest influence and, therefore, the extremely low-interest rate environment has affected it to a large degree. The change in interest rates from when this policy was sold (1979) to today's rates is significant. As an example, if in 1979, this policy was priced and the expected dividends to be declared were based on an interest rate of 10%, and we are now earning only 2%, dividends will be impacted. Please note this is an example only and not meant to indicate the actual interest rates. All older policies, those issued prior to the mid-90s, are affected in this manner."*

Even with this rationale, if the investment component had taken on a larger role, shouldn't the account have performed extremely well since the 1980s? If the interest rate environment dictates the success of the investment component, why are we constantly shown how successful the investment component is even when rates are low? If dividends are primarily based on interest rates, why does the return of the PAR fund even matter?

I've yet to receive an adequate explanation. There is a severe lack of transparency insurance companies provide when paying dividends to policyholders. Yes, many companies have paid out dividends to PAR policyholders every year since the late 1800s, but **that doesn't mean every policyholder has received them**. For your policy, there has to be an, "overall positive net difference between the expected and actual experiences with regards to these… components."

As I mentioned earlier, I have PAR policies for my children, and they can be a great way to ensure ongoing protection, and will hopefully provide a significant death benefit to their beneficiaries many years from now. In the meantime as the cash value grows, I plan on leveraging the policies to invest. However, if I could go back in time, I would have considered purchasing Universal Life Insurance (ULs) instead.

Why? ULs allow the purchaser to make decisions on how, where, and when their money is invested. You get complete transparency and can decide to carry the minimum cost of insurance, or deposit additional funds that are invested and sheltered within the policy. Furthermore, you get to decide where the money is invested and move it around as you see fit. Every insurance company that offers this product has a list of funds to choose from; you're in the driver's seat. Generally speaking, for every additional $1 deposited into the contract, beyond the cost to carry the premium, the death benefit increases by $1 plus returns. Say you decide to put an additional $100/mo into your $100k UL, and the portfolio you invested in returned 5%/year, your policy would be worth an additional $6,800 in 5 years, with a total death benefit of $106,800. In the context of investments and growth PAR's main advantage seems to be PUAs, where your dividends purchase more life insurance. Over the last 12 months, my kids have received $983 in dividends which purchased an additional $13,000 of PAR life insurance.

Comparing both, PAR is completely hands-off as the investment decisions are made on your behalf. You just pay your monthly premiums and hope the dividends will continue. Whether you're a risk-averse or a risk-taking investor, the autonomy to make your own investment decisions may hold both advantages and disadvantages.

Why choose UL over PAR? Transparency.

MY CURRENT PAR POLICIES

I purchased a PAR policy for each of my children when they were born. Based on the current performance, each of the policies could be worth the following in 20 to 50 years' time.

8-year-old girl

- **Premiums:** $228 per month, with a death benefit of $250,000
- **Current death benefit:** $300,000 (Initial $250,000 + an additional $50,000 due from reinvesting the dividends)
- **2022 total dividends:** $771 (which purchased an additional $11,000 in life insurance)
- **Total accumulated dividends:** $5,377
- **Potential policy value in 20 years (with current annual dividends):** $75,000 with a death benefit of $568,000
- **Potential policy value in 50 years (with current annual dividends):** $1,100,000 with a death benefit of $1,900,000

3-year-old boy

- **Premiums:** $242 per month, with a death benefit of $250,000
- **Current death benefit:** $253,300 (Initial $250,000 + an additional $3,300 due from reinvesting the dividends)
- **2022 total dividends:** $212 (which purchased an additional $2,187 in life insurance)
- **Total accumulated dividends:** $467
- **Potential policy value in 20 years (with current annual dividends):** $75,000 with a death benefit of $410,000
- **Potential policy value in 50 years (with current annual dividends):** $1,100,000 with a dealth benefit of $1,470,000

A COMPLETE LACK OF TRANSPARENCY

When clients are choosing where to invest their money, transparency is key.

Every investor has the right to know where their money is going, how their funds are being invested, and what the future might look like in a variety of potential economic scenarios. Sure, no advisor has a crystal ball, and nothing is guaranteed, but an experienced and knowledgeable advisor should be able to illustrate what certain asset classes are expected to return, and calculate what someone's account might be worth in 10, 20, or even 50 years.

This is inherently the problem with PAR policies and the dividend scale: insurance companies don't share any of their assumptions as it relates to your specific policy, which is what your policy illustrations are based on.

You can access your insurer's annual report and see the size of the fund, current performance, and historical returns, but as an investor, you deserve to know the specifics of how your personal dividend is calculated: something blatantly missing from your annual statement.

What is the DSIR based on? Here is an excerpt from industry material (I don't want to name the company as singling them out wouldn't be fair; this issue is endemic).

