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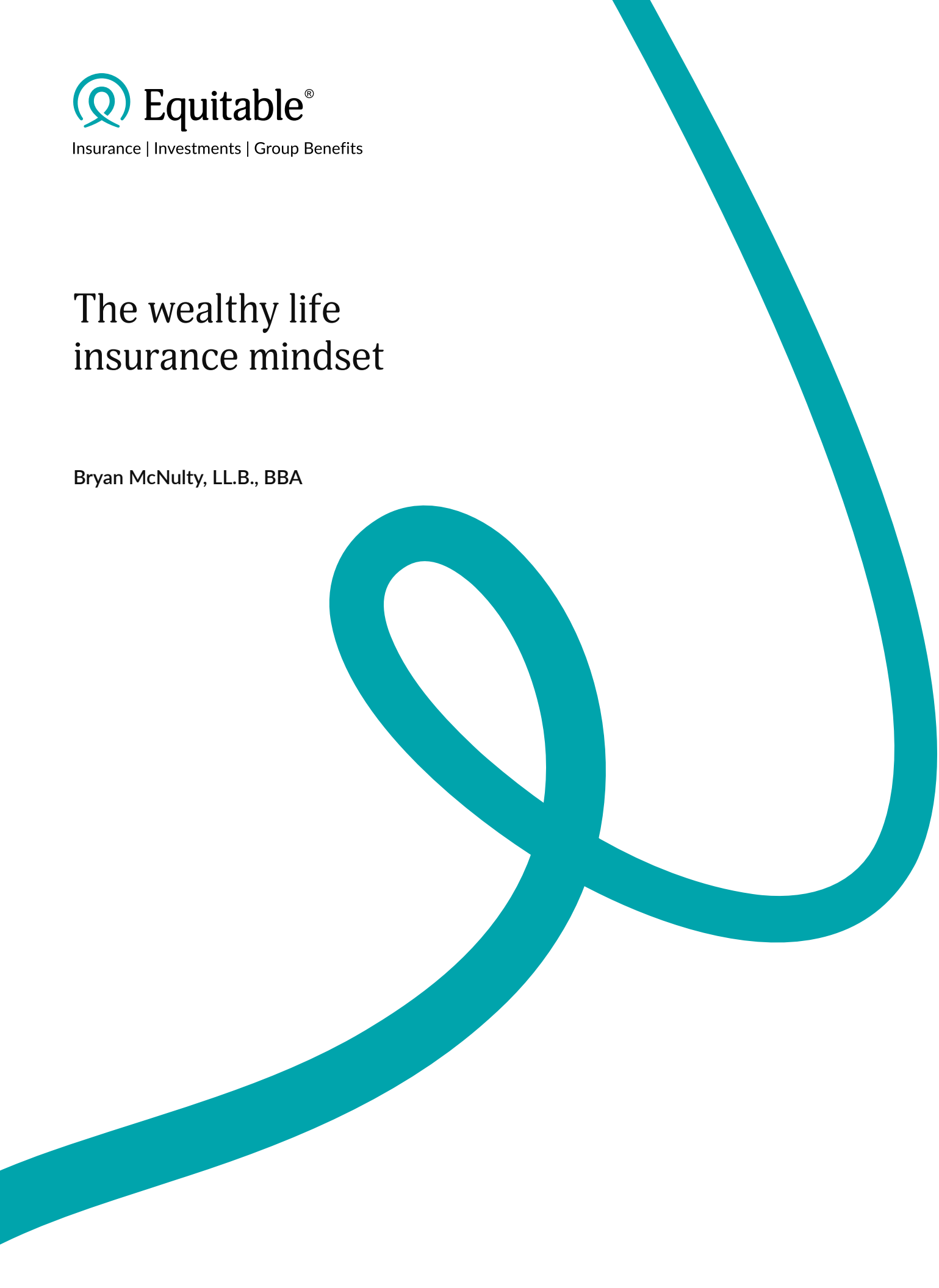
The wealthy life insurance mindset

Bryan McNulty, LL.B., BBA



Abstract

Why wealthy individuals buy safe investments and permanent life insurance

As a follow-up to Equitable's article "Life insurance as an asset class – The mutuality edition", Bryan McNulty, LL.B., BBA (Head of Tax and Estate Planning at Equitable), examines why many wealthy individuals prefer safe investments, such as permanent life insurance, over alternative assets that may offer higher returns.

Bryan brings more than 25 years of tax and estate planning experience for high-net-worth individuals. In this article, he examines the psychological and behavioural factors that influence wealthy clients' preference for safe investments. Supported by data-driven research, Bryan offers practical insights to help advisors position permanent life insurance with their wealthy clients.

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An introduction to safe investments and prospect theory

Each year, the Capgemini World Wealth Report examines the investment allocation of high-net-worth individuals (HNWIs), defined as those with more than U.S. $1 million in investible assets. Despite having the financial capacity to take on greater investment risk, HNWIs consistently allocate a substantial portion of their wealth to conservative assets. In 2023, 49% of their portfolios were held in cash, cash equivalents, and fixed-income investments—a proportion that has changed very little over the past decade. This category includes money market funds, bonds, annuities, and similar holdings, which I will broadly refer to as "safe investments."

