

**WHEN IT COMES TO SAVINGS, WHOLE LIFE INSURANCE ONLY TELLS HALF THE TRUTH**

When I started my career as an insurance adviser many years ago, I was taught that it is a good instrument for accumulating wealth. Years later, I found out this was only half the picture.

**W**hy not use insurance as a savings vehicle? After all, it offers better interest rates than the banks, it provides protection against death and disability, and it's a systematic way to save.

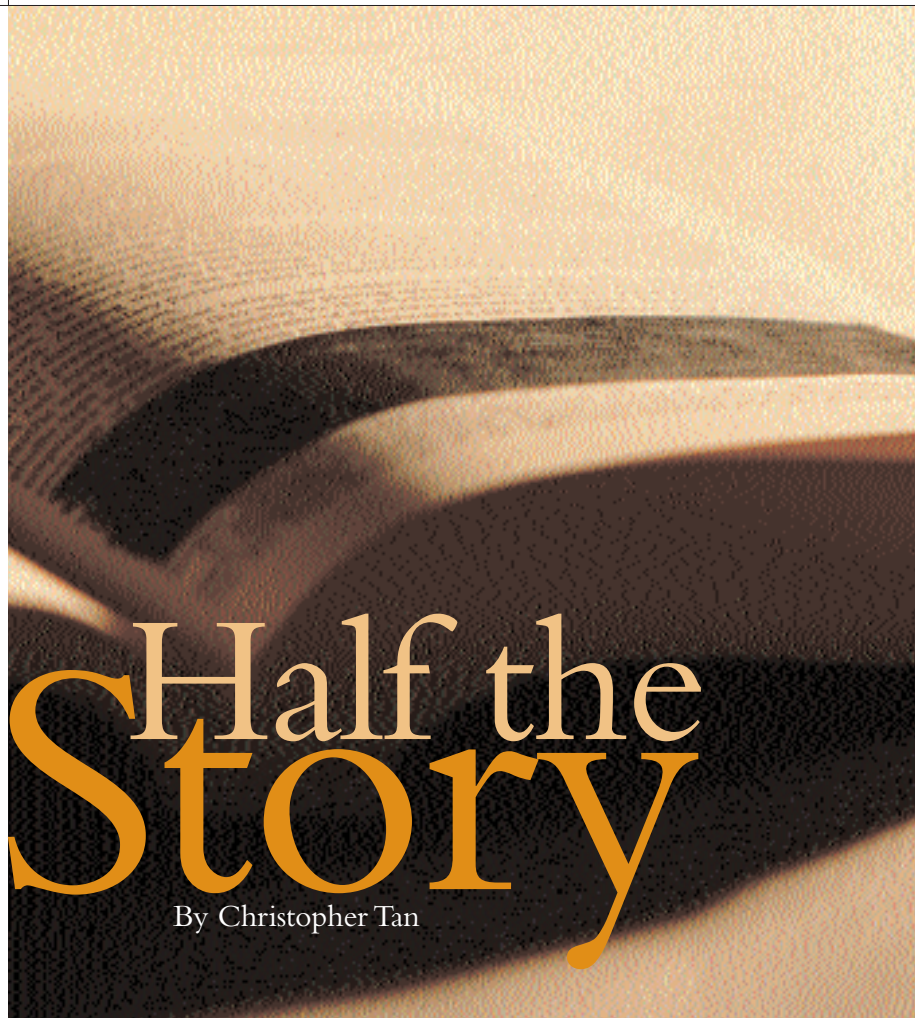
I still hear many people preaching this distorted insurance gospel, even financial advisers, but it's a myth that needs to be dispelled.

So let's start with the so-called advantages. Bank interest rates are currently at an all-time low, so instead of leaving your money in the bank, proponents say you should park it with insurance companies that will give you a higher return. And in doing so, you get the additional protection of a lump sum payment in the event of death, disability, or even if you are diagnosed with a serious illness. In short, its advocates say, insurance is a safe option that can enhance your returns.

But let the truth be out! Those 'advantages' tell only half the story, so before you decide where to put your money make sure you read right to the end.

To begin with, where is your liquidity? Yes, insurance does offer you a higher interest rate than bank deposits, but, as the saying goes, we are not comparing apples with apples. Bank deposits are meant for the short-term parking of your money. They are meant to be liquid, so that you can remove your money without any loss of capital in the shortest possible time. They are also flexible, in the sense that there is no commitment to keep depositing money, so naturally bank accounts come with lower interest rates.

But insurance is a long-term instrument. It is not as liquid as cash in the bank, and if you need money suddenly, or if you need to stop your contributions (premiums), you will most likely suffer a loss when cashing out. You could,



of course, take a policy loan to tide you over rather than surrendering your insurance, but it comes with a cost. You need to put back whatever you take out, plus interest of around 7% to 8% depending on the insurance company.

The protection also comes at a cost. Every single dollar that you pay for your insurance policy goes first to your agent as a commission and to the insurance company as mortality charges (that is, the cost of insuring you), with whatever is left over then being invested. I am not against paying for insurance, but everyone must ask whether they need the additional coverage. If the answer is no then you should not be paying for something you do not need, and if the answer is yes, you still need to make sure you go about it in the right way.

As for the element of safety, it's true that part of your maturity benefit is guaranteed, but the guaranteed component is often a very small part of the overall benefit. Compared to what you have invested, plus your opportunity cost (in other words, what you could have achieved with other investment instruments), you could lose out big time.