> *Participating policyowner dividends arise when the actual experience of the participating account (the combination of investment returns, insurance claims (mortality), expenses, and other factors) are collectively more favourable than the assumptions used when the life insurance policy was priced. This creates earnings within the participating account that may be available to be distributed to policyowners as dividends. In other words, when the experience in the participating account is more favourable than what is required to cover policy guarantees, dividends may be distributed.*
>
> *The dividend scale interest rate (DSIR) is used in calculating the investment component of the dividend. In simplified terms, the investment component of the dividend is based on the difference (or spread) between actual experience and the assumptions made when pricing the product.*

When assessing the dividends that may be received, the determining factors are the assumptions made for the specific policy and the group or "block" in which the policy is placed. Yet, many insurance companies classify that information as proprietary; you're on a need to know basis and you don't need to know. I've requested specific dividend pay out information from every PAR insurer in Canada, and haven't received any adequate responses. Upon inquiry with the companies as to what the assumptions are, they refuse to provide a concrete answer.

Imagine purchasing a stock and the company tells you, 'We'll pay you a percentage of our profits, but only if we make a certain amount of money,' and then proceed to keep those details private. Or, imagine you're buying a mutual fund and you're told, 'We don't pay returns based on how the fund performs; instead, your returns are based on the accuracy of our predictions', with no details and/or context. As a consumer you wouldn't stand for it, and you certainly wouldn't invest.

PAR policies should be no different. It should be expected that insurers, and advisors, provide the specific assumptions underlying your illustrated dividends.

Right now, insurance companies keep this crucial information to themselves, and most advisors don't ask because a $0 dividend isn't considered a possibility.

The question I'm constantly asking:

"What assumptions have you made underlying **my** policy so that **my** policy will be worth $X at age 65? Assuming all other variables stay the same, what does the PAR fund need to return on an annual basis for **me** to receive the annual dividends illustrated?"

I was recently informed that this information is, "outside of what is deemed necessary." If you ask me, this information is critical. The core pitch of the BYOB/IBC concepts are that dividends will create a 'perpetual tailwind' so you can 'make what the banking institutions do'; these claims are wholly inaccurate due to the complete lack of transparency.

While the insurance industry promotes honesty, openness, and transparency, the rules in place that prevent practices like this only work if the companies themselves follow them.

PAR policies have historically been subject to a number of provisions in the Insurance Companies Act (ICA).

In 2005, the ICA was amended to incorporate additional requirements for the management of participating policies. As recently as 2010, new disclosure requirements that support the ICA on the subject of participating policies were enacted. These guidelines are available to view and download on the Government of Canada's website via the Office of the Superintendent of Financial Institutions (OSFI) .

I want to highlight two particular sections of the guidelines:

> *OSFI is committed to having companies enhance the level of disclosure to participating policyholders in order to facilitate informed decision-making and informed policyholder expectations. In this regard, OSFI expects companies to develop and publish meaningful descriptions of the investment income and expense allocation methodologies required pursuant to sections 457 and 458 of the ICA.* (Page 4)

> *The disclosures made pursuant to the Regulations are expected to have the following characteristics for participating accounts and adjustable products:*
>
> - *The description should be understandable by a person with a rudimentary understanding of life insurance concepts and vocabulary. Expert technical knowledge should not be required to understand the descriptions;*
> - *The goal should be clear and straightforward communication that is informative and transparent and leads to an understanding of the company's participating accounts and adjustable policies;*
> - *The disclosure should provide the context within which the information should be considered;*
> - *The disclosure should avoid being overly generic or "boilerplate";*
> - *Disclosure should not include immaterial information or material that does not promote understanding by the reader. However, if in doubt about whether to include or exclude certain disclosures, the company should err on the side of inclusion; and*
> - *The disclosure should recognize the balance between presenting information clearly and understandably while not over-simplifying important complex information or sacrificing appropriate levels of complexity or distinctions.* (Pages 8 and 9)

Based on my understanding of the relevant regulations, it appears that the methodology and assumptions used for determining dividend payouts should be disclosed to individual policyholders, however, this information is not provided. In this instance, insurance companies are failing clients, advisors, and regulators aren't doing their job. As an advisor with some technical knowledge, I'm wholly unable to provide any context so my clients can form reasonable expectations concerning their dividends.

I've spoken to the Financial Services Regulatory Authority (FSRA), OFSI, the Ontario Life and Health Insurance Organization (OLHIA), the ombudsmans for many insurance companies, and receive similar responses each time: 'please refer to the guidelines of each company, and inquire as to how they administer them.'

In the end, insurers still withhold the most important information—**your** underlying assumptions. Because regulators are in no hurry to enforce the disclosure requirements, insurers have managed to avoid providing the desired in-depth analysis of what should be simple: an explanation of how **their** clients—who have contributed billions in premiums—make money from their individual PAR policies.

As I stated earlier, when the insurance companies don't provide fulsome disclosures, advisors are left to fill in the gaps. While insurance companies do show how the PAR funds have performed for the last 30 + years, the lack of transparency around how **your** illustrated dividends are calculated allows advisors to create a concept around PAR policies that falsely promote unlimited dividends and money for life. When specifics aren't fully disclosed, it's easier for the industry to create its own narrative.