It may seem surprising that people with high-net worth put such a large share of their assets in safe investments. Safe investments often provide a lower long-term return than other asset classes such as real estate, equities and alternative investments. Similarly, people often question the decision by HNWIs to pay significant premiums for large permanent life insurance policies.

Although Canadian tax rules provide exempt life insurance policies with favourable tax treatment, which can create good after-tax returns, it is not the sole reason life insurance is purchased. There are many other investments that over a long period have the potential to generate higher after-tax returns. In many examples, which I will explore in more detail, people often don't base decisions only on expected rates of return. However, financial investment advisors, life insurance advisors and accountants spend a lot of time debating the math and assumptions being used to prove which life insurance policies (if any) make the most sense for an individual.

These debates use complicated Excel spreadsheets. They use product performance assumptions that are often controversial, along with estimates for how long someone will live. This is what I call the "Permanent life insurance vs. buy term life insurance (or no insurance) and invest the difference debate." This debate focuses only on the math with each side arguing that it has mathematical proof that its argument is correct. As a result, many people fall back on the answer "it depends on the individual." While this is often true, it ignores how people actually make decisions. The reality is that in most cases it's not about the math.

So why do people with significant assets, who may be able to take on more risk for a higher return, purchase safe investments and permanent life insurance, rather than other assets that may produce larger expected returns at life expectancy?

More importantly, even if you know why HNWIs do this, how can advisors use this information to recognize when a HNWI is likely to buy a permanent life insurance policy, and which policy may be appropriate for that person?

For me, a helpful starting point for understanding decision making is the book (Thinking, Fast and Slow) by Daniel Kahneman.[1] The book shows that people (including me) don't always make decisions from a purely financial perspective. A large part of Thinking, Fast and Slow[2] focuses on how people make choices when risk is involved and explains prospect theory. Prospect theory helps to explain the reasons and decisions many people, including HNWIs, choose safe investments and permanent life insurance - even in situations where such a strategy is not necessary. The decisions people make when choosing investments that have different degrees of risk and certainty are not only surprising but are also important to understand when presenting permanent life insurance policy options to them.

Prospect theory vs. expected utility theory

Before prospect theory, expected utility theory was used to explain how people make decisions. This theory says that people choose between risky or uncertain options by comparing their expected utility. In this case, utility means how much benefit or satisfaction someone gets from an outcome. According to this theory, people make decisions by weighing the potential outcomes of each option, considering both the probability and the value of those outcomes, and then selecting the option that maximizes their overall expected utility.

To illustrate expected utility theory, consider the following example involving investments.

Imagine an investor, Rob, has two investment options:

Option A
A conservative bond investment with a 100% probability of a $24,000 return; and

Option B
A riskier investment with a 33% probability of $25,000 return, a 66% chance of a $24,000 return and 1% chance of $0 return.

Using expected utility theory, Rob would make his decision based on the expected value (or utility) of each option:

Option A
The expected utility is simply the $24,000 return because it is guaranteed; and

Option B
The expected utility is the weighted sum of the utilities of the possible outcomes, so the expected utility is: (33% x $25,000) + (66% x $24,000) + (1% x $0) which equals $24,090

Since Option B has a higher expected value ($24,090 vs. $24,000), expected utility theory predicts that Rob will choose Option B.

Prospect theory, developed by Kahneman and Amos Tversky, and published in 1979 in an article of the same name (the "Prospect Theory paper"),[3] challenged this idea. It showed that people do not always follow expected utility theory when making decisions that involve risk.

In fact, many people would choose Option A, the safer choice, even though Option B has a slightly higher expected value. Experiments showed that people often prefer certainty and avoid risk, even when taking a risk might produce a better outcome.

What does prospect theory tell us?

The studies in the Prospect Theory paper, and subsequent research by Kahneman and Tversky, as well as other psychologists and behavioural economists, clearly show that expected utility theory does not always predict how people make decisions when risk is involved.

Problem 1 in the "Prospect Theory paper" is the Rob example I introduced above.[4] When people in the study were asked to choose between Option A and Option B, 82% chose the guaranteed $24,000 in Option A, even though it was $90 less than the expected value of Option B.

The Prospect Theory paper, and Thinking, Fast and Slow introduce many situations that demonstrate that when people are faced with choices involving risk, expected utility theory often does not predict the choices made by most people.

From these studies and the conclusions that can be drawn from them, I will attempt to provide explanations for the reasons HNWIs purchase a high percentage of safe investments.[5]

As the Life insurance as an asset class article demonstrated, some life insurance policies can form part of the safe investment class of assets in a portfolio. Therefore, many of the explanations for HNWIs purchasing a high percentage of safe investments are helpful in shedding light on why they also or should purchase life insurance policies that fit in this class. However, not all HNWIs use life insurance in this way. Some of the more interesting findings from prospect theory help explain other reasons why wealthy individuals often choose to purchase large permanent life insurance policies.

Principle 1

Risk aversion and the certainty principle when it pertains to gains

What would you choose between these two options?

