Finance for Life™

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What is the Real Rate of Return of a Death Benefit?

Have you ever considered the actual rate of return of an insurance policy? If you do the math and calculate the potential rate of return that can be received tax-free on Term to 100 life insurance policies, you quickly learn that developing a death benefit for your estate can be an effective estate planning tool. To further this illustration, take John for example, a healthy 60 year old male (non-smoker) who purchased a $500,000 life insurance policy.

John wanted to purchase life insurance but was unsure if he should simply invest the money or pay insurance premiums. In order to make his decision, John would have to pay a premium of approximately $10,000 each year for his life insurance. If John is expected to live to age 85, then he would have to pay premium for approximately 20 years, which would equal $200,000. If John invested the $10,000 each year in fixed income GICs and earned 4%, at the end of 20 years he would have $309,000 (assuming no tax on accrued interest during the 20 years). If he were to consider the effect of annual taxes on his interest, he would then have $263,574 (assuming a 36% Marginal Tax Rate). One major advantage to the life insurance proceeds is that they are tax free!

When John then considers the net effect of paying insurance premiums, or investing the money, he realizes that the net

Life Insurance Policy/Investment Analysis

Age	Policy Year	Premiums Paid	Annual Investment Earning 4%	Investment After-Tax Rate of Return*	Death Benefit
60	1	$10,000	$10,400	$10,256	$500,000
65	5	$50,000	$56,329	$53,973	$500,000
70	10	$100,000	$124,863	$115,218	$500,000
75	15	$150,000	$208,245	$184,715	$500,000
80	20	$200,000	$309,692	$263,574	$500,000
85	25	$250,000	$433,117	$353,057	$500,000
90	30	$300,000	$583,283	$454,596	$500,000
**92	32	$320,000	$652,095	$498,943	$500,000
95	35	$350,000	$765,983	$569,814	$500,000
100	40	$400,000	$988,265	$700,555	$500,000

*assuming a 32% Marginal Tax Bracket without inflation considered
**At age 92, if the investor lives that long, his investment return would have more or less equaled the death benefit.

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after tax return on his life insurance policy is 7.37%. When he compares this to the net after tax return of 2.56% on his fixed income investment, the answer is simple! His estate, and heirs, will benefit much more if he were to purchase a life insurance policy. The only question that John still has is what if he lives longer than 20 years? Using the chart above, John is able to compare the net cost at various ages.

In conclusion, John's decision really is based on his goals and objectives regarding estate planning. If John lives past age 92, he would have been better off making an investment. Considering though that actuarial statistics indicate that a current 60 year old male will only live to age 79 (Canada), John may want to consider the life insurance scenario. That would maximize the estate benefit and minimize taxation in his year of passing, as the life insurance policy would provide maximum benefit for pennies on the dollar!

Source of Life Expectancy Chart: http://www.statcan.gc.ca/tables-tableaux/sum-som/l01/cst01/health72a-eng.htm