

*This is an original article written by Philip Loh; the edited version appeared in the Business Times 26 October 2005.*

An interesting question has been circulating in media and insurance facilities; it was posted to various CEOs of insurance companies and associations with confusing and incoherent responses.

The question is, “Would you recommend a regular premium investment-linked plan (RP ILP) to somebody who is 50 years old if what he wants is only protection and not concerned with the returns?”

There are two reasons why this question may prove difficult to handle. The first is the assumed logic that if an insurance policy is good for the insurance companies to sell, it is bad for the policyholders to buy. This is seemingly the argument upheld by the media in various published reports. The question created much tension when posed to CEOs of insurance companies because selling RP ILPs are “good” for the insurance companies especially when the policyholders are older since the insurance charges imposed would be higher, which translate to more profit. Insurance companies today prefer to market ILPs because of the lower capital requirements and financial risk since the policyholders bear the investment risk themselves. What I am proposing is that a policy can be good for both the insurance company and the policyholder. In other words, I believe that there could be a win-win situation

The second reason why many insurance experts find it hard to give an affirmative answer is the failure to recognise the FACT that buying insurance when you are 50 years old is ALWAYS going to be costly, no matter in which forms you choose. The cost of covering a senior is definitely going to be tens of times more than that of covering a 20-something. If we can only acknowledge this simple fact, the next question we should then be asking is whether there are better alternatives to achieve the same end. In other words, is there a more cost efficient way to acquire insurance cover when you are at Age 50?

The base line assumption of our analysis is that buying insurance cover at Age 50 is going to be expensive. What we seek to establish is whether RP ILP is MORE expensive than other viable options. To start, let do some number crunching.

Comparison of RP ILP with BTID (Buy term and invest difference)

Life Assured, Male, ANB-50

Approach	Sum Assured	Duration	Premium (Yearly)	Payout in 20 years
RP ILP	\$100,000	NA	\$3,000	\$31,300 to \$54,100
Term	\$150,000	20 years	\$1,800	\$0
Recurring SP (Pure Investment)		NA	\$1,200	\$34,500 to \$55,100

The first situation is that the policyholder wants the cover only for a fixed duration, say 20 years. We explore then the option of BTID vs. RP ILP. After 20 years, the projected returns under both approaches yield pretty similar results. The fund type used under both approaches is the same so there should not be any difference in

investment return and fund management fees. Although the BTID approach gives marginally better return, a RP ILP would allow you to continue your protection beyond 20 years whereas the term cover under the BTID would have expired and renewing the cover then would be subjected to medical underwriting. Hence, I would opt for RP ILP in this instance. Similar analysis done with a 30 years BTID scenario yielded pretty consistent findings and I challenge the critics to prove otherwise.

The second situation is that the policy holder wants the cover to extend for life. That means he wants to maintain the cover until a death claim is admitted. Since there is no term policy that covers for life, we compare RP ILP with the alternative of getting a Profit-participating whole life policy.

The premium is fixed at \$3,774/yr and the Basic Sum Assured is \$100,000  
 The premium for the whole life policy used in our comparison is payable only until Age 80.

Approach	Duration of Policy	Total Cover (Effective Cover)	Payout
Whole Life (Par.)	5 years	\$105,204 (\$94,727)	Guaranteed - \$8,300 Total - \$10,477
Whole Life (Par.)	10 years	\$110,949 (\$86,398)	Guaranteed - \$19,300 Total - \$24,551
Whole Life (Par.)	15 years	\$119,022 (\$78,513)	Guaranteed - \$31,100 Total - \$40,509
Whole Life (Par.)	30 years	\$232,484 (\$63,366)	Guaranteed - \$72,700 Total - \$169,118
RP ILP	5 years	\$128,300 to \$134,500 (\$100,000)	\$10,600 to \$11,700
RP ILP	10 years	\$128,300 to \$134,500 (\$100,000)	\$28,300 to \$34,500
RP ILP	15 years	\$147,500 to \$165,500 (\$100,000)	\$47,500 to \$65,500
RP ILP	30 years	\$194,400 to \$325,500 (\$100,000)	\$94,400 to \$225,500

In this comparison, it seems that whole life policy approach would give the policyholder better value. At 30 years, the policyholder is expected to receive payout from the whole life policy of \$169,118 assuming Gross investment return of 5.25% p.a. from the insurance company's life fund. For the RP ILP approach, the payout would only be \$94,400 assuming gross investment return of 5% p.a.

On closer examination, we notice that the effective cover of the whole life policy is not \$100,000 as the policyholder gets older. (Effective cover is defined as the excess of the insurance payout above the surrender value.) The risk that the insurance company is bearing is in fact the "effective cover" which drops below \$100,000 as the policyholder gets older. What this means is that the insurance company is technically reducing your effective cover as you get older. In our example, the effective cover under the RP ILP is maintained at the full \$100,000.

Understanding the concept of “effective cover”, what we usually advocate to an older client when buying a RP ILP is to reduce the effective cover as he gets older to reduce his insurance cost. Note that the “total insurance payout” can be maintained at \$100,000 or above. For example, one can reduce the “effective cover” by \$10,000 every 5 years. Using this approach, the payout under a RP ILP should be higher than a traditional life insurance if we can at least achieve an annualised yield of about 6% p.a.. A 6% gross annualised return can be easily achieved by investing in a portfolio of global equity. We can safely ignore the fluctuation of the portfolio value over time since we do not intend to surrender the policy at any point.

#### Key suggestions on the RP ILP approach

- 1) Reduce effective SA by 10% every five years to reduce insurance charges.
- 2) Invest in a 100% global stock portfolio to yield a higher return in the long run. This is counter-intuitive since the risk profile of the policyholders may suggest a low risk investment approach due to his age. However, the risk profile is irrelevant since we do not intend to surrender the policy. Most investment experts would agree a 100% equity portfolio should give us at least 6% p.a. over time.

\*\*\*Note in our example, the 5.25% p.a. Gross return assumed in the profit participating Whole Life policy may fall short as well if the investment climate in Singapore is adverse over the duration of the policy.

We conclude that a RP ILP can be used to cover a senior person if the programme is designed carefully and specific planning approaches are adopted to ensure success. The caveat is that due to the complexity of the planning and support required, most financial advisors may not be equipped with the relevant skills and technical expertise to advise the client adequately on the issues involved. Coupled with the high turnover of insurance advisors, there is also a good chance that the advisor who implemented the program for you may not be there to ensure the smooth running of your program in the years to come. This, I believe is the greatest risk to consider when a 50-year old is buying a RP ILP.

Variable Life program (what RP ILP is known as in the United States) was and still is one of the fastest growing insurance plans in the United States. Over the past 20 years, its popularity had overtaken that of traditional whole life program due to its flexibility and better yield. However, many independent financial advisors (iFAs) in Singapore have resisted marketing the plan as they stand to gain more by advocating a Buy-Term-and-Invest-the-Difference approach. Besides charging an up-front planning fee, they can also earn an ongoing asset under management fees for managing the differences. Although the BTID approach is popular among higher net-worth individuals, its validity for lower to middle income Singaporeans are highly questionable since iFAs may not pay much attention to the smaller investment accounts. RP ILP is a “mass market product” and I contend that for the most of us who form the “masses”, it still serves our basic needs of insurance and protection pretty well. There is always room for insurance companies to lower commission rates and insurance charges to pass on more benefits to the policyholders; the financial services industry in Singapore is still in its infancy. With a dynamically changing financial services landscape in Singapore, I believe that market forces would eventually have their way and find their own equilibrium, as they always do.