

Section 2

Understanding and Managing Debt

INTRODUCTION

Just saying the word “debt” will bring a visceral reaction by many.

I think it’s a fair statement that people don’t like debt.

Why is that?

The obvious reason is that no one likes owing other people or entities (lender/banks) money.

-With debt comes **repayment**.

-Repayment is seen as a **financial burden** (which no one likes).

-Debt is not associated with **financial freedom**, which is what most people in life strive for (and most never get to).

If you talk with older people who have paid off their home mortgage, many will tell you the day they paid off their mortgage was one of the **happiest moments** of their life.

With this section of the course material, it is my goal not necessarily to change your mind about debt (although I hope many readers do change their minds about “good” debt). My goal is to make sure you **understand debt** and why there is such a thing a “good” debt.

Like the rest of this course, my goal is to educate readers so they can make **“informed decisions”** about the “best” use of their money.

However, I do understand when it comes to debt, people have such an aversion to it that they will still choose to pay down “good” debt even though it harms them from a long-term financial point of view.

GOOD DEBT VS. BAD DEBT

The first thing you need to understand is that there is such a thing as good debt. Authors such as Dave Ramsey preach the concept of becoming debt free and, to put it bluntly, he is both clueless and doing a disservice to those who take advice from him.

QUESTION: If I could lend you money at a 3% interest rate and you could take that money and earn 6%, how much would you want me to lend you?

ANSWER: _____.

If you are of the mindset that debt is bad, you might have put zero as your answer.

Let’s look at the math of growing money over 30 years. We’ll start with taking \$100,000 and growing it at 6% net (net meaning that taxes and expenses on the growth have already been taken out).

<u>Year</u>	<u>Start of Year Balance</u>	<u>Contribution</u>	<u>6.00% Growth</u>	<u>Year End Balance</u>
1	\$100,000	\$0	\$6,000	\$106,000
5	\$126,248	\$0	\$7,575	\$133,823
10	\$168,948	\$0	\$10,137	\$179,085
15	\$226,090	\$0	\$13,565	\$239,656
20	\$302,560	\$0	\$18,154	\$320,714
25	\$404,893	\$0	\$24,294	\$429,187
30	\$541,839	\$0	\$32,510	<u>\$574,349</u>

Now let's look at the expenses on borrowing \$100,000 at a net cost of 3% where the interest on the debt rolls up (no payments on the loan).

<u>Year</u>	<u>Start of Year Balance</u>	<u>Contribution</u>	<u>3.00% Interest Expense</u>	<u>Year End Balance</u>
1	\$100,000	\$0	\$3,000	\$103,000
5	\$112,551	\$0	\$3,377	\$115,927
10	\$130,477	\$0	\$3,914	\$134,392
15	\$151,259	\$0	\$4,538	\$155,797
25	\$203,279	\$0	\$6,098	\$209,378
30	\$235,657	\$0	\$7,070	<u>\$242,726</u>

If you borrowed \$100,000 at a 3% interest rate and grew that money with a net gain of 6%, how much money would you have?

+\$331,623 (\$574,349 - \$242,726)

QUESTION: If I could lend you money at a 3% interest rate and you could take that money and earn 6%, how much would you want me to lend you?

ANSWER: _____.

If you didn't answer as much money as we would lend you the first time, I hope you did the second time I asked it.

What's the point of this example/exercise? It's to facilitate a discussion about residential mortgages.

MORTGAGE DEBT CAN BE GOOD DEBT

QUESTION: Is it a good financial decision to pay off your mortgage quickly?

ANSWER: _____ (Yes or No)?

Many people will answer yes to the above question. However, as the math of the previous example illustrates, it is NOT a good idea to pay down debt on a primary mortgage.

A caveat to the above statement about paying down mortgage debt is the interest rate of the loan. If mortgage rates get near 6%, then, depending on the assumed net rate of return you could generate on money invested outside of the house, paying down mortgage debt can be a good financial decision.

At the time this course was written, we have historically low lending rates. Most people can obtain a mortgage with an interest rate of less than 4% (which can be locked in for 30 years).

When mortgage interest was deductible to many Americans, the math is even more compelling as a reason not to pay off the mortgage early. However, under the current tax law, the vast majority of Americans won't write off the interest on their mortgage so the previous example is all that's really needed for this course material (although, if you are one of the few who can write off the interest on your mortgage, then paying it off makes even less sense).

As stated, Dave Ramsey and others preach to everyone who will listen that you should make it your life's goal to pay off mortgage debt as soon as possible. This is fatally flawed thinking if the goal is to build maximum wealth for retirement.

DISCIPLINE IS NECESSARY

The caveat to the obvious math behind why paying off your mortgage is a bad idea is that you MUST have the discipline to take the money you would have used to pay off your mortgage early and grow it in a safe manner for use at a later time.

If you are going to take the money you would have used to pay down your mortgage and instead spend it on non-necessary items, then you would be better off paying down and paying off your mortgage to grow your wealth.

TAKE AWAY

Low interest debt can be good debt.

DEBT REFINANCING

Consumers, especially with their homes, get a mortgage and then seem to almost forget about it over the years. Many people set up auto payments so their mortgage is paid for from their checking account and don't do what seems to be simple, which is to look at mortgage rates at least once a year.

