At least, that's not what the government wants you to think.

This is the same government that refers to taxes as “investments” and the printing of money that inevitably leads to inflation as “quantitative easing.”

The regulators even go as far as to prohibit life insurance agents from referring to life insurance as an investment, even though some forms of life insurance are registered as “investment security,” require a stock broker's license to sell it, and are sold "by prospectus."

In my opinion, the government doesn't do a very good job at defining anything, so I take their definitions of things with a grain of salt. So should you. Here's why...

The definition of “investment” according to Merriam-Webster is: *The outlay of money usually for income or profit.*

This begs the questions – **What is income? And what is profit?** Again, from Merriam-Webster:

Income: *A gain or recurrent benefit usually measured in money that derives from capital or labor.*

Profit: *A valuable return; gain; the excess of returns over expenditure in a transaction or series of transactions.*

Can a life insurance policy produce income to the policy owner? And can a life insurance policy produce a profit to the policy owner?

To answer these questions, we need to quickly review some of the basics of **Life Insurance 101** .

Life insurance comes in two generic forms: Temporary insurance and permanent insurance.

Temporary life insurance, commonly referred to as term life insurance, is insurance that is not designed to last a lifetime. Term life usually provides coverage for a period, or term, of years. That term may be one year, or five years, or as many as thirty years. It is designed to expire before the ages when most people will die, through an ever increasing premium. In general, term life insurance has no cash values, so when you cancel your insurance, you get nothing back. The premiums are low when you're young, but over a lifetime, term life insurance becomes cost prohibitive to own.

Permanent life insurance is life insurance that is designed to last a lifetime, usually with level premiums for life. The premiums are higher to start, but over a lifetime it actually costs less than term life insurance. Many permanent policies have cash surrender values, so that when you decide to cancel your policy, you get something back. You may also borrow from the life insurance company using your cash values and death benefits as collateral for the loan.

Each type of insurance has its own distinct advantages and disadvantages, but comparing them is not the purpose of this article.

Because temporary life insurance, or term life insurance, generally has no cash values, it generally does not meet the definition of investment, and it cannot produce a profit or generate income for the policy owner (although it can replace income for the beneficiaries after a claim is paid, but that's not the topic here today).

The purpose of this article is to demonstrate whether or not a permanent life insurance policy can be an investment, using the dictionary definition. Specifically, can a permanent life insurance policy generate a profit for the policy owner? Also, can a permanent life insurance policy produce income for the policy holder?

If a permanent life insurance policy can generate a *profit* and/or produce *income* for the policy owner, then it would meet the dictionary definition of an
investment
.

For this article, I'm going to use an imaginary person, a woman age 35, who is healthy and does not use any tobacco. The permanent life insurance policy she purchases will be a Whole Life policy. This policy is “participating” which means it is eligible for dividends from the insurance company. These dividends reflect a return of premiums to the policy owner that are a result of excess interest earned on the insurance company's general account and profits from the insurance operation. Dividends are not guaranteed.

Her policy:

Face Amount (death benefit): $1,000,000
Annual Premium: $10,080
Dividend Option: Purchase Paid-Up Additional Insurance.

At age 65, she would have cash surrender values of $462,825 and death benefits of $1,101,825, based on current assumptions, which largely reflects the market interest rates the insurance company can earn today. Her total premiums paid by age 65 are $302,400.

I may have attended a public school, but $462,825 is more than $302,400. The difference is $160,425, and that difference represents a *profit* upon surrender of this policy. Upon surrender, the insurance company will issue a Form 1099 to the policy owner to use to report that $160,425 *profit* on their tax returns, and the Internal Revenue Service says that *profit* is taxable as ordinary income under IRC Sec. 72(e).

So, even though some government entities and many self-anointed pundits say life insurance is not an investment, the Internal Revenue Service most certainly thinks life insurance is an investment (at least, when there's profit upon surrender).

But what about income? Can a life insurance policy produce income, meeting the other definition of an investment?

One of the settlement options, or standard non-forfeiture options, on a Whole Life policy is the annuity option. Instead of a lump sum of cash upon surrender, the policy owner may elect to receive payments over a period of time, or their lifetime, or both. These payments are called an **annuity**.

In the case above, the owner at age 65 could elect to convert her life insurance policy into a guaranteed income for life. The life only annuity option would pay her $2,022 per month for the rest of her life, guaranteed, no matter how long she lives. Upon her death, these payments stop.

Alternatively, she could elect a life with 10 year period certain option. The monthly annuity would be $1,985 per month, for the rest of her life, guaranteed, no matter how long she lives. If she doesn't live at least 10 years, then her beneficiary would receive $1,985 per month until at least 10 years of annuity payments have been made. These annuity payments are built into the policy at issue, and cannot be reduced, even though they were purchased 30 years earlier. Current annuity payments might be higher in the future, but the policy has guaranteed minimums as a standard feature.

As you can see, a Whole Life policy can produce *income* to a policy owner while they live.

Since a permanent life insurance policy can produce both *profit* and *income*, then it meets the dictionary definition of an *investment*. Because the Internal Revenue Service requires citizens to report *gains* or *profits* as ordinary income, then at least part of the federal government deems that life insurance can be an *investment*.

There's more evidence to support the fact that life insurance can be an *investment*, producing both profit and income for the policy owner. To wit:

Permanent life insurance can be used as one of the funding vehicles for a defined benefit pension plan, including a fully insured defined benefit pension under IRC Section 412(e)(3). Life insurance can also be used to partially fund a profit sharing plan under IRC Section 401(a), an investment option in a salary deferral 401(k) plan, and an investment option in a 457 deferred compensation plan.

Corporations purchase permanent life insurance, commonly referred to as **Corporate Owned Life Insurance** (COLI), to “informally fund” non-qualified deferred compensation plans on their executives and key people who suffer from reverse discrimination due to caps on the amount each employee can defer into a 401(k) plan. From the perspective of a corporation, a permanent life insurance policy can most certainly be an *investment*.

Banks purchase permanent life insurance as an *investment*, even though their regulators prohibit such practice, *unless* the policies fall into a **safe harbor**: The bank has to have a *bona fide* business purpose for the death benefits. Banks meet this *safe harbor* by having written salary continuation plans, deferred compensation plans, and key person death benefit plans. Once they have these written plans in place, they buy permanent life insurance policies with premiums measured in the billions of dollars.

One banker described **Bank Owned Life Insurance** (BOLI) as a *"constantly resetting municipal bond that I never have to mark to market."* The reasons bankers love life insurance is that there is no market volatility, and no interest rate risk. The cash values always grows at least at at minimum guaranteed rate, and the default risk is lower than virtually any other alternative, with the exception of US Treasuries (and who knows if that will remain true going forward?). Plus, life insurance has the added bonus of tax-deferral, and banks are like people in the respect that they seek to defer taxes as much as possible.

Banks love life insurance so much that 49 out of the 50 largest banks in America have more cash value life insurance in their Tier I capital reserves than any other asset class. Banks not only think life insurance is an *investment*, they believe is a a very secure, low risk place to warehouse their cash.

In summary: Is life insurance an *investment*? It most certainly meets the definition of an *investment* according the dictionary, as well as the definition according to the Internal Revenue Service. Banks, corporations, pensions, and qualified retirement plans see it as an *investment*.

But can life insurance be an *investment* for you? That is a question that can only be answered by consulting with a professional life insurance agent.

If you would like to learn more about **life insurance as an asset class**, please call today **(800) 680-5596**, or click on the contact button and send me an email.