INVESTMENT-LINKED BUSINESS – A TIME-BOMB?

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Abstract. This is a paper on investment-linked policies and asks the fundamental question as to whether or not such policies have the potential to become "time-bombs" in the future to life insurance companies. The author believes that life insurance companies can avoid such issues by communicating changes to customers in a timely manner and investing into better customer relationship management techniques.

Key-words: investment-linked policies, time-bomb, customer relationship management

1 Introduction and time-bombs in general

The purpose of this paper is to examine how investment-linked policies (ILPs) could become "time-bombs" to cause a public relations nightmare to an insurance company or even the entire industry. This is a timely subject in the light of recent bad press on ILPs in Singapore. Although the subject of this paper is focused on annual premium ILPs, some of the points raised will also apply to the single premium variant.

In this paper, a "time-bomb" is defined to be something underpinning a life insurance product that is latent and which has the potential in the future to be seen by the customer in a very different and controversial way from how it is seen or accepted now. Examples include, say, a certain product feature, a selling method or even an administrative process.

All actuaries would appreciate the fact that despite the company's good intentions in designing and marketing a product, there is a risk that

- Distributors sell the product in a different manner than intended.
- At some point in the future, the end-customers and regulators (or the law courts if it ever reaches this stage) have reason to interpret a product-related issue in a manner that is disadvantageous to the company.

The fuse that ignites the "time-bomb" is usually lit by a consumer who, having been aggrieved in some way by the insurance company or her representatives, decides to up the ante with the media. In this way, a simple issue can quickly escalate into a bigger one if a critical financial press and a consumerist society who is quick and ready to demand compensation fuel it. Hence indiscretions that would be acceptable today become completely unacceptable by customers in the future. Unfortunately, life insurance products are affected more than other consumer products simply because products sold many years ago and that are still "renewing" their premiums cannot be ignored.

In this paper, we examine the possible causes and solutions for "time-bombs" from the perspectives of

- product design,
- sales disclosure,
- selling method and
- customer management.

2 Background

ILPs were introduced into the Asian region in the 1990s. It now forms a significant part of new business written as shown in the new business data for selected countries.

Country	**Estimated % of New Business share for Investment Linked Products in 2004 (API + 10% SPI)**
Philippines	5
Hong Kong	48
Singapore	35
Malaysia	45
Indonesia	37*

* based on API + 100% SPI

Of particular noteworthy interest is the ILP penetration of 45% for Malaysia and 37% in Indonesia. In these countries, ILPs are a relatively new (5-6 years) phenomenon and the rapid acceleration of sales of ILPs reflects a preference by customers and the distribution (agency forces) for such products. In the more mature ILP markets such as Hong Kong and Singapore, the ILP penetration has stabilized or is even dropping as customers choose "safer" and more "stable" havens such as Participating plans. Is this perhaps something that Malaysia and Indonesia can learn?

3 The Singapore Story

ILPs started to be sold in Singapore from 1992. These products were presented as flexible alternatives to traditional plans. Policyholders were allowed to select their mix of investments (asset classes and market sectors) as well as vary their premiums and insurance coverage according to their circumstances.

When first launched, the regulatory and disclosure requirements for ILPs were very rudimentary and similar to those for traditional plans. Through the years, this has been constantly evolving and, in common to other countries, gravitating towards increasing levels of disclosure.

The main sales method for life insurance is through a direct agency force but in recent years, sales through bancassurance channels have increased in importance. The Financial Advisers Act came into law in 2002, but distribution through independent financial advisers has yet to make a significant impact in the industry. Sales of insurance policies (mainly single premium type) have been boosted through the liberalisation of investment choices for Central Provident Fund savings in recent years.

Singapore has an open economy with a well-educated population that is increasingly exposed to technological and economic developments. With increased affluence and a more vocal press, the consumer protection movement has gained some strength in ways similar to other western countries and more advanced than her Asian neighbours.

