

(This article appeared in The New Paper on 26 August 2003)

ASK DR MONEY

LIFE INSURANCE: Do it yourself and save

BY LARRY HAVERKAMP
(www.AskDrMoney.com)

Q: I own six life insurance policies, but I have never really understood them. Is life insurance a good investment?

A: It's good and bad.

Good: Term insurance is necessary, easy to understand and reasonably priced. It pays when you die.

Good: ILP (insurance linked products) are like unit trusts but sold by insurance companies. They are a good way to invest.

Bad: Whole life and endowment policies are what most agents try to sell you. These combine insurance and investments. They have four serious defects which few people realise at the time of purchase. My advice is, 'Take the good and drop the bad.'

Here's how: Buy (i) term insurance and (ii) an ILP or Unit Trust. I call this DIY for 'Do It Yourself' insurance.

It gives four big benefits over whole life and endowment policies.

DIY's 4 BENEFITS:

1) With DIY insurance, you know if your investments have done well or poorly because unit trusts and ILPs tell you the performance of the fund over the past 1, 3, 5 and 10 years.

Whole life and endowment policies don't tell you this information in their policy statements or benefit illustrations (BI).

They only tell you the company's own estimates of future returns.

Here's a test: Ask your insurance agent, 'Take this policy you want me to buy. Suppose I had purchased it 10 years ago. What would my return have been?'

Send me an e-mail if any one of Singapore's 15,000 insurance agents will give you this basic information.

On the other hand, unit trusts and ILPs have never said: 'We decline to reveal our past performance, but we are hoping for a 6 per cent return in the future.' Investors would not stand for it.

2) DIY tells you where your money has gone. Insurance companies do not. That's because a big part of your insurance premiums go to a 'policyholders' fund' which the insurance company invests for you.

Insurers will not reveal names of the stocks, bonds and real estate where they have invested your money. They can say 'because of the low interest rate environment, we have been forced to cut your bonus.'

Possibly, your bonus was cut because they made poor investment decisions.

3) DIY adjusts to your 'risk profile'. An 86-year-old grandmother, a 20-year-old national serviceman and a 40-year-old family man each have different investment needs.

While agents are becoming financial advisers and talk sensitively about risk profiles, insurers still practise a 'one size fits all' approach.

Whole life or endowment premiums go into the single huge policyholders' fund where everyone shares in the same investment pie, regardless of his risk profile.

ILPs and Unit trusts are different. You can select among 578 Singapore funds to find the ones that fit your needs precisely.

4) DIY doesn't tie up your money. But for insurance policies, the lock-in period is long. For an endowment policy, it is about half the life of the policy. For example, a 20-year regular premium endowment policy will break even after about 10 years. A whole life policy will break even in about 20 years.

With DIY insurance, you can buy a unit trust or ILP one day and sell it the next. It's no problem.

The most you will lose is your initial commission, which can be as low as 2 to 2.5 per cent for a unit trust purchased online.

DIY IN 2 STEPS

It's easy to build your own DIY insurance.

Step 1: Buy term insurance.

Mrs Money and I own a lot of 'term' insurance. This pure life insurance with no investment component will ensure that when I die, my family will be VERY RICH.

So rich, that if I was married to anyone but the wonderful Mrs Money, I would fear for my life!

Term insurance is simple and it's easy to compare - shop for the best deal.

Step 2: Buy unit trusts or ILPs (insurance linked products).

Unit trusts are sold through banks and online sellers like Finatiq and DollarDex with online sales commissions as low as 2 per cent.

ILPs are like unit trusts but sold by insurance companies. The sales commission is usually 5 per cent but can be as low as 3.5 per cent.

They typically allow you to switch at a low cost among the 10 to 20 funds sold by the insurer.