I am constantly running into people who have mortgages with a 4% rate or 4.50% rate. As of the time I'm writing this material, you can get a 30-year mortgage for as low as 3.25%.

The current rates aren't necessarily the point I'm trying to focus on. The point is that, if you are not paying some attention to mortgage rates, you may be costing yourself tens of thousands of dollars in wasted interest payments.

The next question is how much lower does the rate need to be in order to make refinancing worthwhile. The answer is, it depends on the closing costs. If you can get a no-closing cost loan (which you might be able to get from your current lender), then any drop in rates is worthwhile.

If a new lender requires an appraisal (\$550) and closing costs of say \$1,000, then you need to do a little math to figure out if it's worth it.

If you have a \$380,000 mortgage balance and 25 years left on a 30-year mortgage, going from a 4% rate to a 3.75% rate will save you \$15,624 over the life of the loan.

If you went from 4% to 3.5%, you'd save \$31,023.

This assumes you purchased a 25-year loan to keep the loan length the same.

What would I do during a refinance?

I'd stretch out my amortization back to 30 years. I would pay more in interest by doing so, but what did that do for me? It freed up cash flow.

Why would I want to free up cash flow? Because I'd use that money more efficiently to grow wealth outside of my mortgage.

I'll leave it up to readers and their trusted advisors to sit down and map out the best financial plan. It is my hope that after reading this material you'll understand the "best" use of your money and many times that will NOT include aggressively paying down "good" debt.

THE HOME EQUITY ACCELERATION PLAN (HEAP)

Because I've been educating consumers on mortgage debt for over ten years, I know that, even though it is not mathematically smart to pay down low interest mortgage debt, many people still want to pay down their mortgage debt as fast as possible.

Because of that, I rolled out HEAP.

What is HEAP?

Let me start by asking you the following question:

If you had the opportunity to pay off your mortgage, 5, 10, 15+ years early, save in excess of \$100,000 in mortgage interest payments WITHOUT changing your current spending habits, would you be interested?

Everyone with a mortgage should say yes.

How does HEAP work?

HEAP helps people use "every available dollar every day to pay down mortgage debt."

The compounding effect of using every available dollar every day to pay down mortgage debt can save you thousands of dollars in interest over the life of the loan.

Let's look at an example of how HEAP helps reduce mortgage debt.

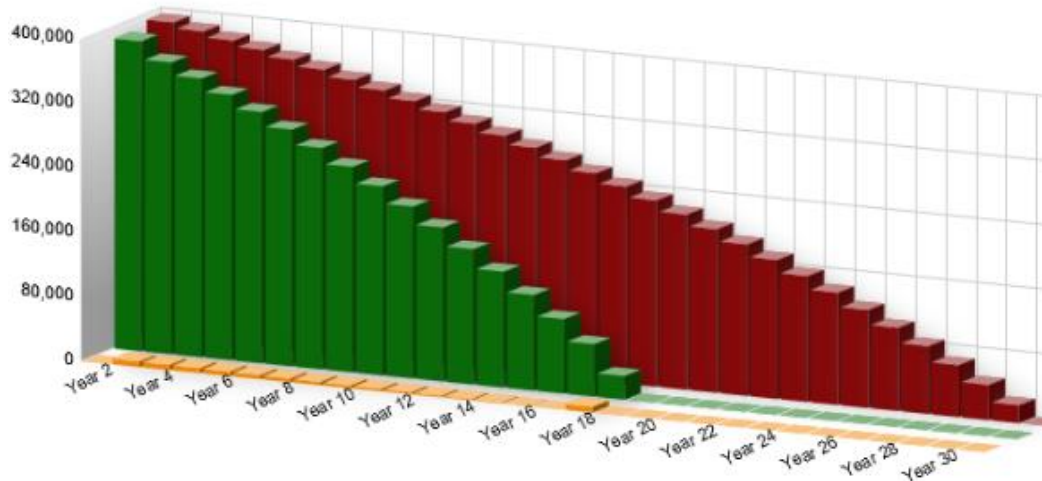
- Home value = \$500,000
- Initial mortgage = \$400,000
- Initial interest rate = 4%
- Term = 360 months
- Total after-tax income = \$5,000 a month (\$60,000 a year)
- Total monthly expenses including the mortgage = \$4,300

What are the benefits of using HEAP for this client?

-Years of interest saved = 12

-Total interest saved = \$123,150

The following chart illustrates the benefits of HEAP. The maroon bars are the 30-year mortgage. The green bars are the payments using HEAP.



Everyone who sees the above chart wants to have their own HEAP numbers run.

How to do you get your HEAP numbers run?

If you are taking this educational course from a financial planner, insurance agent, CPA, or attorney's website, that advisor has access to my HEAP software and can run your numbers.

But as I've already stated, aggressively paying down low interest debt is NOT the best way to grow maximum wealth for retirement. So, even though I created the HEAP software, I don't recommend clients use this plan in an aggressive manner to pay off their home mortgage debt.

HIGH INTEREST DEBT (DEDUCTIBLE OR NOT) IS BAD DEBT

Unfortunately, there are far too many people who have credit card (CC) debt. CC debt is some of, if not the worst, type of debt you can have.

QUESTION: Should you pay off high interest CC debt before saving for retirement?

