Should You Look at Insurance as an Investment?

The arguments for and against that point of view.

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Is a permanent life insurance policy an investment? One financial professional might answer that question with a "no," while another might say "in a sense, yes." Just as some people see a home as an investment, while others do not. Opinions differ.

Everybody can agree on the core purpose of a permanent life insurance policy. It offers a death benefit (read: liquidity), which can help a household out in an economically trying time and potentially help heirs pay estate taxes. That death benefit may also be used to provide an inheritance. In a business context, it may help a company weather the loss of a key employee or fulfill a buy/sell agreement.

You can draw some parallels between a permanent life policy and a Roth IRA. Permanent life insurance is usually paid for with after-tax dollars, and after-tax dollars go into Roth IRAs. Both a Roth IRA and a permanent ("cash value") life insurance policy permit tax-advantaged growth. Some whole life policies pay policyholders tax-free dividends, and tax-free income streams can be derived from Roth IRAs. When comparing only these features, a whole or universal life policy may seem akin to a Roth IRA for the risk averse.[1,2]

The comparison only goes so far, however. If you stop contributing to an IRA, you still have an IRA – an asset you own. If you stop paying premiums on a life insurance policy, that policy will lapse and you will forfeit what you have contributed to it. Also, while you determine how much you want to contribute to an IRA each year, the insurer determines how much you will pay in policy premiums per year.[3]

Those premiums could potentially rise. Low interest rates have recently meant lower profits for major insurers, and that is why some universal life policyholders have been hit with double-digit premium increases in the last two years.[4]

Yes, you may borrow tax-free against the cash value of a permanent life policy to pay for everything from eldercare to home improvement projects to college educations – but such loans can be expensive. Interest of 7-8% is common. If you fail to pay the loan off, the policy's death benefit could be reduced.[3]

Some simply regard permanent life insurance as a risk management tool. You can find many financial professionals who see life insurance policies as poor retirement savings vehicles. What should you contribute to first: a workplace retirement plan that may offer you matching dollars, an IRA you own, or a life insurance policy that could have higher annual fees and lower annual returns than both?

Still, wealthier households may want to explore permanent life insurance options. The typical middle-class couple may not be able to afford the premiums for such policies, especially in retirement – and they may find they have better wealth-building options earlier in life. Executives and other high earners who regularly max out their 401(k)s or IRAs, however, may find these policies very useful for purposes of diversification, risk management, and estate planning. They may see permanent life insurance as a worthwhile choice – and as an investment.

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Citations

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