Option A:
80% chance to get $40,000; or

Option B:
Guaranteed $30,000.[6]

80% of the participants chose the guaranteed $30,000 in Option B rather than the 80% possibility to get $40,000 in Option A, even though expected utility of Option A is $32,000. The explanation for this is that when gains are certain, people are risk averse. The idea being that the enjoyment from gaining $30,000 is greater than an 80% chance of a $40,000 gain when there is a 20% chance of obtaining nothing.

Risk aversion likely surprises very few people. However, there are important limits to its application: Risk aversion only applies to choices that have a reasonably high degree of certainty and when the choice with certainty involves gains.

The importance of certainty

When the above example was changed to the following options, the results were different:

Option A:
20% chance to get $40,000; or

Option B:
25% chance to get $30,000.[7]

In this case, 65% of participants chose Option A, even though their chances were higher in Option B to receive $30,000. The fact that Option B did not have a high degree of certainty appears to be the reason.

When the example changed once more, the results demonstrated that degree of certainty matters:

Option A:
45% chance to get $60,000; or

Option B:
90% chance of $30,000.[8]

In this example, both had the same expected utility of $27,000 but Option B had a higher degree of certainty. As a result, 86% of people chose it over Option A, which had a lower degree of certainty but a higher potential payout of $60,000.

Risk aversion with certainty only applies in respect of gains

Although this will be explained in more detail when I discuss loss aversion, when the problems above are not dealing with gains but dealing with certain losses, people are less risk averse and will seek risk in some circumstances.

Principle 2

Loss aversion and risk taking

> *During presentations, I have asked advisors in attendance:*
>
> *"Who would agree to a single coin toss, where if you correctly choose which side lands face-up (heads or tails), you will receive $150,000. But if you are wrong, you pay me $100,000?"*
>
> **Over 90%** of the people in attendance at each presentation would not agree to the coin toss.

This was consistent with a key principle in expected utility theory. Expected utility theory predicts that if someone has $1 million and loses $500,000, that pain from the loss is greater than the pleasure of gaining $500,000. However, expected utility explained this because the person's wealth dropped from $1 million to $500,000. It does not explain how people make decisions when facing losses, and how that is different than when they face gains.

Prospect theory goes further and explains how strongly people feel losses and how they make decisions when faced with losses and called it "loss aversion." Under loss aversion, the intensity of a potential loss of $100,000 is worse than the positive feeling of a $150,000 gain. In chapter 26 of "Thinking, Fast and Slow", Kahneman explains that this loss aversion ratio is usually in the range of 1.5 to 2.5, meaning that for most people to accept a gamble, the gain has to be 1.5 to 2.5 times larger than the possible loss.[9] Of course, it depends on how risk averse a person is and the ratio would be much larger if the loss could financially ruin a person.

The impact of this loss aversion led to some surprising findings. The first surprising discovery is that when facing certain losses, people are not risk-averse; they take risks. Instead of certain gains, in Problem 3 of the Prospect Theory paper the two options looked at were losses:

Option A:	**Option B:**
80% chance to lose $40,000; or	$30,000 loss.[10]

92% of people chose to take the risk in Option A. Instead of facing the certainty and pain of a guaranteed $30,000 loss in Option B, people chose a 20% chance for no loss even if there was an 80% chance to lose $40,000 (expected utility theory projects a $32,000 loss).

"You just like winning and dislike losing – and you almost certainly dislike losing more than you like winning."[11]

- Kahneman

Kahneman explains when people face two bad options, with one choice having a high certainty of a loss, they often choose the riskier option that has a chance of avoiding the loss. This is the opposite of how they behave with gains.

However, when the chance of a loss is very small, they become risk-averse and pay the small amount to avoid it. This is the second surprising conclusion from loss aversion, and it was demonstrated when the following two options were provided:

Option A:
0.001 chance to lose $50,000; or

Option B:
$50 loss.[12]

In the study, 83% chose Option B, the certain loss of $50 rather than the 0.1% chance of a loss of $50,000 in Option A. This situation should sound familiar. This is why people purchase warranties and insurance in general. People prefer paying $50 rather than facing 0.1% or less risk of a $50,000 loss.[13]

People are even willing to pay more than the actuarial odds of the loss occurring, although an element of that can be the overestimation of a remote loss occurring. Kahneman and Tversky found even when people know the probability of a rare event occurring, they mentally overestimate the likelihood of it happening, such that a 1% probability event has a decision weight of 5.5%, increasing it from a rare event to a possible event.[14] For example, if an actuary tells you there is a 1% chance you will die in the next year, you will likely equate it to be much higher chance of death, such that you will make decisions including paying premiums on life insurance as though there was as much as a 5.5% chance of you dying in the next year.

Principle 3

The reference point matters

If Person A has $1 million and their wealth increased to $2 million, and Person B has $3 million and their wealth dropped to $2 million, most people would agree Person A would likely be happier with their wealth than Person B. Person A gained $1 million and Person B lost $1 million, so loss aversion would explain Person B not being as happy as Person A, even though both end up with the same $2 million of wealth in the end.

