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# The facts of life insurance

Stuart Chapell asks if a high-death-benefit insurance policy makes sense for the wealthy and whether you can guarantee returns.

It is rare for the wealthy to have no liquidity needs of any sort. Sometimes, a need for liquidity is relatively easy to identify, e.g. the payment of estate taxes or the repayment of borrowings secured on illiquid assets. On other occasions, the generation of liquidity may assist in meeting issues arising from more complex circumstances, e.g. adequate provision for family members where much of the wealth is tied up in a family business, or in real estate, or where there are children (and possibly grandchildren) from more than one marriage.

However, the wealthy are not usually attracted by high-death-benefit life insurance policies. Many consider they do not need one, as they already have, or consider themselves capable of generating over their lifetimes, more than sufficient wealth to meet their needs and the needs of their family, whatever the contingency.

These views should be challenged. One way to do so is to look at high-death-benefit life insurance in a different way, as being akin to a long-term investment.

## Insurance analysed

Whereas investors may once have had legitimate expectations of annual double-digit investment returns from a diversified portfolio of investments, in the current environment of low interest rates, low inflation and lower investment returns, such expectations are probably no longer realistic.

Long-term investment returns can vary considerably, particularly when charges and tax are taken into account. As charges apply to almost all investors, they are factored into our analysis, but this article does not take into account the various tax regimes that may apply to different individuals or types of investment.

**Table 1**

| MALE AGE | UK RESIDENT (PREMIUM IN GBP) | NON (PR |
|---|---|---|
| 45 | 38,350 | |
| 50 | 44,150 | |
| 55 | 55,850 | |
| 60 | 72,000 | |

PREMIUM RATES SUPPLIED BY RISK ASSURED LTD AND SUBJECT TO CHANGE

**Table 2**

| AGE | | UK RES |
|---|---|---|
| | 1.5% YEARS | 4. YE |
| 45 | 63 | 4 |
| 50 | 57 | 3 |
| 55 | 48 | 3 |
| 60 | 40 | 2 |

THESE FIGURES ARE FOR ILLUSTRATION ONLY

**Table 3**

| AGE | | UK RESI |
|---|---|---|
| | 1.2% YEARS | 3.2 YEA |
| 45 | 67 | 46 |
| 50 | 61 | 42 |
| 55 | 52 | 37 |
| 60 | 42 | 32 |

THESE FIGURES ARE FOR ILLUSTRATION ONLY

In the event of our hypothetical individual’s death after the payment of just one annual premium, the net return on the policy will be many thousands per cent

Table 1 shows whole of life (WOL) insurance annual premium rates for a UK resident and a non-UK resident (male, non-smoker) for a level sum assured of GBP4 million on a guaranteed basis. There is no investment content at all in this WOL policy; it offers pure life cover only. It cannot be surrendered for value. If the premiums cease, the policy will lapse without value.

Just how many years will it take our hypothetical individual to accumulate a fund of GBP4 million, based on annual savings equivalent to the annual premiums in Table 1?

To answer this question, I will use long-term gross investment returns of 2 per cent (low), 5 per cent (medium) and 8 per cent per annum (high). These happen to be the projection rates prescribed by the UK Financial Conduct Authority from 6 April 2014 for all tax-advantaged products (e.g. ISAs and regulated pensions). At this stage, I will take tax out of the equation but assume charges of 0.5 per cent (low), 1 per cent (medium) and 1.5 per cent per annum (high), which I will deduct from the gross investment returns and which will reduce the long-term net investment returns to 1.5 per cent, 4 per cent and 6.5 per cent per annum – not unrealistic in the current economic climate.

What does Table 2 tell us? At a high long-term net investment return of 6.5 per cent per annum, it will take a 45-year-old UK resident investor 32 years to accumulate GBP4 million, but, at a low long-term net investment return of 1.5 per cent per annum, it will take the same investor 63 years.

At the same high long-term net investment return of 6.5 per cent per annum, it could take a 60-year-old non-UK resident investor 21 years to accumulate GBP4 million but, at a low long-term net investment return of 1.5 per cent per annum, it could take the same investor 34 years.

In 32 years' time, the 45-year-old UK resident would be 77, while, after 63 years, they would be 108. In 21 years' time, the 60-year-old non-UK resident would be 81, while, after 34 years, they would be 94.

## Taxation

It is difficult for most individuals to save or invest in a completely tax-free environment, outside of savings vehicles attracting state support. Where the individual is UK-resident but non-UK-domiciled, they may be able to benefit from the remittance basis of UK taxation. Other individuals may reside in countries or states that do not impose taxes on income or gains.

Having previously ignored tax, I will now make what I consider a fair and reasonable deduction for taxes on income and realised capital gains of 0.2 per cent per annum, which, for the purposes of our analysis, will leave us with net (after charges and tax) long-term investment returns of 1.2 per cent, 3.2 per cent and 5.2 per cent per annum. The effect of this can be seen in Table 3, above. Of course, it should be stated that tax laws are subject to change and depend entirely on individual circumstances.

## Guaranteed returns

It is also difficult, if not impossible, to obtain guaranteed long-term investment returns. Alternative savings vehicles may target a particular long-term investment return but will generally not guarantee to achieve it, and you may get back less than you invested.

By contrast, provided the WOL policy is still in force when our hypothetical individual dies and the insurance company (or its successor) remains in business, the sum assured of GBP4 million is guaranteed to be paid to their estate, or possibly to the trustees of a suitable trust for the benefit of their chosen beneficiaries. This is so regardless of when death occurs. Indeed, in the unfortunate event of the death of our hypothetical individual after the payment of just one annual premium, the net return on the WOL policy will be many thousands per cent.

## Mortality

Most of us shy away from facing our own mortality and simply do not want to talk about it. Fortunately, a majority also understand the need to consider making a will and/or creating a trust in their lifetime to make adequate financial provision for their family and dependants.

Most will also understand and appreciate (given the above) that, from a pure investment perspective, a high-death-benefit life insurance policy can make economic sense, especially should anything happen to the individual during the early years of the policy.

I do not argue that investors abandon all other forms of long-term savings in favour of life insurance – just that a high-death-benefit guaranteed WOL insurance policy can be viewed as a prudent long-term investment, given that it offers a guaranteed investment return with no volatility and none of the market risks typically associated with long-term savings and investments.

## Conclusion

In an environment of low inflation and lower investment returns, it can make sense for wealthy individuals to consider high-death-benefit life insurance to meet both investment and liquidity objectives. In all instances, I would advise individuals to discuss their options with their own advisors and take into account any risks inherent in the solutions under consideration.

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