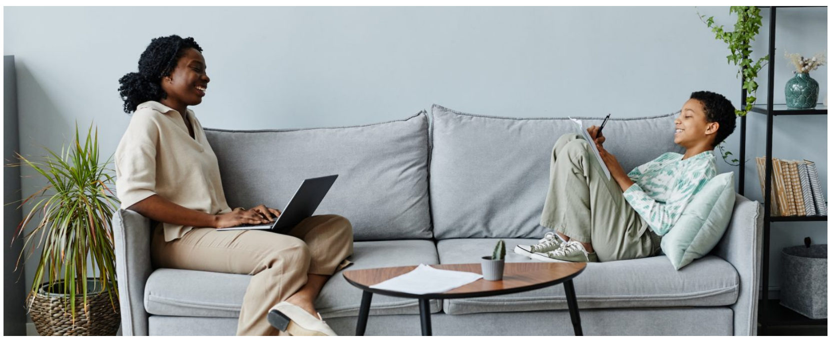
Advertiser disclosure

Is Whole Life Insurance a Good Investment?

Whole life insurance isn't a fit for everyone, but it offers guaranteed returns and can supplement retirement income.

By Katia Iervasi
Apr 11, 2022
Edited by Lisa Green



The investing information provided on this page is for educational purposes only. NerdWallet does not offer advisory or brokerage services, nor does it recommend or advise investors to buy or sell particular stocks, securities or other investments.

Key takeaways:

- Whole life insurance offers coverage and earns interest over time in a cash value account.
- As an investment, whole life insurance may suit high net worth individuals and parents with lifelong financial dependents.
- Depending on your budget, the low rates of return might not offset the high premiums.

On the surface, life insurance is a simple concept: You pay an insurance company a premium and, when you die, the company pays your beneficiaries. But whole life insurance also features an investment component, which is where things can get complex.

These policies earn interest in a tax-advantaged account and offer guaranteed returns, but they're expensive and not suitable for most people.

» MORE: Whole life insurance definition

How whole life insurance works as an investment

Whole life insurance is two products rolled into one: a permanent life insurance policy that offers lifelong coverage, plus a savings account.

When you pay your premium, the insurer invests a portion to give your policy a cash value. This account grows over time at a fixed rate guaranteed by your insurer. The cash value portion grows tax-deferred. This means that any interest you earn isn't taxed, as long as you keep the funds in the account.

Once you've accumulated enough cash value, you can begin to take out loans against your policy. While you don't need to pay back these loans — it's your money — your insurer will subtract any outstanding loans from the payout when you die.

If you choose to buy a policy from a mutual life insurance company — an insurer that's owned by its policyholders — you might receive dividends based on the company's financial performance. You can cash them in, use them to pay premiums or buy additional insurance to boost the face value of your life insurance policy. If you choose that option, your cash value will increase as well.

» MORE: Best whole life insurance companies

When is whole life insurance worth it?

Whole life insurance can make sense as an investment in these situations.

You've maxed out your retirement accounts

If you're a high net worth individual who has made all the allowable contributions to your tax-advantaged accounts like 401(k) plans or individual retirement accounts, you could use a whole life insurance policy to top up your tax-deferred savings.

The cash value will earn interest over the years, and when your children are adults, your mortgage is paid off or you no longer need life insurance for whatever reason, you can surrender your policy and collect the cash. If you surrender the policy, be aware that you might be subject to income tax on the value it has gained, and your beneficiaries won't receive a death benefit when you die.

You have a lifelong dependent, such as a child with a disability

Life insurance can offer peace of mind to anyone with financial dependents. If you're a parent caring for a child with a disability, a whole life insurance policy might suit your situation as it provides lifelong coverage. It will pay out regardless of when you die, giving your family a sense of financial stability.

To ensure your child is still eligible for government benefits, like Supplemental Security Income, avoid naming them as your beneficiary[1]. Instead, consider setting up a special needs trust. An attorney can connect your whole life insurance policy to the trust, and you can appoint a trustee (such as a guardian) to manage the money on behalf of your child.

» MORE: Life insurance planning for parents of children living with a disability

You want to help your family pay estate taxes

Is your estate worth $12.06 million or more? That's the federal tax exemption limit for 2022, so the IRS might levy an estate tax on any assets above the threshold when you die[2].

In addition, some states charge their own estate or inheritance tax. For example, New York's estate tax kicks in after $6.1 million[3].

Thanks to the cash value component, whole life insurance is a form of "forced savings." Whether you hold the policy until you die or surrender it for cash when you retire, whole life insurance can give your loved ones the money they need to pay estate taxes without having to dip into other accounts.

You want to diversify your investment portfolio

Whole life insurance is a steady investment in that the cash value grows at a set rate, and returns are dependable. They're not subject to the ups and downs of the market, so you won't lose any money if the market takes a turn.

This differs from other permanent policies, like variable life insurance and variable universal life insurance. With these policies, the cash value grows at a variable rate, meaning returns are subject to market conditions and aren't guaranteed.

» MORE: Average life insurance rates

The drawbacks of whole life insurance as an investment

While whole life insurance has its perks, it's not the right policy for most people. Before you sign

While whole life insurance has its perks, it's not the right policy for most people. Before you sign up for a policy, be aware of these downsides.

The premiums are expensive

The cost of whole life insurance tends to be much higher than term life insurance. For example, a healthy 40-year-old man can expect to pay an average annual premium of $6,388 for a $500,000 policy, while a woman of the same age might pay $5,467, according to Quotacy, a life insurance brokerage. To compare, a term life policy for a healthy 40-year-old would cost $340 for a man and $287 for a woman, on average.