ANSWER: _____ (Yes or No)?

I tipped the answer to this question by putting it under a section titled high interest debt is bad, but I am constantly surprised at how people incorrectly deal with CC debt.

I may be stating the obvious, but I wanted to explain why bad debt needs to be avoided and paid off before you should start saving for retirement.

The best way to understand why you should pay off CC debt before saving for retirement is with an example. Let's say you have \$10,000 in CC debt and that you have \$500 a month that can be allocated to:

1) Pay down CC debt quickly.

2) Pay the minimum payment each month towards the CC card and the remainder of the \$500 can be used to build wealth for retirement.

The average credit card interest rate on a CC is 17.55%.

How long would it take to pay off a \$10,000 CC bill using the 17.55% interest rate?

If you just paid the minimum each month it would take over 100 years to pay off the credit card debt.

For the first part of this example, we will assume that you paid enough each month to pay off the CC in ten years with the remainder of the \$500 being put towards investments to build wealth for retirement earning only 5% net each year.

After ten years, your CC balance would be zero and you'd have \$50,667 in an investment account (remember, part of the \$500 in the example went to pay down CC debt and the rest was used to invest to build wealth).

For the second part of this example, let's assume you took all \$500 and put it towards paying off your CC debt (meaning you would allocate NO money to grow wealth for retirement until after the CC is paid off).

With the \$500 a month payment, it would take approximately 24 months to pay off your CC debt. After the CC debt is paid off, you can then invest ALL \$500 a month towards building wealth for retirement for the remainder of our ten-year example.

After two years, your CC balance would be zero; and at the end of the 10th year, you'd have \$59,864 in an investment account.

Which do you like better; \$50,195 or \$59,864 in your investment account after ten years?

It is because of the math illustrated in this example that it is best to pay off high interest debt before starting to save for retirement.

QUESTION: Should you pay off high interest CC debt before saving for retirement?

ANSWER: _____ (Yes or No)?

TAKE AWAY

The longer you wait to pay off high-interest debt, the more it will harm your ability to grow maximum wealth for retirement.

CAVEAT

The one caveat to paying off credit card debt is if you are an employee who is able to participate in a qualified plan at work where the employer offers a match.

For example, if you defer \$500 into the qualified plan each month, the employer may match that at 100% up to 3%. If you have that ability, then it would make sense for you to take maximum advantage of the employer's matching contribution.

CAUTION

If an advisor (insurance agent, financial planner, etc.) tells you it's a better idea to fund an annuity, cash value life insurance, or an investment instead of paying off high interest rate credit card debt, make sure you don't work with such an advisor (they do not have your "best" interest in mind).

DEBT REDUCTION AND BUDGETING APP

When I was creating this course, I came to two conclusions:

1) I needed to create a simple debt app to help people understand how much money they are wasting by not paying down high interest debt.

2) People need to get on a budget. Without a budget, it's difficult to figure out where you are spending money in a wasteful manner and nearly impossible to set yourself up to save the maximum amount of money for retirement.

So, before rolling this educational course out, I created a simple but powerful debt reduction app and a full-blown budgeting app.

The debt reduction app allows you to input your credit card, student loan, or other high interest debt and then 1) change the order you pay them off; and 2) add extra money above the minimum payment to see how that affects paying off the debt.

Let's look at an example of how the debt app could be used.

The following example has a total amount of non-mortgage debt of \$25,500. This includes two higher interest rate credit card balances and a lower interest but higher balance student loan debt.

I'm going to assume that this example client has \$500 a month to budget to pay down these debts. The minimum monthly payments equal \$325 (meaning an extra \$175 will can be allocated to pay down these debts).

The question is, in which order should they be paid off?

In the following chart, you can see the interest rates, minimum monthly payments, and the order of payments for the first example. The student loan debt is the largest and let's say that the example client wanted to pay that off first, followed by credit card #1, and then credit card #2.

	Remaining Balance	% Rate	Minimum Payment	Payment Order
Credit Card 1	\$4,500	13.00%	\$50	2
Credit Card 2	\$9,000	17.00%	\$150	3
Student Loan	\$15,000	5.00%	\$125	1

What is the total interest paid in the above example and how long would it take to pay off all the debts?

Total interest = **\$11,151**

Total number of months = 73 (just over six years).

What if we changed the order to pay off the highest interest rate debts first?

	Remaining Balance	% Rate	Minimum Payment	Payment Order
Credit Card 1	\$4,500	13.00%	\$50	2
Credit Card 2	\$9,000	17.00%	\$150	1
Student Loan	\$15,000	5.00%	\$125	3

What is the total interest paid in the above example and how long would it take to pay off all the debts?

Total interest = **\$6,889**

Total number of months = 64 (just over five years).

So, just by changing the order in which the bills this example client paid off first, he/she could have **saved \$4,626** in interest.

While you don't necessarily need a debt app to tell you to pay off high interest debt first, the app can be useful in a few different ways.

1) It will help users understand how long it takes to pay off these types of debt (which will be shocking to many).

2) You can use the app to see how much quicker you can pay off the debt by adding additional payments.

For the next example, I'm going to assume that this example client could cut out some other monthly expenses and could find an extra \$150 a month to put towards these bills (and that the bills will be paid off in order of the highest interest rate first).

