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Is it worth investing in ILPs?

Financial advisers debate the pros and cons of single-premium investment-linked insurance products

| BY KELVIN TAN |

Forking out money for unnecessary insurance coverage doesn't make sense. Yet, that's exactly what many investors who buy single-premium investment-linked insurance products (ILPs) are effectively doing without realising it, says Christopher Tan, chairman and chief executive officer of independent financial advisory firm Providend.

Single-premium ILPs function exactly as ordinary unit trust funds, except that they also offer investors some degree of life insurance coverage, or death benefit. Typically, the minimum death benefit offered by these products is 125% of the amount invested. So, if an investor were to place $10,000 in a single-premium ILP, his dependents would receive the higher of $12,500 or the cash value of the ILP in the event of his death.

However, industry professionals like Tan don't see the point of including that sliver of life insurance coverage in the product. "When you invest $10,000 in a single-premium ILP, generally you will get an extra $2,500 in insurance coverage," explains Tan, who was voted Singapore's top financial adviser representative by *Asia Financial Planning Journal* for this year. "But do investors really need that $2,500 cover? I just can't understand this." Ultimately, insurance agents and their clients regard single-premium ILPs as investment rather than insurance products, he adds. "So, why pay for mortality [charges] when you did not buy the fund for protection purposes in the first place?"

Insurance coverage is not free

According to many financial advisers, a key reason single-premium ILPs have been so popular is because investors are often under the impression that the insurance coverage that comes with it is free. "But nothing is free," says William Cai, chartered financial consultant and director of independent financial advisory firm Frontier Wealth Management. Standard ILP products have mortality charges embedded in them as long as their value is below 125% of the investment sum. The charges vary according to investors' age and sex, and whether they are smokers or non-smokers.

Tan believes many investors do not realise they are forking out money for unnecessary insurance coverage

Cai: Investors who invested in technology-related ILPs five years ago may be paying more than they expected

Ng: An insurance company can help retail investors by taking an active role in the selection of funds and fund managers

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For their part, proponents of single-premium ILPs argue that the mortality charges, which range from 1% to 4% of the value of the investment product, are comparatively low for the coverage that investors get. For instance, a 30-year-old non-smoking male investor is typically paying just $2.30 per year for the $2,500 coverage on a $10,000 investment, says Dennis Ng, a certified financial planner. "Even when this person is much older at say, age 60, the insurance charges only works out to $36.35 per year," he adds. "[And], the insurance charge is usually waived once the value of the investment exceeds the sum assured."

Still, cheap as the insurance coverage is, investors could find themselves paying more than they thought they would if their single-premium ILPs underperform, thereby increasing the so-called "sum at risk" faced by the insurance companies that sell them. The term "sum at risk" refers to the amount above the value of an ILP that the insurance company would have to pay upon a death claim. For example, an insurance company that sells a single-premium ILP with a 125% death benefit cover would incur a sum at risk of $12,500 (25% x $50,000) for a product valued at $50,000. If that ILP were to subsequently depreciate in value by 70% to $15,000, the "sum at risk" for the insurer would balloon to $47,500 ($50,000 + $12,500 - $15,000), and the mortality charges borne by the investor would shoot through the roof.

According to Cai, those who invested in technology-related ILPs five years ago are likely to face this predicament. Based on his calculations, a 50-year-old male who invested $50,000 in a single-premium ILP would generally have to pay $43.90 per year for insurance coverage if the sum at risk stands at $12,500. If that ILP depreciates 70% and the sum at risk swells to $47,500, the investor would need to fork out $166 for the insurance coverage. That only accentuates the losses faced by investors in a poorly performing ILP.

However, with the expertise and due diligence process employed by some insurance companies in choosing fund managers for their ILP products, the likelihood of severe underperformance probably isn't that high, say some insurance industry experts. "An insurance company can help retail investors by taking an active role in the selection of funds and fund managers," says Ng. "They can send a clear signal by changing a fund manager to keep their other fund managers on their toes. I've noticed some changes being done in recent years in many ILPs."

With large insurance companies engaging fund managers on their behalf, ILP investors are often also getting access to the expertise of institutional fund managers that do not market their funds at the retail level, says Ng. "With ILPs, you can tap into the expertise of institutional companies, such as Capital International, Wellington Management and Goldman Sachs, which you might not gain access to as a retail investor investing in a typical unit trust," he adds.

Costs aren't comparable

In addition, unlike ordinary unit trust funds, single-premium ILPs do not incur trustee or custodian fees and prospectus printing costs. "Furthermore, some of the ILP funds are quite sizeable," says Ng. Larger funds tend to have lower expense ratios because they are able to achieve greater economies of scale and cost efficiency. "For instance, the [four-star, Mercer-rated] Global Supreme — a global balanced fund — offered by Great Eastern has a fund size of about $590 million as at Feb 28, 2005 and an expense ratio of 1.08% for last year," Ng adds. Most global balanced unit trust funds have expense ratios of above 1.5%.

Critics of ILPs, however, counter that expense ratios reported by ILPs aren't directly com-

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