This, in my opinion, is the basis of the 'Infinite Banking' and 'Becoming Your Own Banker' concepts.

I want to make this abundantly clear: with Participating Life Insurance, you aren't borrowing from yourself, and you are not your own bank.

You're essentially:

- Taking out a loan from the PAR fund, secured against the cash value of your policy
- Paying interest (in addition to your normal monthly premium payments) to the PAR fund that you, and all other individuals who are contributing to that fund, have a vested interest in.

The question is, is this a smart move? If the withdrawals aren't subject to taxes, it could be a viable option depending on the individual's circumstances. For example, I've taken out lines of credit against several insurance policies as investment vehicles, borrowing money, investing, and claiming the interest as a deduction. This can be a profitable strategy, however, I only reap the benefits when I lend the borrowed money to someone else, not when I pay interest into a fund that in turn provides me returns in the form of dividends, with little to no transparency on the underlying payout methodology.

SCENARIO

You've paid off your house and decided to take out a home equity line of credit with ABC bank for $500,000 at a 4.5% interest rate. You start paying back only the interest each month, which is $1,875. Your advisor recommends that you take that $500,000 and buy ABC bank's stock to 'recapture' the interest you were paying to the bank because the stock pays an annual dividend of 5% to its shareholders.

Observations

We can all agree on two things:

- This is probably a decent investment, as you'd make 0.5% after paying the interest, while participating in the upside of the stock.
- You're not "your own bank." This is a simple case of leveraging to grow your net worth.

The concepts of "Becoming Your Own Banker" and "Infinite Banking" may sound more appealing, especially when marketed as an easier way to make business purchases, down payments, or buy a car without borrowing from traditional banks. Despite this, I'm still a strong advocate of the strategy of borrowing to invest, but only if the return on the investment is higher than the interest paid on the loan. While the pitch may not be as glamorous, it's an honest assessment.

All sizzle, no steak*

By now we've established that the disclosures around how PAR dividends are determined and paid out are vague, making the BYOB/IBC claims incredibly misleading.

Excerpt from a recent PAR annual report from one of Canada's largest insurers:

How we allocate participating policyowner dividends

Any amount distributed from the participating account as policyowner dividends is divided among groups of policies with common attributes. The amount, if any, credited to each policy within a dividend group varies depending on the earnings considered to have been contributed by that group. This is known as the contribution principle. A policy may not be credited a dividend, for example, if it's in a group of policies that made no contribution to participating account earnings.

Examples of how we determine groups include:

- The year a policy was issued
- Time periods in which premium payments, guarantees or pricing assumptions were similar
- Plan types
- Base risk classifications (for example, male or female, smoker or non-smoker)
- Issue ages

In following the contribution principle, several elements are considered in addition to dividend groups. For example:

- Generations of policies
- Legal and regulatory requirements
- Professional guidelines
- Industry practices

We distribute dividends according to the terms of each policy, the base coverage amount and coverage from paid-up additional coverage. The premium payment due on the first policy anniversary must be paid before we credit a dividend.

Canada has been experiencing historically low interest rates for an extended period. Whether or not a policy is credited a dividend, the guaranteed cash values will continue to grow as shown in the contract, and the basic payout is guaranteed. If a policy isn't credited a dividend in any year this won't reduce the cash or payout values that accumulated up to that point, as long as premiums are paid when due and policy values haven't been used for any purpose, as may be specified under the contract or elected by the policyowner.[1] Future increases in interest rates, as well as other factors, may increase dividends, which may have a positive impact on future policy values.

Before any participating policyowner dividends are declared, the appointed actuary must report to the board of directors on the fairness to participating policyowners of the proposed dividend scale and whether it's in accordance with the company's dividend policy.

Does this make you feel like your dividends will be either 'uninterrupted' or 'infinite'? Does it feel like you are 'becoming your own banker'?

*Seems to have come into use during the mid-1900s and comes from a 1937 book about salesmanship called Tested Sentences that Sell, written by American Elmer Wheeler: "Don't sell the steak — sell the sizzle." Wheeler meant a salesman should describe what a product can do for a buyer, not simply what the product is (Grammarist.com)

In this example, the language is abstract. As you continue reading, there are even more statements that are, in my opinion, misleading.

The dividend scale interest rate is only one factor that contributes to an individual policy's performance.

It's used to determine the amount of participating policyowner dividends that come from participating account investments and can't be directly tied to the cash value growth in a particular policy. The actual cash value growth in a policy varies based on a number of factors.

For example:

- Type of product
- Product features
- Premium-paying period
- Issue age
- Rating
- Dividend option
- Dividend scale

Our long-term investment strategy, together with our smoothing approach, helps reduce the impact of short-term volatility on the investment component of participating policyowner dividends.