In February 2005, newspaper articles with the following head-lines appeared in the Singapore press, 'exposing' a potential time-bomb in the insurance industry.

12 February 2005: Insurance 'time-bomb' set to explode
12 February 2005: Wanted: More transparency in investment-linked policies
15 February 2005: Elderly and the sick face highest risk of hidden costs in policies
16 February 2005: Insurers need to be more upfront about 'hidden' costs
19 February 2005: Case[1] calls for more transparency
22 February 2005: Insurers issue FAQs on investment linked plans
27 February 2005: Is your insurance policy a waste of money?
3 March 2005 : Five reasons why ILPs are an insurer's best friend
12 March 2005 : ILP sales processes could be reviewed

[1] Consumer Association of Singapore

The above articles were all written by a single journalist. The screaming headlines as well as the frequency of the articles meant that policyholders were soon calling up their agents or insurance companies for clarification. The Singapore insurance industry was forced to react by allocating resources to answer these queries during the "month of madness".

The Life Insurance Association, some individual CEOs and other insurance professionals were also forced to resort to the press forum to address the issues raised, as shown in the following headlines.

19 February 2005: Each type of plan has its own merits
24 February 2005: Hidden charges? Insurers required to state all levies
24 February 2005: Current practice adheres to global best practices
18 March 2005 : Investment-linked policies – Misconception in reports

The issue, as perceived by the journalist, was an alleged lack of transparency in ILP policies with apparent hidden insurance charges that escalated "exponentially" as a policyholder gets older. Her articles were backed by actual feedback of policyholders who had been shocked to see insurance charges "eating" into the accumulated fund that they had enjoyed for many years.

The life insurance industry defended by replying that the heart of the problem was not with the fundamental design of the product (which is the truth of the matter!), nor from agents making promises many years ago that the company couldn't keep, but rather a mismatch between the product and the customers' needs. They pointed out that customers who did not want such a high insurance cover could elect to reduce the sum-assured.

Comments were also made that suggested that perhaps more transparency and disclosure were required for ILPs. Here, it is noteworthy to mention that in

Singapore, a typical disclosure pack accompanying an ILP sale is over 20 pages so it is dubious if adding more disclosure would have helped enhance the customer's understanding of the product!

The following conditions related to the sales method and performance of ILPs would have also led to the issue gaining momentum and sympathy in the minds of Singaporeans who had purchased an ILP:

- ILPs products were typically promoted on the basis of investment return and annual fund performance league tables. Customers who purchased an ILP when they are young would have enjoyed a period in which their fund (net of premiums and charges) grew.

- The Singapore economy subsequently suffered from several years of low returns for equities while interest rates also fell to historically low levels. This double blow dampened the accumulation of many ILP funds and in certain cases the fund, net of premium additions and charge deductions, could be reducing.

- The 'issue' about critical years in the life insurance industry was still fresh in people's minds

Needless to say, the debate between the press and the life companies created the impression to policyholders that insurers had something to hide. The public relations damage had been done and the "time-bomb" exploded.

What needs to be recognised is that ILPs are complex financial instruments, and when the flexibility to vary many aspects of the contract – its premiums, its benefits and the investments – is permitted, it is almost certain that after some time, most customers will not understand what has happened to the product that they have purchased in terms of its returns and how these returns get affected by new unit allocations (from payment premiums), by insurance charge deductions or if there is a non-payment of premium.

Without sounding obvious, it is precisely this aspect – the understanding of the customer's view of the product – that perhaps companies (who sell large volumes of ILPs) could have managed better.

An insurance contract involves a long-term relationship between the customer and the company. Most Asian insurance companies today focus on the distribution side of the business to build scale in a short time as possible. It is rare to find a company who is prepared to invest a similar amount of time and resources to build up a post-sale capability to ensure that the customer truly understands the product that he or she had bought.