What is the total interest paid in the above example and how long would it take to pay off all the debts?

Total interest = **\$4,608**

Total number of months = 46 (just under four years).

What I think a lot of users will use the app for is to pick a time frame when they want these types of debts to be paid off. For the last example, I'm going to assume the person wants to pay off all three debts in three years (36 months).

How much extra above the original \$500 a month allotment would be needed?

\$290 extra for an allotment of \$790 a month to pay off all three debts in 36 months.

The total interest paid is \$3,553.

How do you get access to the debt reduction app?

It's free to use and you can get access to it a few different ways. If you are taking this course because an advisor set you up with it, you should be able to get it on his/her website.

Otherwise, you can email me at roccy@financialliteracycourse.net and I'll email you a link so you can get access to the app for free.

Full-Blown Budgeting App

Using the debt app can be an enlightening experience.

However, to get the best use out of the debt app, you need to come up with a realistic budget. Only if you have a realistic budget can you decide how much you can afford to pay extra on debts in an effort to pay them off.

In addition to figuring out how much you can budget to pay down "bad" debts, what's also important is to use a budgeting app to determine how much you can afford to save for a down payment on a home, save for college, and ultimately save for retirement.

The only way to maximize your ability to save is to:

- 1) Figure out where you are spending money.
- 2) Figure out if all your expenses are necessary.
- 3) Change your spending habits.

The best way to motivate yourself to change your spending habits is to commit to doing a full budget so you can see exactly where you are spending your money.

Why don't people create budgets?

- 1) They don't want to allocate the time.
- 2) They are a pain in the neck to do.
- 3) They are an even bigger pain in the neck to update.

I can't help you if you can't find time or motivate yourself to find the time to put together a budget (although if you are going through this course you are probably the type of person who will make the time).

The online budget app can help you with 2) and 3).

The online budgeting app is as simple as it gets.

- 1) You create a login.
- 2) You start inputting your monthly expenses.
- 3) You save your data and run a report.

The fact that you can save the data is a really big deal. This allows you to allocate 5 minutes here or 10 minutes there when trying to find time to input the data. If it takes 3, 4, 5 sessions to get all your data in there, that's fine. The goal is to commit to getting it in there.

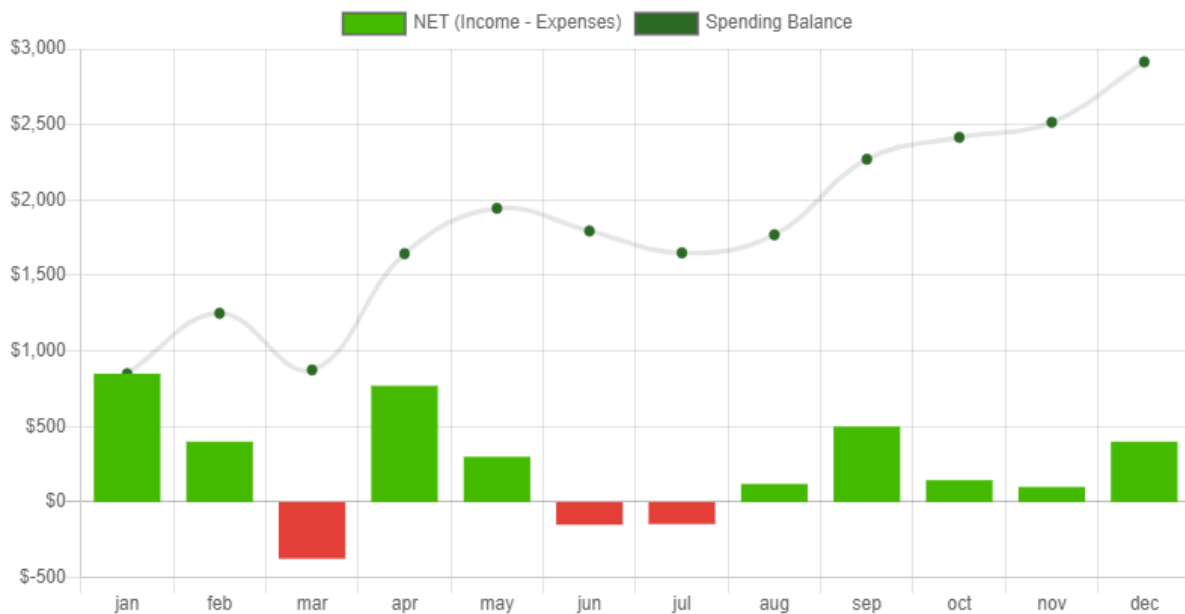
Once it is in there, because it is saved, you have the ability to update it with real data from the prior month (which I highly recommend).

If you can imagine estimating a 12-month budget and then updating it every month with real data, then you're really starting to paint a true picture of how you spend money.

Once the data is in there (even just your best guess data), then you can make decisions about whether you want to change your spending habits or not and then figure out what you want to do with your surplus (extra) cash flow each month (pay off other debts, save it for a short-term purchase, or invest it for long-term savings).

I can't stress readers enough the importance of keeping a budget and updating it monthly if you can. It will change the way you think about how you spend money (a bi-product of that will be more financial awareness).