If you're purely interested in life insurance coverage, you might be better off buying a term life insurance policy and funneling the savings into other investment vehicles.

» MORE: Term vs. whole life insurance: How to choose

The cash value is slow to grow

For the first few years, your insurer will direct a chunk of your premiums to fees, commissions and other administrative costs. Eventually, a higher percentage of your premium will go toward your cash value. But this takes a while, so it can take 10 to 15 years (or even longer) for you to build up enough cash value to borrow against.

If you'd prefer an investment that offers positive returns quickly, you'll want to look elsewhere. And if you are interested in the kind of investment offered by whole life insurance, try to buy a policy while you're young so you have plenty of time to reap meaningful returns.

The cash value rate of return can be low

The average annual rate of return on the cash value for whole life insurance is 1% to 3.5%, according to Quotacy. While whole life insurance offers fixed, guaranteed returns on your cash value, you may earn higher returns with other investments, such as stocks, bonds and real estate. Consult a fee-only financial advisor to learn about tax-advantaged investment options that suit your risk tolerance.

You can't control your portfolio

With whole life insurance, the investments are chosen and professionally managed by your insurer. As a policyholder, you have no say over the type of investments, or how much money to allocate to them.

On one hand, this makes whole life insurance a hands-off investment. But if you're a seasoned investor, you may not like relying on your insurer's investment managers to deliver returns for you.

In that case, you could consider policies that invest the cash value more aggressively and allow you to choose your investments from a portfolio presented by your insurer. These include variable life insurance and variable universal life insurance, which typically have the highest risk and highest possible returns for life insurance.

There can be tax implications if you withdraw cash from your policy

Generally, you only pay taxes on the cash value if you access it — and the IRS only charges a tax on the amount that exceeds the policy basis. This is the amount of money you've already paid in premiums, minus any dividends you've received.

If you withdraw less money than the policy basis, those funds are yours, tax-free. But any withdrawals over that are subject to income tax. You may also pay taxes if you surrender your life insurance policy, or if you borrow against your life insurance and don't repay the loan. Speak to an accountant to learn more about how whole life insurance can affect you at tax time.

» MORE: Is life insurance taxable?

More about whole life insurance

Check out these additional resources about whole life insurance.

Whole life insurance definition

How does whole life insurance work?

The cost of whole life insurance and why it's so high

Best whole life insurance companies

Article sources

Back to top

About the author: Katia Iervasi is a lead writer for NerdWallet, where she focuses on insurance and oversees our "best of" life insurance pages. Her work has been featured in The Washington Post. Read more

DIVE EVEN DEEPER IN INSURANCE

Compare Life Insurance Quotes

by Georgia Rose

Read more

Life Insurance: Policies, Types and Quotes

by Georgia Rose

Read more

8 Best Term Life Insurance Companies in February 2023

by Georgia Rose

Read more

Explore **INSURANCE**

Banking
Credit Score
Checking
Savings
Prepaid Debit Cards
Money Transfer
CDs

Credit Cards

Financial Planning
Paying off debt
College Savings
Making Money

Financial News

Insurance
Auto Insurance
Homeowners Insurance

Mortgages
Mortgage Rates
Mortgage Process
Homeownership
Homeownership Costs
Selling Your Home
Home Affordability
Property Taxes

Learn more about the app

Download on the App Store | GET IT ON Google Play

Credit Card Basics

Credit Cards for Bad Credit

Student Credit Cards

Rewards Credit Cards

Credit Cards for Average or Fair Credit

Cash Back Credit Cards

Balance Transfer Credit Cards

Airline Credit Cards

Low Interest and No Fee Credit Cards

Life Insurance

Medicare

Renters Insurance

Pet Insurance

Investing

Retirement Planning

Roth IRA

Estate Planning

Brokers

401k

Loans

Auto Loans

Student Loans

Small Business

Running Your Business

Small-Business Loans

Up your money game with a NerdWallet account

Continue with Apple

Continue with Google

or continue with email

By signing up, I agree to NerdWallet's Terms of Service and Privacy Policy.

Reward Optimizations

Rental Cars

Travel Insurance

ABOUT

Company

Leadership

Careers

Corporate impact

Diversity & Inclusion

Editorial guidelines

Star rating methodologies

Editorial team

News

Press kit

Investors

HELP

Help center

Support team

Community

Security FAQs

LEGAL

Terms of use

Privacy policy

California privacy policy

Privacy preferences

Do not sell or share my personal information

Disclaimer: NerdWallet strives to keep its information accurate and up to date. This information may be different than what you see when you visit a financial institution, service provider or specific product's site. All financial products, shopping products and services are presented without warranty. When evaluating offers, please review the financial institution's Terms and Conditions. Pre-qualified offers are not binding. If you find discrepancies with your credit score or information from your credit report, please contact TransUnion® directly.

NerdWallet Compare, Inc. NMLS ID# 1617539
NMLS Consumer Access | Licenses and Disclosures

California: California Finance Lender loans arranged pursuant to Department of Financial Protection and Innovation Finance Lenders License #60DBO-74812

Property and Casualty insurance services offered through NerdWallet Insurance Services, Inc. (CA resident license no. OK92033) Property & Casualty Licenses

NerdWallet™ | 55 Hawthorne St. - 11th Floor, San Francisco, CA 94105

NerdWallet USA | NerdWallet UK

NerdWallet CA | NerdWallet AU