For the Singapore example, perhaps

- annual statements could have been presented in a more user friendly and layman nature that show how the ILP fund changes from one period to the next – a presentation similar to bank accounts would help policyholders understand the contributions vis-à-vis the deductions and the fund return
- a projection of future fund values that clearly shows future charges and contributions could accompany each statement
- customer forums could be run regularly to get feedback on the statements

- proactive sharing of customers queries and complaints could be done with other customers – indeed, prior to the press "expose", the servicing department of companies had already been handling the same issues albeit on a case by case basis.

4 Other examples

This section discusses other "time-bombs" that could possibly exist with ILPs. In considering whether or not these are "time-bombs", we try to learn from history or predict the future by thinking of possible adverse scenarios. A different view could well be taken from the reader of this paper that the scenarios below may not happen or are perhaps not significant enough to warrant being labelled as "time-bombs".

4.1 "Overselling" of death benefit

Example: Product X, a Whole of Life ILP with no maximum relationship between premiums and the sum assured, is targeted to run out of units at a certain duration (e.g. 20 years) in the illustrations.

Since product X is illustrated to lapse at a projected point in the future, it is actually a term product. When X is illustrated to "disappear" at a rate of return that is higher than the guaranteed rate used to price traditional term products, X will have a competitive advantage in terms of sum-assured per dollar of premium.

The "time-bomb" here is that customers think that they are buying a Whole of Life product when in fact they are only getting a term product. Even if X is described to be a "Term ILP", most customers will not appreciate what this means. Only if actual returns happen to equal the projected rate will the customer enjoy coverage for the period shown. At a lower actual return, the life of the policy is much shorter. Of course, if returns were higher, the policy will last beyond the targeted duration and this justifies the "Whole of Life" label of the policy.

The issue underlying Product X is not so much product design but rather the selling method which could be argued to be misleading – a whole of life product being sold on a term basis.

On the disclosure side, although the illustration may well include a reference to coverage being terminated prematurely if actual returns are lower, the customer will not understand this unless a sensitivity of the lapsation year is clearly shown.

On the customer management side, very little can be done although a periodic re-projection of the date of lapsation (which will depend on the actual performance) will help to some extent to reinforce the notion of early and volatile lapsation risk in the minds of the customer.

A prudent way to resolve this issue through product design is perhaps to set a maximum sum assured that can be purchased for a given premium or to ensure that only those products that are supportable up to a certain age on a low projection rate can be illustrated. These conditions may need to be imposed by the regulators but it could also just need the prudent hand of the product development actuary in the company.

4.2 "Underselling" of death benefit

This is the reverse situation of example 4.1 above.

Product Y i.e. a Whole of Life ILP with no minimum relationship between premiums and the sum assured is sold to customers who only want a small sum-assured (perhaps due to health reasons) but has a large budget for premiums

The "time-bomb" here is that customers think that they are purchasing a plan for investment purposes but are not aware that the front-end load of the ILP eats into their contributions and depresses the return on premiums. Some customers may well come back after the first year, or perhaps after 2-3 years, to complain that they have been mis-sold a plan that is apparently performing very poorly.

This is a product design issue that can only be resolved by imposing a minimum sum assured for a given premium to ensure a minimum participation before the plan can be classified as an "insurance." In Malaysia, recent changes to the regulatory framework for ILPs require a minimum sum assured of 40 times the annual premium and sets a limit of RM 5,000 per annum per life for front-end loaded ILPs. Above this threshold, the agent must sell single premium top-ups should the customer want to add additional premiums to the plan.

4.3 Mortgage Endowments

Typically, a benefit illustration for an investment-linked policy would be given to prospective customers based on two or three rates of return (high, medium and low).

This is especially important for endowment products and reference could be made to the case study of the mortgage endowment problems in the UK. For such products, the targeted maturity fund is set

a) either, to be equal to the endowment sum-assured (thereby repaying the mortgage) using the high illustration rate. Clearly, a company that could project investment returns at a higher rate would put itself in a more competitive position.

b) or, to be equal to the endowment sum-assured using the medium illustration rate with the hope of a nice little nest-egg at the end of it (after paying off the mortgage) if returns were higher.