Expected utility theory could not explain this and expected both people would be equally happy as they had the same wealth of $2 million. Prospect theory introduced the relevance of the reference point before a gain or loss when decisions are made.

Problems 11 and 12 in the Prospect Theory paper demonstrate the relevance of the immediate reference point:[15]

Problem 11

On top of whatever you already own, you have been given $1,000. You must choose one of the following:

a) 50% chance to win an additional $1,000; or

b) Gain $500 for sure.

Problem 12

In addition to whatever you own, you have been given $2,000. You are now asked to choose one of these options:

a) 50% chance to lose $1,000; or

b) Lose $500 for sure.

In both examples, the final wealth is identical if they make the same choices in both problems; the certainty of having $1,500 or accept the gamble so they end up with either $1,000 or $2,000. However, in problem 11, 84% chose the $500 guarantee of a gain and 16% chose the gamble, whereas in problem 12, only 31% chose the guaranteed loss of $500 and 69% accepted the gamble.

The key point is that each participant started at the same point (whatever they owned before the problem), but some were given $1,000 and some $2,000 before being asked to choose. It is the participant's wealth at the time they were given $1,000 or $2,000 that became the relevant reference point rather than what they started with before the study.

In other words, what a person has at the moment of a decision is the relevant reference point, not what they had 10 years ago, five years ago, yesterday or even an hour before is what influences how they act and when the principle of loss aversion is relevant. This explains Person B whose wealth decreased by $1 million, from $3 million to $2 million, being less happy than Person A even if Person B had no money 10 years ago.

Principle 4

The endowment effect – the pain of selling things you own

Richard Thaler, one of the founders of behavioural economics realized after reading about loss aversion and reference points in the Prospect Theory paper that they explain the endowment effect.[16] The endowment effect happens when people value something more simply because they already own it. For example, someone might be willing to pay up to a certain price to buy an item, but once they own it, they refuse to sell it, even for more than that amount.[17]

Thaler, in his 2015 book "Misbehaving: The Making of Behavioral Economic"[18] provides many examples and experiments[19] that demonstrate the endowment effect, including:

- A male colleague in 1975, whose maximum price he was willing to pay for a bottle of wine was $25, would not later sell the same bottle, even for $100.
- People that purchase concert tickets who were only willing to pay $500 to get them, were unwilling to sell them at much higher price.
- Participants in studies that were given a school coffee mug or a pen (which have an identical monetary value), were unwilling to trade the item they were given for the other item.

Thaler realized after reading the Prospect Theory paper, that for the endowment effect, the reference point is whether a person owns or does not own the item.

If the person owns it, the decision to sell it is based on the pain of giving it up. If the person does not own the item, the decision is based on the pleasure of obtaining it. The principle of loss aversion shows that the pain of giving up the item is in many cases much larger than the pleasure of obtaining the item.

Prospect theory: The role of the four principles in financial decisions

Principle	Description	Impact
1. Risk aversion and certainty principle (gains)	People prefer certainty in gains, even if the expected return is lower.	Individuals make investments that often favour guaranteed outcomes, even when riskier options offer higher expected returns.
2. Loss aversion and risk seeking (losses)	Losses feel more painful than the pleasure from equivalent gains; people take risks to avoid certain losses but pay for certainty to avoid unlikely immediate losses.	Individuals may take risks to avoid certain losses but are willing to pay for certainty to avoid rare but severe losses.
3. Reference point	Decisions are influenced by the current wealth level or status (i.e., "don't drop below this.")	As wealth increases, individuals become more risk-averse about losing what they have achieved, increasing assets to preserve that new reference point.
4. Endowment effect	People value what they own more than what they don't, making them reluctant to sell assets.	Individuals place high value on preserving cherished assets within the family or ensuring that they go to intended heirs. They are likely to pay a price to avoid the risk of losing the assets.

Although the four principles in prospect theory that I have summarized may not provide all the reasons HNWIs decide to purchase safe investments and permanent life insurance policies, I would argue they play a major role in these decisions.

How prospect theory principles explain decisions by high-net-worth individuals

Purchase of safe investments by HNWIs

Prospect theory suggests that HNWIs often choose safe investments that offer a lower expected return but with greater certainty rather than other asset classes, which can be explained by risk aversion. Like most people, HNWIs prefer guaranteed positive returns over the possibility of larger returns that may or may not materialize.

More importantly, loss aversion also plays a key role. Many of the safe investments' assets have little or no chance of losing money. However, investments in real estate, equity and other ventures carry a risk of losing some or all of the principal invested.[20] The pain of potential loss with these investments is often greater than the pleasure of their potential gains. As a result, a significant portion of a portfolio in safe investments helps limit the loss potential.

Reference points for wealth also lead to the purchase of safe investments. Each time a person hits a higher level of wealth, they create a new reference point, or a level of wealth they do not want to fall below. For people who recently became wealthy over a short period of time, some continue taking the same risks that made them wealthy. However, many wealthy people realize, or learn from others' experiences to understand that the skills to get rich (particularly quickly) are often different than the skills to stay rich.[21] Often getting rich requires a person to take substantial risks, and in some cases risking everything, but once a person obtains wealth, the same "all in" strategies could significantly reduce or even eliminate that wealth.