One-year returns (at Dec. 31)	2020	2021
[redacted] dividend scale interest rate	5.1%	5.1%
S&P/TSX composite total return index	5.6%	25.1%
Five-year GICs	1.3%	1.0%
Government of Canada five to 10-year bonds	0.7%	1.3%
Consumer price index	0.7%	3.4%

In this example, if I had taken $1,000 and invested it in the S&P/TSX at the beginning of 2020, by the end of the year, I would have approximately $1,056. However, if I had taken the same $1,000 and used it to pay annual life insurance premiums, I wouldn't have had $1,051 at the end of the year. Based on this chart, it may seem as though the Dividend Scale Interest Rate (DSIR) is treated similarly to a rate of return, and that you'd see a 5.1% return on the investment component. This is a common misconception where advisors refer to the DSIR as a rate of return, but that's not accurate. In reality, as seen from my dividends, returns in the early years, as a percentage of the premiums paid, are relatively high, but it's impossible to know whether or not this—or any dividend—is sustainable.

A quick example, I ran an illustration for myself, a 38-year-old, non-smoking male with this same company. Paying $1,716 per year in premiums, I'd be able to purchase a $100,000 PAR policy, where all my dividends are reinvested (PUAs).

Here's what that looks like in the current dividend scale environment, over the next 20 years:

Policy values

		Guaranteed values			Non-guaranteed values Current dividend scale		
Year	Age	Guaranteed annual premium ($)	Guaranteed cash value ($)	Guaranteed death benefit ($)	Total annual premium ($)	Total cash value ($)	Total death benefit ($)
1	39	1,716	86	100,000	1,716	182	100,425
2	40	1,716	172	100,000	1,716	472	101,291
3	41	1,716	258	100,000	1,716	885	102,610
4	42	1,716	344	100,000	1,716	1,351	104,054
5	43	1,716	431	100,000	1,716	1,853	105,543
6	44	1,716	1,091	100,000	1,716	2,975	107,104
7	45	1,716	1,991	100,000	1,716	4,396	108,781
8	46	1,716	3,137	100,000	1,716	6,135	110,596
9	47	1,716	4,540	100,000	1,716	8,212	112,571
10	48	1,716	6,206	100,000	1,716	10,648	114,725
11	49	1,716	8,145	100,000	1,716	13,465	117,079
12	50	1,716	10,365	100,000	1,716	16,684	119,652
13	51	1,716	12,873	100,000	1,716	20,327	122,462
14	52	1,716	15,678	100,000	1,716	24,420	125,528
15	53	1,716	18,786	100,000	1,716	28,986	128,867
16	54	1,716	20,353	100,000	1,716	32,175	132,430
17	55	1,716	21,953	100,000	1,716	35,545	136,149
18	56	1,716	23,585	100,000	1,716	39,105	140,024
19	57	1,716	25,248	100,000	1,716	42,863	144,055
20	58	1,716	26,942	100,000	1,716	46,826	148,242

*Example illustration showing what a policy could look like under their current DSIR (Dividend Scale Interest Rate).

In my first year, $1,716 in premiums will reward me with $96 in dividends ($182 total cash value minus $86 in guaranteed cash value), followed by $204 in the second year ($472 current total value, minus $172 guaranteed value minus the $96 in dividends I received in year 1), and so on. How do they know this? These values are set in stone **assuming** their predictions for you are accurate. Keep in mind, these assumptions, which are the source of your policy illustrations, and thus your returns, are considered "proprietary."

By running the same illustration and reducing the Dividend Scale Interest Rate (DSIR) by 2%, we start to see significant differences. That 40% overall decrease (5.1% to 3.1%) looks like this: By age 88, under a current dividend scenario, this policy will have $296,000 in cash value and a death benefit of $351,000. If that scale is reduced by 2%, your cash value at age 88 now becomes $166,000 with a death benefit of $196,000. Why such a difference? The only explanation I've heard thus far has blamed a "significantly reduced interest rate environment", with no further context.

Policy values

Year	Age	Guaranteed values: Guaranteed annual premium ($)	Guaranteed cash value ($)	Guaranteed death benefit ($)	Non-guaranteed values Current dividend scale less 2.0%: Total annual premium ($)	Total cash value ($)	Total death benefit ($)
1	39	1,716	86	100,000	1,716	181	100,421
2	40	1,716	172	100,000	1,716	467	101,269
3	41	1,716	258	100,000	1,716	870	102,544
4	42	1,716	344	100,000	1,716	1,316	103,913
5	43	1,716	431	100,000	1,716	1,789	105,291
6	44	1,716	1,091	100,000	1,716	2,864	106,688
7	45	1,716	1,991	100,000	1,716	4,213	108,114
8	46	1,716	3,137	100,000	1,716	5,846	109,576
9	47	1,716	4,540	100,000	1,716	7,777	111,080
10	48	1,716	6,206	100,000	1,716	10,017	112,630
11	49	1,716	8,145	100,000	1,716	12,578	114,232
12	50	1,716	10,365	100,000	1,716	15,474	115,890
13	51	1,716	12,873	100,000	1,716	18,716	117,607
14	52	1,716	15,678	100,000	1,716	22,318	119,388
15	53	1,716	18,786	100,000	1,716	26,290	121,236
16	54	1,716	20,353	100,000	1,716	28,786	123,134
17	55	1,716	21,953	100,000	1,716	31,376	125,061
18	56	1,716	23,585	100,000	1,716	34,061	127,016
19	57	1,716	25,248	100,000	1,716	36,842	128,997
20	58	1,716	26,942	100,000	1,716	39,721	131,003

*Example illustration showing what a policy could look like under a current minus 2% DSIR (Dividend Scale Interest Rate).

