

This is an original article written by Philip Loh.

12 reasons why a Regular Premium Investment-Linked Policy should be the FIRST insurance policy you buy

If you are considering buying your FIRST insurance policy (assuming you are in your twenties or early thirties), a Regular Premium Investment Linked Policy (RP ILP) would be the most suitable choice. A recent ST article quoted that 350,000 RP ILPs have been issued in Singapore. So what makes people buy RP ILPs? Read the following to find out:

Reason 1 – Low-cost Buy Term and Invest the Difference (BTID) whole life policy

Compare the returns a 30 year-old male non-smoker enjoys by buying a RP ILP with a basic sum assured of \$500,000 and costing \$4,000/yr of premium, with the returns he will enjoy if he buys a 30-year \$500,000 term plan costing about \$1,665/yr and investing the difference in a unit trust. Using the same fund type, at the 30th year, the RP ILP approach gives a higher return than the traditional BTID approach.

	Sum Assured	Annual Premium	Projected return using a gross return of 5% p.a.	Projected return using a gross return of 9% p.a.
BTID approach				
30 years Term policy	\$500,000	\$1,665	0	0
Unit Trust	Investment Value	\$2,335	\$124,000	\$258,000
RP ILP approach				
RP ILP	\$500,000 + Investment Value	\$4,000	\$127,000	\$283,000

A RP ILP ensures continuity of cover for as long as you wish. If you choose the BTID approach, you would not be able to extend your insurance cover beyond the 30-year term WITHOUT increasing your costs.

The above analysis excludes additional financial planning fee that many “buy term” proponents charge and the additional “asset under management” fee for managing your investment. With additional fees factored into the analysis, the result would be even more compelling. Furthermore, the mortality charges expensed in a RP ILP are different from those in a term policy. In a RP ILP, because the insurance companies are already earning a trailer fee for managing your investment, the built-in mortality charges are kept lower. On the other hand, they charge more in term policies to cover their overheads since they are not earning any income “investing the difference” for you.

Many people ask why conventional BTID proponents claim that theirs is a low-cost approach when the results do not show. As most BTID analyses are done in the United States, it does not hold true in Singapore where there is no economy of scale to create the low term premium environment for the traditional BTID theory to work.

Reason 2 – Effective Forced Savings

Some financial planners suggest that separating your term cover and investment simplifies things. After working with 500 professionals and executives, nothing is further from the truth. The key lies in the “discipline” to invest the difference. Most assume the front end load of most insurance policies benefit only the financial advisors. In fact, front end loading ensures that the whole program continues for the longest period possible during which the policyholder would enjoy the greatest benefits.

Under a front end loading arrangement, it would usually take about 10-14 years for the policy to break even. Thus, most policyholders would discipline themselves to contribute premium for that period of time. Under a conventional BTID approach, the “investment component” may break even from the second year. However, many investors are tempted to use that money for some of their immediate cash flow needs like wedding or renovation, hence derailing them from their long-term financial objective.

Reason 3 – Premium Holiday Feature

Policyholders can stop paying their premiums when cash flow is tight and continue payment later WITHOUT having to pay back the outstanding premiums. And there is NO interest charge. Many complaints against traditional whole life policy is if you stop paying your premiums, an “automatic premium loan” kicks in to pay for the outstanding premiums, and you are required to pay the “automatic premium loan” back with interest. RP ILPs’ premium holiday feature helps policyholders through tough time without creating a bigger problem for them later. Through the course of my work, I have seen many lapsed policies because the policyholders cannot afford to pay back their “automatic policy loan”.

Reason 4 – Flexible Withdrawal Option

RP ILPs are the most LIQUID permanent insurance policy in the market. One concern people have when buying a traditional life insurance is that their money gets committed for the next 20 to 30 years, and are not accessible in times of need. RP ILPs allow policyholders to withdraw money from their accounts, without the need to pay back. This feature is heaven-sent for many during tough times. One policyholder who recently lost his job was glad when I told him he could withdraw up to \$7,000 from his RP ILP without reducing his coverage.

Reason 5 – Adjustable Insurance Cover in accordance with your needs at different life stages

The need for insurance changes over time. When an individual starts a family, his need for insurance will balloon. His RP ILP will allow him to increase his coverage without the need to pay a higher premium. The trade-off is a lower net return as more of his premium go to the insurance charges. His need for insurance decreases as his children grow older. He can then reduce his coverage to lower the insurance cost and improve the rate of return.

In a traditional life or term policy, the level of cover is “cast in stone” the day you buy it, leaving very little room for adjustment. If you want to increase your insurance cover, your only option is to purchase another policy to supplement your existing one. Maintaining two or more policies will result in higher policy fees. For example the premium for an insurance policy with a sum assured of \$100,000 is

cheaper than the aggregated premium for four policies of the same type with sum assured of \$25,000 each.