A person's reference point, which again, is the amount of wealth he or she does not want to drop below, helps determine their asset mix, and the appropriate number of safe investments to maintain that reference point. Problems 11 and 12 in the Prospect Theory paper showed that when a person attains a higher level of wealth (regardless of where they were previously), he or she has a new higher reference point for which the person becomes risk-averse and loss-averse. As a result, the dollar amount invested in safe investments typically increases as wealth grows.

Purchase of permanent life insurance by HNWIs

As life insurance can be structured in different ways, the reasons that large permanent life insurance policies are being purchased by HNWIs depends on how the policy is structured and its purpose. I will look at some of these policies and purposes to review where prospect theory provides an explanation why HNWIs purchase large policies that they may not "need."[22]

Permanent life insurance as its own asset class

In the Life insurance as an asset class article, the case was made that Equitable's permanent participating whole life (par) Equimax Wealth Accumulator® 20-pay product, with the use of the maximum Excelerator deposit option (EDO), was its own asset class.[23] This is because the par fund is broadly diversified, and Canada's favourable tax rules often allow the policy's cash value and death benefit to grow at returns that are higher than fixed income investments with similar or lower levels of risk. In addition, the policy provides strong liquidity throughout its life.

As a result, like the safe investments, HNWIs purchase this product or similar variations of it for the same reasons that they purchase safe investments – risk aversion, loss aversion and to maintain a reference point for wealth.

However, not all HNWIs buy par or permanent life insurance policies simply as a safer investment or for early liquidity. There are many other situations where these policies are useful. Prospect theory helps explain these situations, and why these products can still make sense for HNWIs in different contexts.

Permanent life insurance as a long-term asset where short-term liquidity is not a concern

Many HNWIs already hold safe investments and have significant liquidity. Despite this, they often purchase large permanent life insurance policies even when additional short- or medium-term access to cash is not required.

HNWIs have their own time horizons of not only when or if they anticipate needing liquidity during their life but also what level of wealth they want when they die and what is the earliest age that it is required.

Fortunately, insurance companies have multiple products with various time horizons for paying premiums to satisfy individual needs. I have provided in the Appendix of this article a comparison of death benefit and cash values for various Equimax® par policies that Equitable offers using similar cash premiums being paid over the same number of years. For consistency with the Life insurance as an asset class article, I have used the same insured in that article: A non-smoking, 50-year-old male.

For simplicity, I compare the Equimax Wealth Accumulator 20-pay policy with the maximum EDO used in the Life insurance as an asset class article, but rather than funding it for 15 years, it is only funded for 10 years. It is compared to five other Equimax policies that will also be funded annually with $150,000 for 10 years.[24] Projected values for each policy are based on the current dividend scale interest rate (DSIR) as of September 2026, less 1% (current DSIR less 1%).

The values in the Appendix compare the death benefit and cash value for each policy option for selected years. Different policies offer better liquidity (i.e., higher cash value) than other policies at different ages and higher death benefits than other policies at different ages. This allows advisors to choose the option that provides what a client is looking for in terms of liquidity and death benefit based on the ages that are most important. These preferences are often based on the individual's financial situation and how the principles of prospect theory impact decision making by that individual.

For many HNWIs, a specific death benefit that increases substantially throughout the individual's life may matter more than liquidity in the short- or medium-term. For others, they may want a higher death benefit, but at age 70 or 75, they also want certainty of liquidity at that age. If these are corporate-owned policies, we would also consider the addition to the corporation's capital dividend account and the after-tax amount that is received by the corporation's shareholders when the insurance proceeds are distributed to the shareholders of the corporation.[25]

In my experience with business owners and wealthy individuals who purchase life insurance when short-term liquidity from a life insurance policy is not a priority, the death benefit is a priority regardless of when the insured person dies. However, there is an emphasis on age near or around life expectancy. I will review three categories for the purpose of this death benefit in respect to a purchase decision. In many cases, two or more of these categories may be applicable.

Maximizing the value of assets owned at death

Many HNWIs want to maximize how much they have at death. The purpose of this amount is to pass wealth to the next generation and/or create a legacy through a donation. Prospect theory does not explain why people have these objectives,[26] but it provides an explanation as to why a permanent life insurance policy may be acquired to help make this happen.

There are two main elements to the decision with most permanent life insurance policies that have a potential increase in value in the mind of HNWIs that are beyond the face amount of death benefit on the policy:

Element 1: The guaranteed element is the face amount of the life insurance policy. Because the individual is risk averse, this provides certainty of the death benefit provided based on the premium paid; and

Element 2: The second element is more complex. It is the life insurance product chosen and the ability to over-fund or continue funding a policy for extended years so that there is a potential for a higher death benefit and greater liquidity in the policy many years before death of the insured. This potential for increased returns is attributable to the returns on the investment funds utilized in the policy and favourable tax rules that can increase both the death benefit and the cash value.