I have many policies on the books where the dividends being issued are a fraction of what was illustrated 20 to 40 years ago. It's important to remember, contrary to the BYOB/IBC pitch, you're borrowing from something you have zero control over. There's no guarantee the growth of **your** PAR policy will cover the build-up of debts over time. So if you are getting dividends, and those dividends are covering the interest payments, there's no guarantee that will continue in the long run, and no data provided to form realistic expectations.

Some of my clients who have large loan balances and dropping dividends end up cashing out or paying the debt down with cheaper money via a home equity line of credit and/or refinancing their mortgage. My conversations with these clients are different because the policies I inherited (took over from older advisors) weren't sold aggressively. In many of those cases, their advisor has passed away and I'm doing my best to help them understand their insurance portfolio. Fortunately, most of these clients had low expectations and viewed these products as life insurance/investment hybrids with accessible cash in an emergency. However, newer policyholders who were promised 'income for life' are potentially setting themselves up for a rude awakening 30, 40, or 50 years down the line, thanks to proprietary assumptions. The problems my clients are experiencing are nothing new, and I believe the BYOB/IBC concepts are taking us down a similar path.

This isn't the first time that my industry has faced scrutiny resulting from misleading illustrations. In the 1990s and early 2000s there were a slew of settlements paid out by insurance companies accused of deceptive sales practices going back to the 1970s, 80s, and early 90s.

Why? Vanishing premiums.

Back in the 1980s, interest rates were peaking and dividends were plentiful. The computer revolution helped facilitate sales through complex computer illustrations which all seemingly guaranteed huge windfalls well into the future.

The pitch was simple: make payments for only a short period of time, and the dividends would take care of the rest. Even though the dividends weren't guaranteed, advisors pitched historical returns and a conservative investment approach, acting like the party would go on forever. What wasn't disclosed, according to policyholders, was the fact that the values were driven by assumptions that weren't disclosed in the sales presentations; sound familiar? Purchasers had no clue that a reduced dividend could result in the reappearance of those vanishing premiums.

As interest rates came down and premiums reappeared, the sales practices started to gain regulatory attention. The problem got so bad that in 1992, the U.S. Senate stepped in with hearings. Given how slow politicians and regulators were to respond, policyholders started to independently organize, with the result being legal action. Insurers claimed they provided disclaimers that stated, "dividends are not guaranteed and are expected to change," but the packages omitted any details relating to the assumptions the illustrations depended on.

Furthermore, these disclaimers were routinely glossed over by agents selling the products. Insurers claimed the illustrations weren't a contract, and only facilitated the purchase of the policy. Insurers also argued that the legal time frame for filing a complaint had expired, and that the alleged misstatements were related to long-term predictions, which are difficult to forecast with certainty.

Despite the legal challenges that exist to this day, those assumptions still aren't disclosed, and continue to be proprietary.

It's important to clarify that the allegations in these lawsuits weren't based on contract wording. There were no guarantees the premiums would ever "vanish," and furthermore, the verbiage was clear; dividends were issued at the company's discretion based on the economics of the time. Policyholders were suing based on the assertions and oral statements provided by the sales agents and the material clients were provided, which they claimed misrepresented the product. In 1997, the University of Chicago Law School published a journal article about the ongoing cases, titled The Law and Economics of Vanishing Premium Insurance, and reached the following conclusion:

> **IV. CONCLUSION**
>
> **Declining interest rates, not deceptive sales practices, are responsible for the failure of vanishing premium life insurance policies to perform as well as initially hoped. Plaintiffs, particularly those in class actions, should not be allowed to use the legal system as a form of insurance to protect against the consequences of declining interest rates. When the liability and damage issues presented in vanishing premium cases are properly analyzed, the life insurance industry's exposure is far less than commonly assumed.**

*From the 1997 Chicago Inbound, University of Chicago Law School. The Law and Economics of Vanishing Premium Insurance by Daniel R Fischel and Robert S. Stillman.

A quick review of this article indicates it was, in my opinion, written by someone who was never pitched the product. Nevertheless, these cases led to huge jury verdicts and multi-million dollar settlements both here and in the United States. If the policy owners at that time were told how dependent these returns, and in turn premiums, were on the interest rate environment, where a reduction in rates could cause the premiums to return, they would have a point. However this is far from the case, and the practice continues to this day.

It's not only PAR policies: just a few years ago, the Supreme Court of Canada green-lit a $2.5 billion lawsuit against Sun Life over the mis-selling of Universal Life policies. Even though this is a completely different type of policy, and not necessarily the fault of Sun Life itself, it's clear that product misrepresentation in the insurance industry is endemic and hasn't completely gone away.