Instead of having one policy each to cover death, critical illnesses, disability income, accident and hospitalization, and one investment plan, it is simpler to handle one that consolidates all the different types of cover.

Reason 6 – High Transparency

A task force comprising MAS and LIA representatives are exploring ways to improve the overall disclosure and transparency of insurance companies' life funds and how their performance correlates to the bonus payouts that policyholders receive in their profit participating policies. Despite this commendable effort, given the nature and complexity of "life fund", the days of total transparency may be far away.

On the other hand, **RP ILPs offer policyholders total transparency** as they are able to keep track of the performance of their funds. Ironically, many problems highlighted in the media on RP ILP are due to their high level of transparency. For example, the media was able to highlight the concern that insurance charges may eventually outstrip the premium contribution because the charges are clearly disclosed in the Product Summary of the RP ILP.

Reason 7 – Risk reduction through global diversification

One key differentiating factor between traditional life insurance and RP ILP is that the latter allows you to invest in a diversified global portfolio of bonds and equities. Although life funds are predominantly invested in fixed income instruments, the exposure is largely in Singapore and only a small portion is invested overseas. ILPs on the other hand allow you to reduce your investment risk through the timeless theory of diversification, which is the simplest way to reduce investment risk WITHOUT sacrificing portfolio returns. Hence, we have the paradox of higher returns with lower risk in a RP ILP.

Reason 8 – Risk reduction through "dollar cost averaging"

Again, this is a simple yet effective method to reduce investment risk. RP ILP reduces your risk as your investments are spread out regularly over the whole time horizon, thereby enabling you to level out the volatility of the market and reap the benefits of staying invested over the long term. Instead of investing all your money at one go, you invest a small amount every month, hence averaging out your buying price. For example, if you had invested all your money in a technology fund at the peak of the tech bubble in early 2000, you would still be 60% down today. If however, you had spread out your investment on a monthly basis, you would be surprised to discover that you are in fact making a small profit now.

Reason 9 – RP ILP has an ASSURED VALUE

Many people assume that since you bear all the investment risks there is no assurance on your policy value. To understand how the assured value is formed, we need to examine how we derive our return in a RP ILP. Essentially, every month as you contribute your premium, after offsetting the charges, the balance would be applied to purchase investment units in a fund. Each policyholder would have an account denoted by the insurance company to store the "units" he has purchased over the years. Unlike a traditional policy where you do not own the "life fund" you are

investing in, you actually own the investment units in your RP ILP account. **The valuation of the units in your RP ILP account IS your assured value.**

At the request for withdrawal, the insurance company would liquidate some of your “units” in your RP ILP account and convert them to cash for you. In the case of a policy loan made on your traditional life policy, since you do not own the “life fund” which you are borrowing from, you would have to pay back the “loan” with interest.

Reason 10 – Converting your RP ILP into a retirement plan that pays a periodic income

For a retired individual in his 60’s, the need for insurance would be low. This is supported by the economic life value model of calculating insurance needs. The primary concern at that time would usually be retirement financing. It would then be an appropriate time to reduce the insurance cover, and focus the policy on generating a good investment income to fund the retirement. The policyholder may decide to keep some critical illnesses cover to provide for liquidity concerns in the event of a major illness, but a large portion of the cover can be removed to enhance the overall investment yield.

Reason 11 – Reduce your investment risk as you approach retirement

One latest concept in fund management is “life stages fund” which reduces your exposure to equities and increases the percentage of fixed income as you get older. This minimizes the impact of a crash in the stock market on your retirement fund. RP ILP allows you to place a bigger portion of your assets in equities when you are younger and reduce it when you get older. Under a life policy which invests in a “life fund”, the investment allocation is fixed. You would have no say on the asset allocation.

Reason 12 – Non-accelerated Critical Illnesses Cover

Most traditional critical illnesses plans offered by insurance companies in Singapore come with built-in death coverage. There is a significant number of single Singaporean from well-to-do families who do not need a big amount of death coverage. Their main concern is coverage when they are critically ill. With the built-in critical illnesses cover in traditional CI policy, they would have to purchase the “death coverage” that comes with it. Using a RP ILP, policyholders can reduce their death coverage and buy a higher critical illness cover instead. Then, his cover **is more in line with his actual insurance needs.**

I wish to stress that the implementation of an RP ILP is complex and appropriate advice need to be sought from an experienced financial planner. This is because a RP ILP is unlike a traditional life policy where you are assured of a generic result.

Just like there is no single car that can win the fancy of all drivers, there is no financial plan that can meet ALL the needs of every consumer. It remains the job of a professional financial planner to help you identify your unique concerns and put in place a program to address them. A good financial advisor can connect with you on a human level, and help you gain greater clarity and confidence of your financial future. Only then, can the objective of financial planning be fully met.