Besides, the money you place with an insurance company is invested in the equity and bond markets, which are subject to market risk. It is hardly surprising that over the last few years, when the market was bearish, many insurance companies adjusted their bonus rates downwards.

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And it's not as if insurance gives you the flexibility to change fund managers if you are not happy with the results. You have to keep saving, and if you cash out during an emergency you either lose coverage or you lose money.

### BETTER WAYS TO SAVE?

So what are your alternatives? First, decide whether you need the insurance. If so, separate your need for insurance from your need to invest or save, then buy a plan that is without profits or non-participative, or even a term plan according to your needs. Simply put, whether you need insurance to cover you for the rest of your life or for a fixed number of years, pay only for the protection part of the insurance and nothing extra.

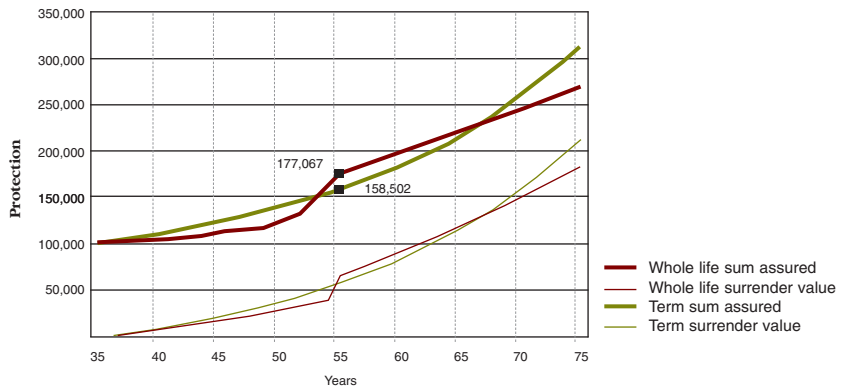
As for your savings, invest them directly into unit trusts or equivalent instruments yourself. So instead of using a dollar to buy an insurance policy, with 20 cents designed to cover your insurance costs and the remaining 80 cents invested by the insurance company on your behalf, buy 20 cents' worth of insurance and invest the rest.

To explain why, let's look at an example. Imagine an investor – we'll call him David Tan – who will be 35 on his next birthday and is a non-smoker. He could choose to take out a whole life, with-profits insurance policy with a sum assured of S\$100,000. Premiums would come to S\$2,965 a year. Or he could start a term plan (without profits), also assuring a sum of S\$100,000, for an annual cost of S\$1,280.

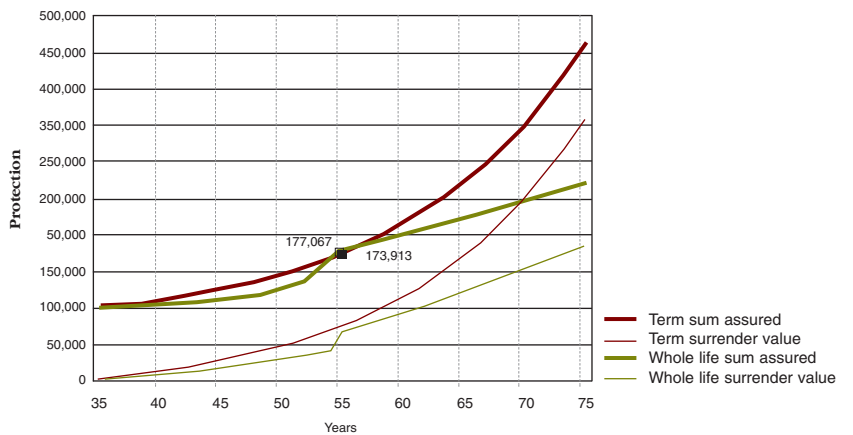
That leaves him with S\$1,685 still to invest. If we assume that David manages a return on investment (ROI) of 5% a year, then both the "sum assured" and "surrender value" of the term plan remain close to, but usually better than, a whole life insurance plan. But if we assume a higher ROI of 7% a year, the term plan beats the whole life insurance throughout. At Provident we did similar studies starting at ages 45 and 55 and the results were similar.

Now the sceptics, of course, will question the ability of investors to achieve a return of 5%, let alone 7%, but we believe it is possible with the right asset allocation, close monitoring of the market and a regular review process. Furthermore, and particularly as fund managers become more transparent, the flexibility you enjoy when managing your investment portfolio may make this method more effective and efficient.

### TERM VERSUS WHOLE LIFE INSURANCE - 5% P.A. ROI



### TERM VERSUS WHOLE LIFE INSURANCE - 7% P.A. ROI



### STICK TO THE PLAN

The problem with buying a 'without profits' insurance policy, though, is that many people do not invest the difference as planned, or they don't invest it properly. If a person buys stocks they do not understand, or 'flavour-of-the-month' unit trusts, then the chances are that they will not create a diversified portfolio or an appropriate asset allocation.

But if you engage an adviser to help you, which I suspect most people do, you must at least expect your adviser to be able to help you construct a portfolio and monitor it for you. If not, then you have probably got the wrong adviser.

By using insurance as your sole savings tool to reach your financial objectives, you either have to set aside a lot of your income each month to accumulate enough money, or you may have to wait a very long time. Insurance policies might offer better interest rates than banks, but beyond that the returns are not exciting.

Insurance, as its name makes clear, is insurance. It is a means of protection and not a savings tool. Putting money into life insurance and investments is, unfortunately, a zero-sum game: the more money you put into life insurance, the less you can invest to achieve your financial goals. If you use the right instrument for the right purpose, and if you learn to separate protection from investment, you'll stand a much better chance. **si**

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