To an extent, today's purchasers have less to fear as some things have changed. There are more guarantees and disclosures have improved. But for many who currently have PAR insurance, the problems aren't felt immediately, and tend to appear later in life. In my practice, this is an ongoing question—should I keep the insurance, reduce it, or just drop it altogether, especially when dividends are a fraction of what was illustrated? Nowadays, BYOB and IBC claims are more open-ended, and because these strategies are generally not supported by insurers, this time advisors are on the hook.

During the vanishing premium settlements, the plaintiffs claimed that the assumptions, upon which the illustrations (and thus dividends) depend, were hidden. Despite the lawsuits and settlements, this is a practice which continues to this day.

Total CSV in first 10 years

Competitive Net Cash Flows (CSV minus Premium)

- 20 Pay
- Male, NS
- Age 45
- $750 000

Total CSV	A 6.0	B 6.0	C 5.1	D 6.05	X 6.0	X Rank
Year 1	18,607	15,366	19,948	14,447	20,303	1
Year 2	42,839	42,318	42,377	40,327	45,472	1
Year 3	70,893	66,777	66,639	73,419	74,997	1
Year 5	140,058	129,689	124,885	136,489	145,008	1
Year 10	322,021	331,922	314,736	334,843	335,346	1
Annual Premium	29,020	30,069	30,300	32,060	29,897	2

*When advisors are pitched PAR products by insurers, we're routinely shown long-term comparisons of how different company returns stand up. In this example, a 45-year-old male has to pay $30k in premiums for a guaranteed 20 years, but is eligible to receive dividends for life. Considering each company may have completely different assumptions, it's impossible to compare dividends. A 5% DSIR to company A could be completely different from the same DSIR with company B. It's like trying to compare two stocks without access to their financials. These comparisons are meaningless when the underlying assumptions go undisclosed.

For the last few years I've been seeking to understand more about the assumptions underlying the dividend scales. After doing as much research as I could with the insurance companies, I filed a complaint with the Financial Services Regulatory Authority of Ontario (FSRA).

They sent me the below response:

> *"The Financial Services Regulatory Authority of Ontario (FSRA) is a regulatory agency of the Ministry of Finance that regulates insurance in Ontario. To protect consumers and enhance public confidence in the sectors it regulates, FSRA monitors, investigates and when there is non-compliance with legislation and regulations, takes appropriate enforcement action against the sectors it regulates and persons who are illegally engaged in those sectors.*
>
> *We have reviewed the details of your complaint against X insurance company. As discussed during our phone conversation on June 28, 2021, your complaint concerns the payment of dividends on PAR products underwritten by X insurance company and the variables the dividends are based on. The concerns you have raised do not fall within the scope of the Insurance Act and its regulations and are therefore outside FSRA's jurisdiction. Regrettably, our office cannot assist you further in this matter.*
>
> *If you wish to pursue the matter further, you may wish to reach out to The Office of the Superintendent of Financial Institutions. We hope this provides some guidance to move forward with a resolution. This confirms the FSRA complaint is now closed."*

After this experience, I raised my concerns with the Officer of the Superintendent of Financial Institutions (OSFI), publisher of the 2011 regulations I discussed earlier in the article. OSFI is an independent arm of the Government of Canada that supervises and regulates financial institutions and pension plans. Their aim is to protect depositors, policyholders, financial institutions (FIs), creditors, and pension plan members alike.

OFSI mission statement:

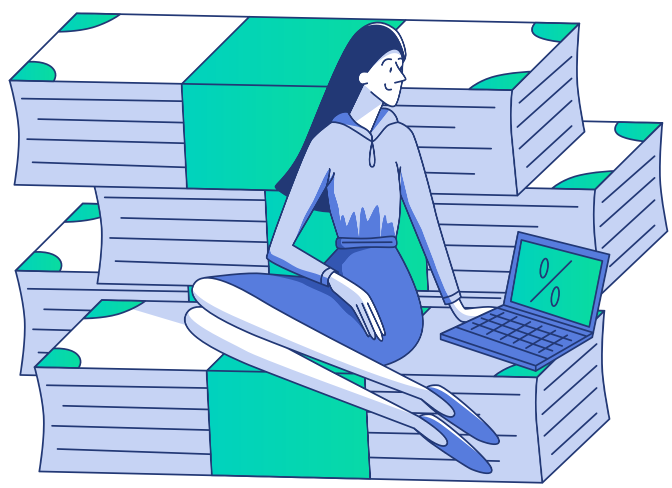
> *"OSFI is committed to having companies enhance the level of disclosure to participating policyholders in order to facilitate informed decision-making and informed policyholder expectations."*

After discussing my concerns regarding transparency, OFSI responded:

> *"When OSFI receives a concern that is within our mandate, we take appropriate action to address that concern directly with the financial institution. If OSFI forms the view that the financial institution is not in compliance with the relevant legislation, or adhering to relevant guidelines, we will advise the financial institution accordingly along with our expectations on rectifying the situation to ensure the financial institution complies with its governing legislation and applicable guidelines.*
>
> *Please note that the confidentiality provision set out in section 672 of the Insurance Companies Act and paragraph 22(1)(a) of the Office of the Superintendent of Financial Institutions Act prevents OSFI from disclosing to you any information we obtain or produce regarding the business or affairs of a company, including any measures that OSFI may take in respect of the matters raised in your emails. Consequently, we are unable to elaborate on our views regarding the specific matters you have set out with respect to X Insurance Co."*

The same institutions we entrust to enforce fair standards and provide transparency reference a law that essentially prevents them from being transparent; go figure.

