Is Life Insurance an Investment?

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August 24th, 2023

While the primary consideration behind life insurance is to ensure the financial security of loved ones, some policies are marketed from a different angle. You may find certain insurance policies are presented as a dual-purpose tool – one that not only offers a death benefit but also includes a tax-advantaged savings vehicle to help save for retirement.

This is possible because when insurance premiums are paid, a portion covers the policy's costs, while the remainder is directed into cash value that earns interest and grows tax deferred. These benefits may sound appealing, but they come with a cost.

Life insurance is not a traditional form of investing, and it's usually not advised to use insurance as an investment vehicle. It's like trying to use a single tool to complete two different jobs – using specialized tools will often lead to better results.

The Purpose of Life Insurance

The primary objective of life insurance is to provide a death benefit that can help your loved ones maintain their lifestyle, pay off debts, and cover other expenses in the event of your passing. This financial protection ensures that your family is not burdened with financial difficulties during an already challenging time.

The Purpose of Investing

On the other hand, investing focuses on growing your wealth over time to support various financial goals while often offering valuable tax benefits. Whether you're saving for retirement, education, or simply building wealth, investing can help you reach these milestones. Investments can include stocks, bonds, mutual funds, real estate, and more, each with its own level of risk and potential return.

Should I Purchase Life Insurance as an Investment?

When it comes to using life insurance as an investment, there are often more suitable options for your portfolio. Insurance policies are often substantially more expensive than other investment options and come with restrictions.

If you have no use for the death benefit, paying a premium solely to access the value of tax deferral may not be a wise strategy. The combination of premium and investment expenses will diminish your overall returns. Instead, it's often recommended to save your money in other types of investment accounts with fewer restrictions and lower costs.

If you've maxed out contributions to tax-deferred accounts, life insurance might seem tempting compared to a taxable account that is subject to interest, dividends, and capital gains tax. However, tax-deferred doesn't mean tax-free. Withdrawing what you've contributed to the insurance policy is tax-free, but any growth and earnings withdrawn will be subject to a more aggressive tax treatment (ordinary income tax). This is because life insurance differs from regular investments and doesn't qualify for the more favorable long-term capital gain rates.

While some argue that life insurance does allow for withdrawals that are entirely exempt from taxes, this only applies if you borrow against the policy. This may seem convenient, but these loans often have unfavorable interest rates.

Another consideration before purchasing life insurance is that while your beneficiary will receive the death benefit, they will not receive the cash value. The money saved in the policy is often forfeited to the insurance company at your passing.

The Bottom Line

In most cases, life insurance shouldn't be used as an investment. While life insurance's core purpose is to offer financial protection, investments are dedicated to building wealth. Blending these two concepts frequently leads to restricted and costly investment choices, which in turn makes insurance-linked investments less attractive compared to more conventional alternatives.