I'm not going to go through a budget example, but I did want to show a chart from the software. The following shows the monthly surplus or deficits in monthly spending and the running total positive cash flow (the dotted line).



Again, the goal is to set up your budget and then tweak it to accomplish your short and long term goals.

How do you get access to the budget app?

It's free for those who have been given access to the financial literacy course by an advisor. If you are taking this course because an advisor set you up with it, you should be able to get it for free from that advisor.

If you signed up for this course on one of my websites, I should have already set you up to use the app.

STUDENT LOAN DEBT

While the country as a whole has a national debt issue, the fastest-growing debt issue facing individual consumers is Student Loan Debt (SLD).

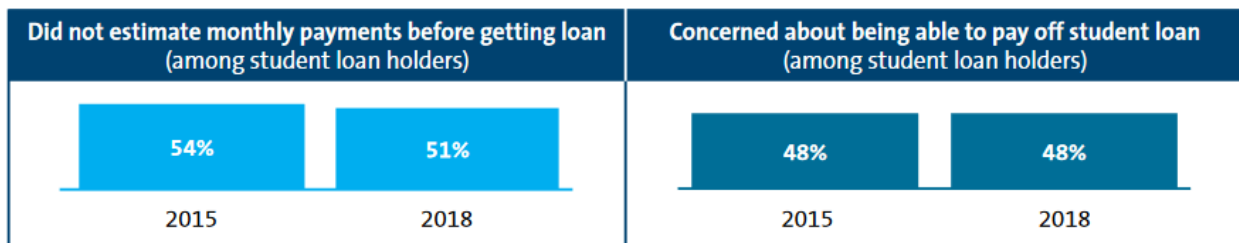
Student loan experts warned the House that the student debt crisis is now a “*trillion-dollar black hole*” and was hurting the financial system.

“Every 28 seconds, another borrower defaults... like kerosene on a fire, student debt is ... tearing our country apart,” stated Seth Frotman, former student loan ombudsman and the executive director of the Student Borrower Protection Center.

FINRA did a study titled: *The State of U.S. Financial Capability: The 2018 National Financial Capability Study (NFCS)*. The study included a section on student loan debt. It stated:

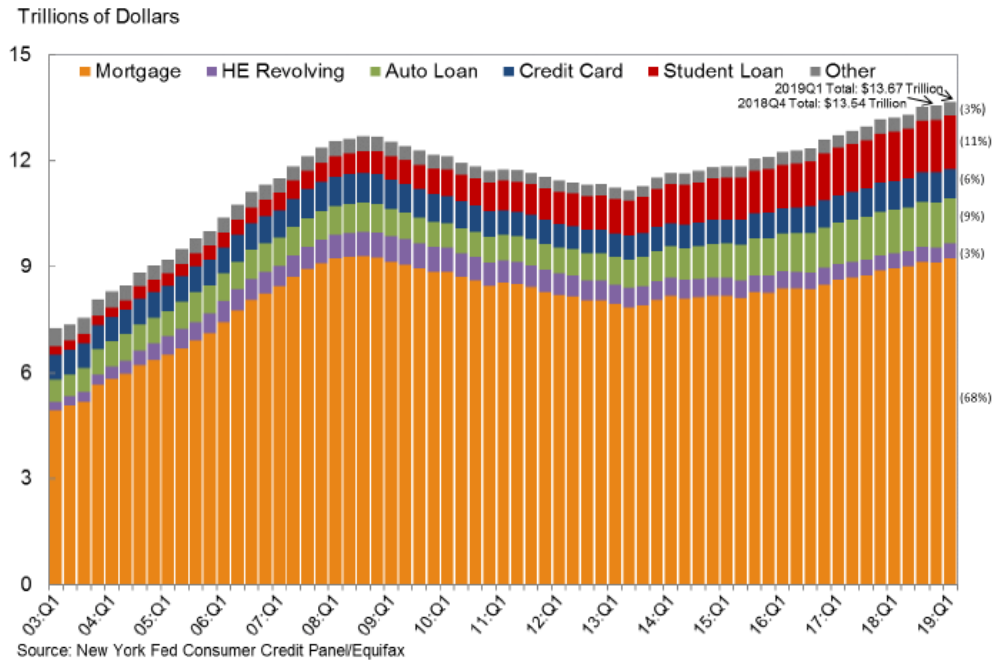
26% **Twenty-six percent American adults** in the 2018 NFCS reported that they currently have a student loan for themselves or a family member (this is stunningly depressing).

Findings from the NFCS suggest that many student loan holders did not fully understand what they were getting into when they took out their loans. The majority of student loan holders (51%) say they did not try to estimate monthly payments when obtaining their most recent student loan, while 43% report they did. Among those with student loans, about half (48%) were concerned that they will not be able to pay off their loans.