It's worth noting that regulating the financial services industry, particularly insurance companies, is a challenging task. Regulators are expected to have an in-depth understanding of a wide range of products and navigate through extensive regulation. Furthermore, I don't believe it's necessary to petition regulators to enforce something that the market could likely do better. We need some client-led pressure; sunlight is the best disinfectant. When more and more clients start asking companies to shed light on the underlying assumptions that determine **their** dividends, companies will eventually need to comply.



THE BOTTOM LINE

If you ask agents and advisors who have been around for 20+ years about PAR insurance, you'll likely hear the phrase 'black box' thrown around, as it's impossible to know what's going on inside.

I first heard this from a chief VP at a major insurer who was hosting an industry event. They provided the most context I've ever received, so I'll share my two key takeaways from that presentation:

1. If you want transparency, don't buy PAR insurance.
2. If interest rates go down, we're all screwed.

This person recently retired and I was able to track them down; the internet is a wonderful thing. They declined to be named and interviewed but were kind enough to give me a few minutes. Our discussion on PAR insurance can be summed up in six valuable points:

- **On transparency:** Clients need to be comfortable buying a black box
- **On dividends and disclosures:** Companies can decide on dividends, and we, the public, have no control and aren't privy to the reasoning
- **On the BYOB/IBC concepts and the advisors who sell them:** These claims aren't accurate: keep your liability coverage when you retire
- **On long-term dividends:** It's a 'trust me' product
- **On PAR insurance:** When sold properly, it's a wonderful product for the right client
- **On buying PAR:** Read the financial facts in detail and know what you're getting into

One potential positive aspect is that rising interest rates can benefit policyholders of PAR policies, as it's believed that increasing interest rates correspond to higher dividends. However, this doesn't excuse the lack of transparency. When my client's grandfather purchased her PAR policy back in 1979, interest rates were at 11%; the Bank of Canada recently increased their benchmark rate to 4.25%.

The question becomes, what do rates need to hit for my client to start seeing dividends? The company in question responded, and I still don't get it.

> *'We **currently** expect that a dividend scale interest rate of 6% or higher could produce a non-zero dividend for policy XXXXXXX, although that could change in the future according to a number of factors, including, but not limited to, how both investment performance and non-investment performance impact future dividend scales which could result in a different threshold for the policy returning to non-zero dividends. The policyowner should not interpret this answer to be a guarantee that if the dividend scale interest rate returns to 6% at some indefinite point in the future that they would definitely see nonzero dividends again. We cannot state this as a guarantee because it is possible that the non-investment experience could deteriorate from current levels, could offset any impact from the more favourable investment experience that would result from the dividend scale interest rate increasing to 6.00%.'*

The goal here isn't to villainize insurance companies, the advisors that sell PAR policies, or even the products themselves. They can be great tools for higher net worth individuals, and high income individuals, as leveraging assets while you're alive, for a product designed to help your family when you die, is an amazing thing. Buy a policy, borrow against it if you can, but don't expect transparency; you probably will not receive what's being illustrated.

I believe advisors should remain true to the key rationale behind insurance, protecting your possessions and providing for your family due to illness, disability, or death. It's important to avoid merging the distinction between investments and insurance.

The consensus amongst insurers competing for your business appears to be that policyholders don't need to see where their returns come from.

The DSIR can change yearly and policyholders will continue paying their premiums without knowing any better. When applying for life insurance, we can't lie or misrepresent our health history for underwriting purposes, but insurers can deem what I consider material information "unnecessary."

These PAR funds are huge, and a cash cow for the companies that manage them. It's likely almost everyone reading this has a friend or family member with one of these products on the books. Six of Canada's largest insurance companies manage a combined **$81+ billion** of your assets; the largest provider manages $50 billion alone.

For reference, the HOOP pension, which provides a defined benefit pension to more than 400,000 healthcare workers in Ontario, (and is one of the largest defined benefit pension providers in Canada), has $114+ billion of assets under management (AUM). The OTPP, which does the same for Ontario teachers, is one of the largest defined benefit pensions in the world, and the wealthiest one in Canada; it has more than $240 billion in assets on the books. A PAR insurance policyholder is a participating member of that fund, and deserves to be treated as such, no matter the size of their premium.

In one of his latest newsletters, NYU business professor Scott Galloway elegantly commented on the state of capitalism; and is a perfect example of what I believe is happening in my industry.