This decision is based on the investment risk that the client may be willing to entertain after obtaining the certainty provided in Element 1, as well as how the policy is structured. These factors should play a role in what permanent life insurance policy and options are recommended to a client.[27]

Paying taxes at death

When a person dies, for calculating Canadian income taxes at death, there is a deemed disposition of many assets at fair market value triggering unrealized capital gains, and the inclusion in income of assets in the Registered Retirement Savings Plan (RRSP) or Registered Retirement Income Fund (RRIF).[28] This can mean a significant tax liability at death.

Many HNWIs choose to purchase permanent life insurance to fund some or all this tax liability. This strategy helps preserve the estate's value or the need to sell valuable income producing assets such as rental properties or a business. In these cases, the life insurance is used to help preserve the estate's value (the reference point) from taxes, from a business facing financial hardship (loss aversion) or avoid selling assets that are important (endowment effect). Often, this is the main way advisors position life insurance to HNWIs and are often successful doing it.

The endowment effect and retaining certain assets after death

In the last section, I mentioned the use of life insurance by HNWIs to purchase life insurance to fund taxes at death so that certain assets do not need to be sold to pay taxes. Selling assets to pay taxes is not the only issue when the endowment effect plays a role. Many HNWIs own assets, such as businesses, real estate portfolios, family homes or cottages. These assets can be difficult or impractical to divide among multiple family members. These assets may have unique value for the deceased or specific family members best suited to own or manage them.[29] Dividing these assets and co-managing these assets can reduce their value (including a loss of the business), cause family disputes that can lead to costly litigation or force a sale at an unfavourable price. Life insurance proceeds can provide compensation to family members who do not receive these assets, allowing the intended recipient to retain the asset without requiring a sale or the "sharing" of the asset which may ultimately result in the loss of the asset.

Bringing it all together

Prospect theory suggests that while financial factors and expected returns matter to HNWIs, psychological factors often play an even bigger role in their decisions:

- Risk aversion creates a desire for wealth preservation strategies by HNWIs that balance certainty with opportunity for growth. Safe investments and permanent life insurance policies (primarily permanent participating whole life insurance) provide certainty with potential for growth.
- Loss aversion, an individual's reference point, and the endowment effect often play a significant role in the decision to incorporate permanent life insurance or other safe investments into an estate plan.

Permanent life insurance policies provide a compelling solution, offering both a guaranteed death benefit and potential for increased value through investment features. This dual nature provides not only peace of mind against a decreasing estate value due to future tax liabilities, but it also preserves cherished assets, ensuring they remain within the family or with certain family members and are not sacrificed to meet tax or family financial obligations.

Understanding how prospect theory influences decision-making can help advisors better support their wealthy clients. Not all HNWIs are the same. They have different goals, different comfort levels with risk, and different concerns about loss.

Rather than presenting the same strategy and product choice to each client, advisors can ask their clients questions and listen to them. This will help advisors objectively determine their clients' desire for certainty and aversion to losses, including the client's reference point and the possible impact of the endowment effect. This knowledge of a client's psychological drivers should allow the advisor to prepare and present tailor-made solutions for a client[30] that respects their financial and emotional priorities in a way that helps the client realize their goals of creating an enduring legacy and satisfies the client emotionally.

Turning knowledge into action: Three ways to incorporate prospect theory principles into client conversations

1. Engage

Advisors should consider moving beyond purely mathematical comparisons about product performance and expectations and engage clients to understand their emotional drivers. By understanding a client's degree of risk aversion, loss aversion, reference points, and the endowment effect, advisors can better identify what motivates their financial decisions and tailor their recommendations accordingly.

2. Ask questions

Ask targeted, emotionally informed questions. Use clarifying questions that uncover not only financial objectives but also emotional priorities, such as concerns about liquidity, discomfort with potential losses, and the importance of preserving specific assets or legacies. This approach helps advisors to present solutions that resonate with clients' true concerns and values. In the section below, "Some possible positioning of permanent life insurance for HNWIs", the "Emotional based clarifying questions" provide some examples of questions that can be asked.

3. Position

Position safe investments and permanent life insurance as tools for wealth preservation and legacy planning. Advisors should explain how these products address not just returns but also psychological needs - such as certainty, the desire to avoid losses, and the wish to preserve or pass on assets. By framing safe investments and permanent life insurance in terms of their roles in protecting wealth, funding taxes at death, avoiding family disputes and resentment, and ensuring important assets remain within the family, advisors can help clients see the value of these strategies in their estate and legacy planning.

Some possible positioning of permanent life insurance for HNWIs

HNWIs objectives	Prospect theory principles	Emotional based clarifying questions
Protecting wealth today and in the future	• Risk aversion and certainty • Loss aversion and risk seeking • Reference point	• Importance of liquidity in the next few years? • How much more painful is a loss than a similar gain? • What impact will death have on the HNWI's family's wealth?
Payment of taxes at death	• Risk aversion and certainty • Loss aversion and risk seeking • Reference point • Endowment effect	• Does the idea of paying taxes at death cause mental pain for you or your family after your death? • Would you or any members of your family be ok if any specific valuable assets (house, cottage, rental property, a business) were sold to pay a tax liability? • If you died in the next year, would you have enough liquid assets to pay the tax at death or be comfortable selling assets? Would any of your family members be willing to obtain a bank loan to pay the taxes rather than sell assets?
Leaving important assets to certain people	• Endowment effect	• What person or people would you not want to get a specific asset? • Why is it important that a specific person or people get the asset? • What happens if the person/people do not get the asset? • Do you want to give the person/people something else?
Leaving monetary bequests to certain people or charitable organizations	• Risk aversion and certainty[31] • Loss aversion	• What is the minimum amount required? Is it a set dollar amount or a percent of assets? • Why is it important? • Are there certain assets that cannot be used to fulfill the bequest?

