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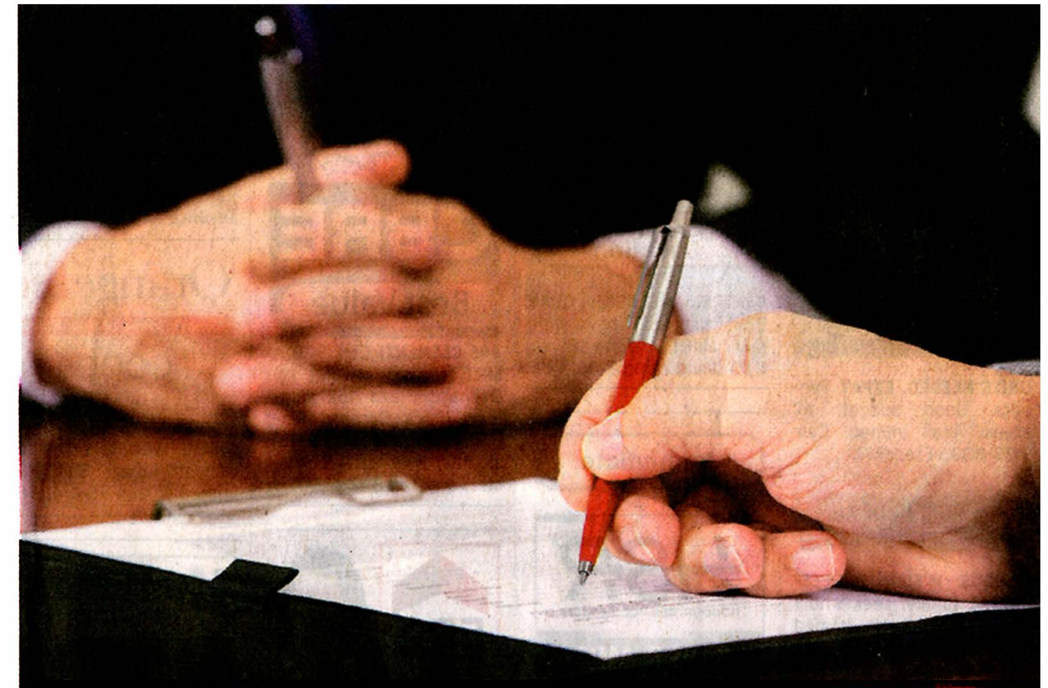
THE LAST WORD

Dr Larry Haverkamp
lhaverkamp@smu.edu.sg

What you need to know about life insurance



MARCHING forward with financial products, last week we talked about banking. This week, it's life insurance.

A historic event happened last week: The rollout of compareFIRST (www.comparefirst.sg) which is a website that compares life insurance. You can compare and see who has the best deals on term, endowment and whole life insurance. You can also find product details for investment-linked products (ILPs) which are like unit trusts. You can even buy direct and avoid an agent's commissions.

The site is a joint initiative by the Monetary Authority of Singapore, the Life Insurance Association, the Consumer Association of Singapore and MoneySense. Why compare? It's because life and endowment policies are our second-biggest investment after our homes, with over $70 billion invested. It averages more than $60,000 per household, which makes it worth the time to find the best deal and compare it to "buy term and invest the rest". That is always cheaper but now you can see how much.

The insurance industry has relied on a service-based model where a single agent serves the client's needs and acts as a trusted advisor. This has served the industry well and works for some clients, but it isn't cheap. Commissions are high, especially for "bundled" products that combine investments with insurance such as endowment and whole life policies. Even reasonably priced ILPs become super expensive when they require regular premiums instead of a single payment. It is a reason to prefer unit trusts, where regular payments are available at no extra charge.

Last Tuesday, compareFIRST was launched and it's off to a good start. It provides consumers with a convenient tool to compare bundled life insurance plus investments, which are at the centre of the investment culture in Singapore.

QuickQuote

> **"Get the best people and don't trust them."**
>
> Donald Trump, 68, New York City real estate developer

The big picture

A big question is: Are these policies worth it? There are cheaper ways to buy life insurance and investments, but the high cost may be worth it to compensate a trusted advisor.

The opposite view is from people who think: "I can save those high commissions if I simply unbundle by purchasing term life insurance and investments separately. It's not rocket science. I think I can do it."

Here are three life insurance problems that are not well understood:

1. How safe is my money?

Are endowment and whole life insurance safe? It all depends on your investment behaviour and the life insurance company. Opt for an "early surrender" and you can expect to pay a penalty. It means if someone falls on hard times and asks for their money back before the policy matures, they can get it but it won't come cheap.

Should the penalties be so high? The industry answer is: "Life insurance is a long-term commitment". But for the consumer, nothing about insurance makes it inherently long term.

In fact, you can DIY (do it yourself) and construct life insurance that is short term. Simply buy a five-year term policy plus a unit trust. If you find you can no longer afford the premiums, you can stop paying and not much happens. Your term insurance will lapse and you will lose the coverage for the rest of that year. So what?

Regarding the investments component, all you have to do is sell the unit trust. Again, nothing happens, except you get back the market value of your investment, which is what you wanted.

It is a different story if you redeem bundled insurance like a whole life or endowment policy, especially in the early years when you can lose as much as 100 per cent of your investment.

2. What are the returns?

A second drawback is the return. How much is it? Is it 0.5 per cent? 1.5 per cent? 3 per cent? No one knows. It is too difficult for customers to calculate and insurers won't disclose returns, even after the policy has matured.

Don't benefit illustrations show returns of 3.25 and 4.75 per cent? Yes. But that does not reflect the actual returns. It is hypothetical. There is no reason to think you will get those returns, although some may think 3.25 and 4.75 per cent are returns they are likely to receive. Not correct.

Something else that is not very clear is these are gross returns. Each shows a column of numbers which is what you would receive if your investment earned 3.25 or 4.75 per cent with no expenses. Of course, that is impossible. Expenses are real and can accumulate to half of your gross returns. Nevertheless, the benefit illustration shows the higher gross instead of the net return figure that you actually get.

3. What happens when the policy holder dies?

The third little-understood feature of these policies is what happens if you die. Then the term portion of your policy will pay your beneficiaries, as it should.

Next, the insurance company takes the investments you have accumulated over the years from your premium payments. Beneficiaries will receive the returns on those premiums, called the "bonus", but it is relatively small. The rest of the investments goes to the life insurer.

This won't happen if you unbundle by investing in, say, a unit trust and term policy separately. Then, beneficiaries receive the term insurance payout and also inherit the full amount of the investment.

An adjunct professor at SMU, Dr Haverkamp contributes this column weekly to help our readers understand money matters better.

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