"Competition depends on rules, and rules depend on umpires. We should fight to protect competition—not winners. Because winners subvert the process. In the name of competition, they demand that their anticompetitive acts go unpunished."

What now?

Personally, I don't believe the answer is more oversight or regulation. Paradoxically, I think it's fair to say that the complexity of our regulatory environment has unintentionally led us to this point. There are too many governing bodies working to reinforce their own existences rather than protecting the needs of consumers. Even though the responsibility should rest on the insurers and brokers/advisors, it's hard to go against the crowd when these products are generally a safe bet; if you pass, your family will get paid.

Earlier, I shared a personal case study from a client. It just so happened that I received her most recent statement a few weeks ago and once again, no dividends as a result of the "changing interest rate environment, as well as… other factors."

This time, while speaking to the insurance company in question, I referenced those OSFI guidelines and pushed further for **her** underlying policy assumptions.

Here's part of that correspondence:

> *"Furthermore, as indicated in the OFSI guidelines, "Disclosure should not include immaterial information or material that does not promote understanding by the reader. As disclosure of an actuarial pricing methodology would not promote understanding by a reader… it should NOT be included."*

I hear it all the time: invest in what you understand. However, I can pretty much guarantee most individuals who purchase PAR policies, and buy into the BYOB/IBC concepts, don't.

Transparency seems like a one-way street, and educating consumers appears to be an afterthought.

At the end of the day, I can claim with 100% certainty that the BYOB/IBC concepts are pure fiction: you aren't borrowing from yourself, and you're not making what the banking institutions do. Like any good fantasy, it only stays popular with a great story. The high level goal - having access to credit at a moment's notice without conditions or approvals - is something I believe in, and an opportunity life insurance can provide. It gives you greater control over the 'banking function' in your life, but will hardly get the 'banker' out of the way all together. When possible you should have a credit facility against ALL your assets: houses, cars, business, investments, and life insurance policies included. Limiting contact with traditional bankers and having access to funds will give you more control over finances, as it's hardest to access credit when you need it the most. Keep in mind this control can come in many forms, and a PAR policy is one of many options.

With PAR insurance you'll have access to cash value which should grow for many years to come, but don't confuse this with "control." The funds are invested for you; it's a "black box." Even worse, we now know the promise of lifetime dividends, in any economic scenario, is as realistic as those "vanishing premiums." Trust, but verify. Until insurance companies pony up and share their assumptions, which is the ONLY data that matters, I will call this out.

So why am I doing this? Truth and transparency matter. If there were a few rogue advisors pitching this, with not much fanfare, I wouldn't care. If the insurance companies shared their assumptions, articles like this would be totally unnecessary, and the BYOB/IBC concept as we understand it today wouldn't exist.

'Do what the wealthy do'

Why do wealthy individuals manage money in ways the rest of us don't? It's simple; they have more of it. As a result they pay more tax, and thus require more creative solutions to mitigate that burden. If you want to emulate their financial strategies, consider starting a business, selling a product or service, or taking calculated risks. In my opinion, a PAR policy is not a path to wealth, but may be a great place to park some of it once you get there. It's like suggesting that buying a Lamborghini is the way to become wealthy, because 'do what the wealthy do'; to me this is just as absurd as the BYOB/IBC claims. After seeing first hand what these same policies from the 70s, 80s, and 90s look like today, I beg you to seek multiple perspectives. Buy insurance to protect your family, but don’t confuse PAR insurance with “controlling the banking function in your life,” or a source of “infinite” dividends you can depend on years into the future. Just like the thousands of people who believed the vanishing premium claims, you’re bound to be disappointed in the coming decades.

At this point I need to call out the BYOB/IBC concept for what it is: a disingenuous misrepresentation of PAR life insurance, while not without its limitations, is a legitimate product, with clear benefits. Having a pre-approved credit facility against a PAR policy doesn’t automatically create your ‘own bank’. Furthermore, if you plan on acting like a bank and leveraging that credit accordingly, don’t assume the dividends will carry the interest payments. While you have the ability to repay the loan at your discretion, the associated dividends are a ‘black box’; minimal transparency and zero control. As a consumer, you should advocate for yourself; be inquisitive, email your insurance company, and partner with your advisor to get these questions answered. I genuinely believe insurance companies have an opportunity to create a competitive landscape by differentiating themselves from each other. Companies should earn your business with a clear vision, and allow clients to contrast different forward-looking assumptions. In this new digital age, transparency matters more than ever, and we have the ability to clarify the rhetoric surrounding these products, while putting an end to the mistakes my industry has made in the past.

My final thoughts: if you’ve bought into these claims and view Participating Life Insurance as a path to wealth, banking, or control, you’re bound to end up disappointed. Financial advisors and individuals alike should push for more disclosure and use historical evidence as a guide until companies provide transparency.

In the end, there’s one thing to keep in mind: You’re not your own banker, and there’s nothing infinite about it.

FOR MORE INFORMATION, GET IN TOUCH WITH ADAM

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