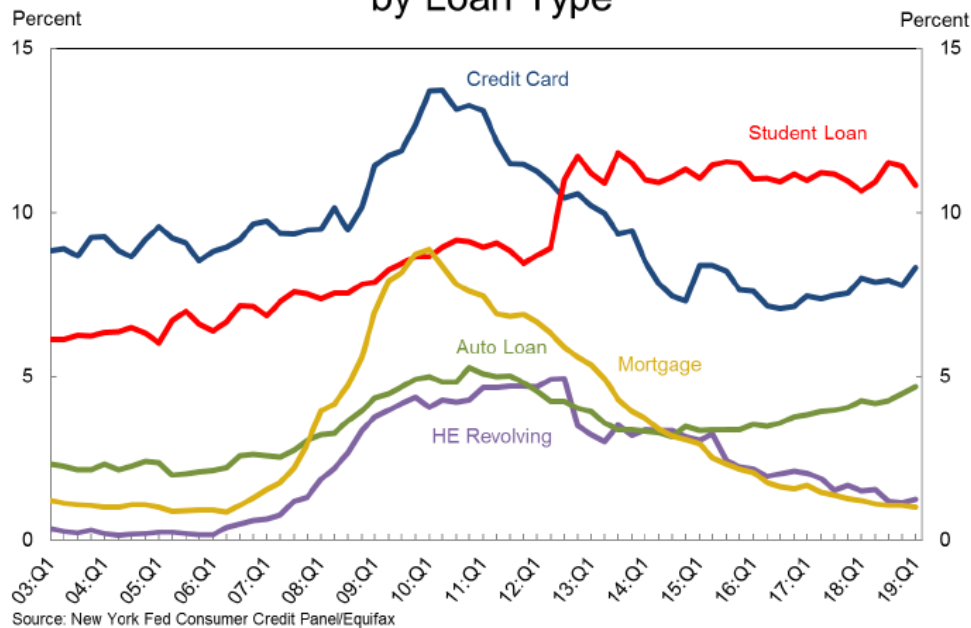
The following graph shows how over the last several years student loan debt has increased to be the 2nd largest debt of U.S. consumers at over 1.5 trillion dollars. It's more than auto loans and credit card balances.

Total Debt Balance and its Composition

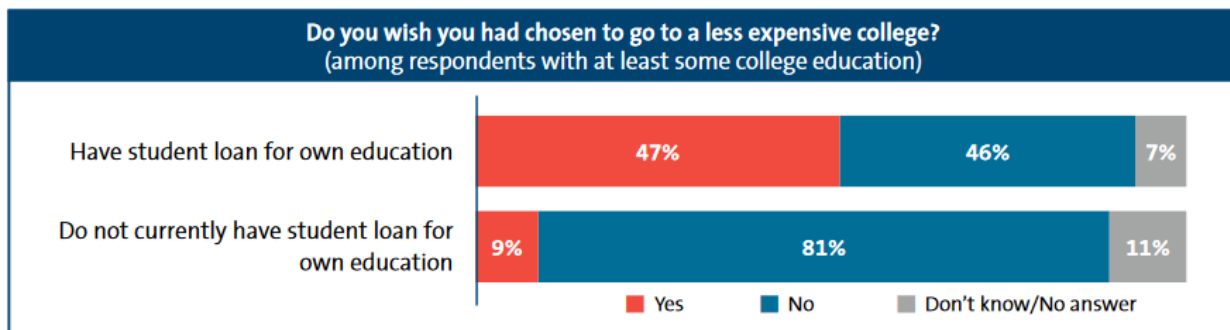


Student loan debt the last few years has overcome other types of debts when it comes to delinquent payments.

Percent of Balance 90+ Days Delinquent by Loan Type



Among those with student loans for themselves, nearly half (47%) say they wish they had gone to a less expensive college, compared to only 9% among those without loans for themselves.



What's the best way to deal with student loan debt?

The best thing to do is do your best to limit the amount of debt you take on. This can be done by using community colleges and/or less name brand schools that are now charging an arm and a leg for school.



Most people have never heard of the Student Loan Eliminator®. It's a revolutionary way to pay down student loan debt.

The Student Loan Eliminator® is a plan that...

“uses every available dollar every day to pay down student loan debt”

Questions for those who have student loan debt:

Question: Are you using every available dollar every day to pay down student loan debt?

Question: If not, would you like to?

The answer to question one for 100% of those reading this paper is **NO!**

The answer to question two for 100% of those reading this paper should be an emphatic **YES!**

Let's look at an example of how the Student Loan Eliminator® works.

Client—**40-year old doctor** with \$175,000 in student loans.

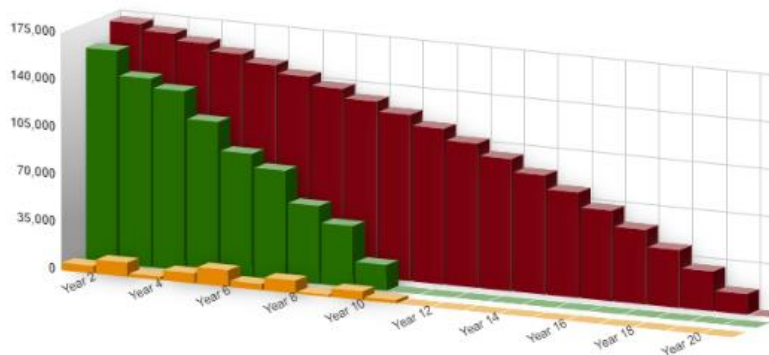
-Monthly income after-tax income = \$10,000 (\$160,000 pre-tax in the 30% income tax bracket).