Appendix

Comparison of Equimax policy at select years[32]

Comparison of death benefit at select years

Age	Equimax Wealth Accumulator life pay max EDO	Equimax Wealth Accumulator 20 pay max EDO	Equimax Wealth Accumulator 10 pay no EDO	Equimax Estate Builder life pay max EDO	Equimax Estate Builder 20 pay max EDO	Equimax Estate Builder 10 pay no EDO
55	$3,386,201	$2,951,358	$2,270,737	$3,451,011	$3,101,198	$2,449,783
60	$4,639,195	$3,964,852	$2,621,571	$4,747,810	$4,173,811	$2,810,685
65	$4,489,303	$3,592,095	$3,036,569	$4,660,180	$3,874,711	$3,285,277
70	$4,468,527	$3,368,685	$3,498,200	$4,717,292	$3,734,973	$3,813,166
75	$4,564,658	$3,879,623	$4,022,960	$4,909,779	$4,311,953	$4,414,318
80	$4,778,854	$4,473,289	$4,632,654	$5,241,136	$4,984,606	$5,113,369
85	$5,105,860	$5,162,110	$5,340,235	$5,708,611	$5,766,862	$5,925,994
90	$5,526,950	$5,936,246	$6,135,917	$6,291,601	$6,647,029	$6,841,996
100	$6,419,670	$7,527,812	$7,773,082	$7,521,635	$8,452,629	$8,730,501
Initial face amount	**$2,130,682**	**$2,130,682**	**$2,106,445**	**$2,166,691**	**$2,089,428**	**$2,307,692**

Comparison of cash values at select years

Age	Equimax Wealth Accumulator life pay max EDO	Equimax Wealth Accumulator 20 pay max EDO	Equimax Wealth Accumulator 10 pay no EDO	Equimax Estate Builder life pay max EDO	Equimax Estate Builder 20 pay max EDO	Equimax Estate Builder 10 pay no EDO
55	$749,289	$739,900	$642,284	$552,816	$441,593	$117,655
60	$1,743,004	$1,668,080	$1,308,256	$1,486,165	$1,334,757	$985,431
65	$2,103,224	$1,897,340	$1,733,936	$2,086,015	$1,991,628	$1,878,633
70	$2,523,890	$2,116,215	$2,250,170	$2,554,874	$2,399,758	$2,452,965
75	$2,891,483	$2,771,165	$2,872,376	$3,122,238	$3,077,270	$3,154,035
80	$3,415,056	$3,485,760	$3,611,387	$3,788,467	$3,880,085	$3,985,573
85	$4,039,788	$4,336,433	$4,486,421	$4,555,393	$4,814,493	$4,953,930
90	$4,708,369	$5,230,394	$5,408,678	$5,388,068	$5,837,436	$6,015,250
100	$6,419,670	$7,527,812	$7,773,082	$7,521,635	$8,452,629	$8,730,501

[1] Kahneman, D. (2011). Thinking, Fast and Slow. Farrar, Straus and Giroux.

[2] Part IV of Thinking, Fast and Slow.

[3] "Prospect Theory: An Analysis of Decision under Risk," Econometrica, Volume 47, March 1979, number 2, page 263.

[4] Problem 1 in the Prospect Theory paper - except I multiplied the values by 10 because the original values were in 1979 Israel pounds, and the numbers used in this problem in the paper represented about 83.3% of one month of the average net income of a household in 1979.

[5] I will be using some of the examples in the Prospect Theory paper and Thinking, Fast and Slow, but I will be modifying the numbers so they are larger than the numbers used in the actual studies. I do this to offset inflation as the original prospect theory studies were conducted in the late 1970's so the amount illustrated should have a similar impact on them as the people in the study. In other words, the financial risk is significant but not overwhelming.

[6] Problem 3 in the Prospect Theory paper with values multiplied by 10.

[7] Problem 4 in the Prospect Theory paper with values multiplied by 10.

[8] Problem 7 in the Prospect Theory paper with values multiplied by 10.

[9] Page 284 of Thinking, Fast and Slow. The explanation provided for this by Kahneman on page 305 in a later chapter is based on evolution and biology with the observation that "Animals, including people, fight harder to prevent losses than to achieve gains". This applies not just in respect of survival but in other matters including monetary losses because it is has been passed in our DNA from other survivors to avoid losses.

[10] Problem 3' in the Prospect Theory paper with values multiplied by 10.

[11] Page 281 of Thinking, Fast and Slow.

[12] Problem 14' in the Prospect Theory paper with values multiplied by 10.

