canada life

Internal rate of return

What clients need to know before comparing policies

When clients shop around for life insurance policies, it's tempting to compare one against the other – or look at how it'll perform over the long-term using illustrated policy values.

However, there are more things to consider. Here are some things clients should know before they compare policies.

Long-term product means change is likely

Life insurance protects clients today, but they probably won't need the policy benefit for 20, 30 or even 40 years down the road. A lot can happen during this time.

More to discover with illustrated values

All clients receive an illustration, based on a company's current dividend scale[1], before they buy a participating insurance policy. It shows how policy values might look if factors included in the dividend scale stayed the same for the remainder of the policy. However, factors used to calculate that illustration will almost certainly change over time, meaning it's probably not a great idea to buy a policy based solely on illustrated values.

Comparisons between companies

Be careful when comparing illustrations between competitors. Illustrations show what might happen to policy values if the current dividend scale continued for the life of the policy. This means short-term disparities in experience between participating accounts may cause substantial differences in illustrated values.

For example, while it's easy to fixate on current differences in the dividend scale interest rate (DSIR) – a major contributor to a company's dividend scale – average historical dividend scale interest rates are similar. If you expect similar long-term future results, the DSIR is one factor you can adjust in the illustration to get a better comparison.

However, if a client looks solely at future illustrated values, they won't see the whole story. That's because while companies may offer similar products, they're not the same. They may be priced with different assumptions, which changes how much clients pay for the same insurance payout (death benefit).

It's important to measure the benefits (insurance payout and cash value) a client may receive at a given point in time for the premiums they've paid.

Whether comparing different types of products offered by one company or similar products between companies, the internal rate of return can be a very useful tool.

[1]Including factors such as investments, expenses, mortality and others.

Dividend scale change: impact

Illustrated values, unless stated as such, aren't guaranteed. At least once a year, Canada Life reviews the participating policyowner dividend scale at which point changes could occur.

When the dividend scale goes up, illustrated values generally increase as well causing a corresponding rise in a policy's internal rate of return. The same thing happens in reverse when the dividend scale goes down.

Internal rate of return

Internal rate of return is an objective way to compare policies[2]. It's a standardized way to show the relationship between cumulative out-of-pocket premiums and benefits illustrated in a given year. You can use it to compare universal to participating life insurance (early or delayed values), and even policies from different companies.

For a proper comparison, clients should decide if short-term or long-term values are more suitable for their financial plan.

For example, if the policy is for estate planning, business succession planning or planned giving purposes, clients will likely focus on the total death benefit value. Alternatively, clients who may want the flexibility to access the cash value while still living may focus more on enhancing the cash value.

Here's an example of how it works

When insurance payout at issue is the same
Policy A annual premium $5,000 **Policy B** annual premium $4,000
Assumes out-of-pocket premiums for 20 years

Which one is better?

Let's look at the internal rate of return to compare the performance of these two policies:	Policy A	Policy B
Annual premium	$5,000	$4,000
Cash value after 15 years	$80,000	$40,000
Internal rate of return cash value at year 15	0.8%	(5.3%)
Cash value after 30 years	$200,000	$140,000
Internal rate of return cash value at year 30	3.4%	2.7%
	Policy A	**Policy B**
Death benefit value at age 85	$400,000	$375,000
Internal rate of return death benefit	4.5%	5.1%

This is a hypothetical example, which demonstrates how to use internal rate of return.

Policy A has higher premiums and internal rate of return for the cash value based on the durations shown. **Policy B** has lower premiums and a higher internal rate of return for the death benefit at assumed life expectancy (age 85).

Which is most important for your client?

With all this information in mind, ask yourself (and your client) if short-term or long-term values are more suitable for their financial plan.

For more information about internal rate of return, contact your insurance sales partner at the product solutions centre.

[2]It's not appropriate to base a buying decision solely on an internal rate of return comparison. The complete illustration, including different plan types, benefits, features, guarantees and riders for each policy should be reviewed with the client before they buy.

The dividend scale interest rate is only one of many factors that contribute to an individual policy's performance. The actual cash value growth in any policy varies based on a number of factors such as type of product, product features, premium-paying period, issue age, rating, dividend option, the dividend scale and others.

canada life

46-11111-5/19