-Total monthly expenses NOT including the student loan debt = \$8,000

-Monthly student loan debt payment at a 6.65% rate = \$1,203

If the student loan was simply paid off over a 20-year period, the total interest paid over the life of the loan would equal \$140,609. By using the Student Loan Eliminator®, the loan was paid off 9.75 years early saving \$75,074 in interest.

In the following chart (which uses the same concept as HEAP), the maroon bars are the student loan debt and the green bars are the debt being paid down faster using the Student Loan Eliminator®.



If you want to pay off student loans in the quickest and most efficient manner possible, the Student Loan Eliminator® is the plan to use.

How specifically the Student Loan Eliminator® works is outside the scope of this educational course.

If you would like more information on how it works, you should be able to get that from your locally trusted advisor.

OTHER TYPES OF DEBT

There are many other types of debts besides mortgages and credit card debt. One of the other primary debts is incurred when you buy a car.

The question you have to ask yourself is whether it makes more sense to pay for something in cash or whether it makes more sense to borrow money to pay for the item and invest the rest.

USING OTHER PEOPLE'S MONEY TO BUILD WEALTH

The concept of using other people's money to build wealth has been around for as long as lenders have lent money. When you choose not to pay off your home mortgage and instead choose to use your extra money to grow wealth elsewhere, you are using other people's money to grow your wealth. The same is true when deciding to pay off other types of debt.

QUESTION: What borrowing rate is too high to make using other people's money not worth using?

ANSWER: _____

FYI, this is a trick question. In order to answer the previous question, you need to know both the lending rate on the loan and the assumed investment rate of return on the money you didn't use to pay off the debt.

Let's look at an example. Assume you are buying a used Chevy Suburban for \$50,000 (crazy that a used Suburban costs \$50,000). Assume the lending rate on the loan is 3% (at the time course material was written, auto loans are less than 3%).

Assume if you invested money somewhere you could generate a 6% net (after all costs and taxes) annual rate of return. Finally, assume the term of the loan is 72 months (six years).

QUESTION: Will you be better off financially after six years by taking out a car loan and investing \$50,000 or paying cash for the car and avoiding the loan?

ANSWER: _____

If you paid cash for the Suburban, you would have avoided paying a car payment of \$759.68 a month for 72 months.

Because you paid cash for the car and will have no car payments, you could choose to invest \$759.68 every month for 72 months. If you earned a 6% net on that money over 72 months, you'd have \$65,972 in your account.

If you borrowed \$50,000, you'd, of course, have \$50,000 cash to invest immediately over the same 72-month time frame.

If you invested \$50,000 earning a net 6%, you'd have \$71,602 in your account.

So, the answer to the question with this fact pattern is that borrowing \$50,000 is better than paying cash for the car. You would have \$5,630 more in your investment account because you took out a loan to pay for the Suburban.

QUESTION: When does it NOT make sense to borrow money to pay for items you could pay for in cash?

ANSWER: _____

The answer is when the interest rate is the same or higher than the net investment rate of return you expect to earn on your investable dollars.

When interest rates are historically low and when you think your realistic return on investment will be higher than the lending rate on your loan, you should always borrow money to pay for cars, boats, etc.

For those of you with student loan debt, the same math applies. If you have a lower interest rate on your student loans than you can achieve by investing your money, you should invest and not be in a hurry to pay off your student loans.

CASH IS KING

While not a mathematical issue as to why paying cash for items may or may not be a good idea, the concept that cash is king is important to keep in mind for other reasons.

I understand many people think that too much debt can be bad and that there can be a negative stigma about debt in our society. However, having cash on hand and a certain amount of debt can be a protective move. What do I mean?

Say you have \$20,000 in savings and because you are averse to debt, you used all \$20,000 to pay cash for a car. Then assume you have a medical issue or some other major expense that costs you \$10,000.

Where do you get the money to pay for that expense? You had it until you spent it on the car. This is an everyday occurrence in our country. The consequences of not having access to your net worth because it is tied up in something illiquid like a car or a home can be devastating.

Health expenses are the #1 reason people file bankruptcy in America. Health care providers are not going to care that you bought a car and that you have no money to pay their bills. They just want to get paid. To pay your bills, you may have to sell your illiquid assets at a significant discount or you may have to put sizable amounts on high interest credit cards.

This can be avoided if you use other people's money to grow your wealth and have access to your wealth because you are growing it in a place you can get your hands on if you need to.

The caveat of growing wealth in, let's say, the stock market (which is liquid for most investments), is to make sure that a certain percentage of your money is in "conservative" investments, ones that will not suffer significant losses if the stock market crashes. I will discuss this in a later part of the course.

TAKE AWAY

Cash is king. Don't get hung up on having too much debt. Good debt is...well...good, so long as you have the discipline to invest wisely the money you have on hand because you borrowed to pay for certain items.

THE SCORPION AND THE FROG

Over the years of doing countless educational seminars for consumers and for advisors, the one story I try to remember to tell at every one is that of the Scorpion and the Frog. The story will drive home the point that we are all scorpions in many ways; and this is NOT something that is helpful when advisors give advice to clients for how to build wealth for retirement.

It's also a great lead into the last part of this section of the course where I talk about one of my least favorite sales platforms used by insurance agents.

And so the story goes.....A frog and a scorpion are sitting on the side of the river.