[13] Problem 14 in the Prospect Theory paper was the opposite and involve a 0.1% change of a $5,000 or a certain gain of $5, and 72% were risk seeking for the chance for the $5,000 gain. This is used to explain why many people play the lottery.

[14] See Table 4 on page 315 of Thinking, Fast and Slow.

[15] For this example, I will use the actual numbers from 1979 in the study when the average income was about $36,000.

[16] Like Kahneman, Thaler won the Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel (often commonly referred to as the "Nobel Prize in Economics") in 2017. Kahneman, although a psychologist, won the "Prize" in 2002. As a person who has passed away cannot receive the award, Tversky was not eligible as he passed away in 1996, even though the award was for most of the work Kahneman did with Tversky.

[17] This effect does not apply to people who own items for commercial purposes such as a product manufacturer or distributor.

[18] Thaler, R.H. (2015). Misbehaving: The Making of Behavioral Economics. W.W. Norton & Company.

[19] Some of the studies were with Kahneman.

[20] If leveraging is involved, the loss could be much more than the amount invested.

[21] I am not sure who originally articulated this idea? I first heard this idea when listening to Episode 4 "Getting Rich vs. Staying Rich" of The Morgan Housel Podcast (March 23, 2023). Morgan Housel is the author of the books The Psychology of Money (2020), Same as Ever (2023) and The Art of Spending Money (2025).

[22] This is not meant to be an exhaustive list. I have intentionally excluded life insurance policies employed in certain leveraged based strategies that have been primarily set-up to extract taxable surplus in a corporation prior to the death of the life insured to reduce or eliminate income tax because I do not think the risks associated with these strategies (including averse tax audit risks, financing risks and interest rate risks) have been adequately disclosed to the clients purchasing them. I do not think these clients receive enough information or advice to calculate the quantum of potential losses and the probability of these losses occurring to make an informed decision – but this is merely my opinion.

[23] The example used is the case study was the policy on a healthy, non-smoking 50-year-old male for this policy issued in early 2025 with annual premiums of $150,000 per year and funded for 15 years.

[24] For the Equimax Wealth Accumulator life pay, Equimax Estate Builder® life pay and Estate Builder 20 pay, the maximum Excelerator Deposit Option (EDO) permitted will form part of the $150,000 premium. For the Equimax Wealth Accumulator 10 pay policy and the Equimax Estate Builder 10 Pay policy, no EDO was utilized because the clients purchasing these products would not likely be prioritizing early cash values.

[25] As the addition to the corporation's capital dividend account can be distributed as capital dividends, and capital dividends are not subject to Canadian income tax if the recipients are Canadian resident shareholders, it positively impacts the after-tax amount of insurance proceeds received by the shareholders. The addition to the capital dividend account from life insurance proceeds equals the death benefit proceeds received by the corporation less the policy's adjusted cost basis. The calculation of the adjusted cost basis of a policy is complicated but is generally, the premiums paid for the policy less the policy's net cost of pure insurance. The calculation of the net cost to pure insurance for a policy is even more complicated. Different policy structures with the same premiums paid will not only have a different death benefit but even if they have the same death benefit, the addition to the capital dividend account may be different. The good news is that the life insurance company, provided it is a Canadian life insurer, will provide these numbers at death and often, if requested, on the policy illustration based on the illustrated numbers.

[26] Behavioural psychology may provide an explanation for why people have these objectives other than the person is intrinsically a good person. There are two concepts called "duration neglect" and "peak-end effect" where the impression that people have of another person's life (or their story) is more dependent on what the person did in the years immediately preceding death rather than the total quantity of good deeds performed during their life. Many people want a favourable narrative of their life. Providing for their family or a philanthropic cause in a significant way at death, may achieve this goal.

[27] A pricing actuary could more clearly and accurately explain this but for this purpose of this paper, it is sufficient to point out that there are choices for some policies in respect how much "extra" can be deposited in the policy or that is already part of the basic premium in some policies (and is non-negotiable).

[28] This tax is deferred if the assets and the RRSPs/RRIFs are transferred to a spouse or common-law partner. This deferral is also available for transfers of non-RRSP/RRIF assets to a qualifying spousal trust that meet the requirements in paragraph 70(6)(b) of the Income Tax Act (Canada).

[29] This issue becomes even larger issue when HNWI remarry or are in a relationship with people who are not the parent of the children of the HNWI. In these instances, often the intention is for the children of the HNWI to inherit these assets, and not new partners. This may also create tax liabilities at that time as those assets transferred to the children are deemed sold at fair market value, triggering tax liabilities that decreases the amount remaining for the surviving spouses and partners.

[30] Behavioural psychology and economics have many methods for positioning (also referred to as "framing") proposals to influence decision making in a way that is consistent with what a person's desires. That could be another article if people like this one.

[31] This objective often arises for purely emotional reasons (altruism, emotional obligations, guilt avoidance, etc.) rather than a financial reason. However, because of its emotional importance, the solution chosen often requires certainty and avoiding losses to fulfill the objective.

[32] 150,000 annual premiums for 10 years. Projected values based on current DSIR (as of September 2026) less 1%.

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