The scorpion says to the frog, "Would you let me get on your back and give me a ride to the other side of the river?"

The frog looks at the scorpion and says, "I can't do that. You'll sting me half way across. I'll die from the sting, and you'll drown."

The scorpion says, "That makes no sense. Why would I sting you when that would mean I'd also be killing myself?"

The frog agreed that it made no sense, and so he allowed the scorpion to hop on his back; and they started across the river.

Half way across, guess what happened? That's right; the scorpion stung the frog.

As the frog was dying and about ready to go under for the last time, he looked up at the scorpion and said, "Why did you sting me? Now we are both going to die."

The scorpion looked at the frog and said, "*I did it because I'm a scorpion and that's what I do*" (meaning scorpions sting no matter what).

The concept in the following pages is a concept sold by scorpions.

BANK ON YOURSELF; BECOME YOUR OWN BANKER, THE INFINITE BANKING SYSTEM

Bank on Yourself (BYOB) (also known as the Infinite Banking Concept and Bank on Yourself) revolves around the idea of "*creating your own bank*" so you can "*borrow from yourself*" instead of a third-party lender like a bank.

Most people hate paying lenders and, therefore, the idea of borrowing from yourself sounds interesting to many who first hear about it.

Is BYOB a scam? Do the following bullet points sound like a scam?

- confuses clients.
- doesn't use math that adds up.
- doesn't compare itself to other better wealth-building tools.
- is sold by agents who don't understand what they are selling.
- incorrectly tells clients that a specific type of life policy must be used to make it work.

Scam is probably too strong a word to use for the BYOB concept. Just saying, it's a concept that consumers are sold without understanding it; and if they did, they wouldn't use it.

What is BYOB and what's **wrong** with it?

In short, BYOB is an A-S-S backwards sales concept that misses the point of using Cash Value Life (CVL) insurance. As you'll learn in an upcoming section of the course, using a CVL insurance policy as a wealth-building tool can make a lot of sense for people under the age of 60. Money is allowed to grow tax free and can come out tax free.

In an upcoming section of this course, you'll also learn about different types of CVL policies including whole life (which I'm not a fan of) and Indexed Universal Life (IUL) (which I am a huge fan of).

Briefly, the "proper" goal with CVL is to fund it over a period of years, let it grow tax free, and then remove money tax free for retirement cash flow.

What BYOB advocated is funding only whole life insurance over a five-to-seven-year period and then use it as your own private bank (i.e., the concept of becoming your own banker).

However, when you run the "real" math behind BYOB, you'll come to find that it makes little financial sense to fund a CVL policy so you can then borrow from it in year six to buy a car.

It makes even less sense to borrow from a life insurance policy to pay off mortgage debt.

The BYOB concept is the *opposite of using other people's money to grow wealth*; and in an age with historically low lending rates, such a sales approach simply makes no sense.

It also makes little sense to use *whole life* insurance as the tool of choice with BYOB when an IUL policy is clearly a better option (however, even if you use UIL, BYOB still makes no mathematical sense). You will learn in detail in an upcoming section why I like IUL as a protected wealth-building tool.

Other People's Money

If a lender would lend you money at 3% where you knew you had the reasonable likelihood of generating returns 6-8%, how much money would you borrow from the lender? The answer should be as much as they will give you.

When you use a lender's money at a reasonable interest rate, it frees up your money to build elsewhere for retirement. *Many insurance agents selling BYOB don't understand this*. If they did, they wouldn't be selling the BYOB concept; they'd be offering the best cash value life policy to build wealth for retirement (not to buy a car).

Does BYOB protect the client from rising interest rates?

BYOB agents tout that the concept is protecting clients by creating their own bank so they don't have to rely on lenders. What they fail to understand is that when you properly fund and use cash value life for retirement purposes, you are creating an emergency pool of money.

The only difference is that you are not funding it with the "intent to borrow" from it in year eight to buy a car (which mathematically makes no sense in a low interest rate environment). If an emergency comes along, the cash in the policy can be borrowed from. If no emergency, then the cash is allowed to grow tax free for years and can be used to generate cash flow tax free in retirement (the ultimate goal of most clients).

BYOB Summary

I've talked with so many BYOB Kool-Aid drinkers over the years I've lost count. I've never talked with one who compared the BYOB concept to other wealth-building tools to create retirement cash flow. Any sales concept that is sold in a vacuum (not comparing it to other alternatives) is a disingenuous sale.

I make this offer to any reader of this course. If you are ever pitched a BYOB type concept, forward it to me for review; and I will freely give my time to pick it apart and show you why it is NOT a plan you should implement.

DEBT MANAGEMENT SUMMARY

Debt management at its core is not difficult to accomplish. There are only a few fundamentals.

- 1) There is such a thing as good debt.
- 2) It is not a good idea to pay down good debt if you have the discipline to use your money in a more productive manner to build wealth.
- 3) Bad debt must be paid off first before building wealth for retirement.
- 4) Low interest mortgage debt can be good debt.
- 5) If you choose to pay off good or bad debt, the best way to do so is through the efficient use of your money. Using every available dollar to pay down debt is the best way to pay off good or bad debt.
- 6) Diligently use a budgeting app to help you accomplish your debt reduction as well as your savings goals.
- 7) Don't be lazy. Be diligent. It's your money.