On the surface, this appears not to be a product design issue nor an issue with the sales disclosure as presumably there were enough protective clauses in the contract to warn the customer about the potential need to increase premiums if returns fall short.

Whether this issue will become a time-bomb depends very much on the subsequent investment returns achieved on the plan and whether (or how) the customer is made aware of any potential shortfall (or excess) of the targeted fund as compared to the mortgage sum-assured.

As the UK experience has shown, customers rarely remember (or have selective memories!) on what has been told to them many years ago. So if little is done to manage their subsequent expectations of the product, they will be the first to complain to the insurance ombudsman or their local member of parliament. In the UK, there were companies who had attempted to manage projected shortfalls in the targeted fund by asking customers to pay additional premiums. Unfortunately, in an environment where the customer is king, the customers took the opportunity to create an issue of the situation. The history books will now record the demise of mortgage endowments in the UK because the regulators subsequently had to step in and made it very difficult for banks to justify the use of endowment mortgages as compared to repayment mortgages.

One interesting consideration is who would be responsible for managing the customer's expectations – the lender (the bank or the building society/finance company) or the insurance company? In the UK mortgage endowment example, it would be the insurer who is responsible to help steer expectations of the accumulated values of the ILP versus the mortgage amount, but in some other models (e.g. Wealth management relationships promoted by banks), the lender "owns" the customer database and would therefore be responsible.

4.4 Non-guaranteed charges

Unlike traditional policies where premiums are level and guaranteed, investment-linked policies tend to designed so that premiums and charges are non-guaranteed. The use of non-guaranteed rates allows insurers to price their contracts more competitively without having to allow for contingency margins and reserve for the guarantees in the pricing.

It may be a number of years before insurers review their charges. When the time comes to increase the charges, clients may then claim that they are under the impression that the charges are guaranteed and it was never explained to them otherwise. This is more likely than not to be caused by a lack of understanding about the plan rather than the transparency of the plan.

Sadly, customers do not really appreciate the subtle differences between the insurance charges and the premiums paid on an ILP. In the Singapore case for example, there was a remark made by the journalist that charges in one year were more than the premium that was paid and the journalist thought that this was incredulous!

But think about it again to a layman, how would you really expect him to understand that his level premium has to be increased – as well as his charges?

Better communication and customer relationship management will certainly be required here.

4.5 Capital Guaranteed Products

These products are basically investment products and can be structured to be in the form of unit trusts (mutual funds) or as insurance products with minimal life cover to qualify as insurance. The comments that follow would apply to generic capital guaranteed products, whether ILPs or non-linked, which are sold by banks (insurance products or unit trusts) and insurers (through agents or bancassurance). As an insurance product, ILPs are more prevalent than non-linked contracts due to the lower capital requirements.

There appears to be strong demand for these products if sales figures are anything to go by. However, is this just a function of the marketing method that is employed? A very likely reason!

These products are usually sold to customers with sizeable bank deposits that are either maturing or about to be renewed. From the bank's perspective, the sale generates a fee income for the bank and meets the objective of making more productive use of bank branches. Banks are also able to pass on a significant chunk of the investment risk to the customer, as otherwise a continuation of the deposit arrangement would have been loss making to bank when interest spreads are low.

These funds also tend to be very popular after stock market 'crashes' as the sponsors of such funds take advantage of the climate of fear and hope. The marketing literature for these funds may also include projected returns using some back-testing method ("if this product had been sold X years ago… this is what you would have got today") which unfortunately do not take into consideration changes in the economic environment.

The structure of the product could be very complex as illustrated in the following (unit trust) example:
This is a 7-year product providing full capital protection at the end of the period. The contract is exposed to an underlying basket of 6 indices, namely the S&P500, S&P ASX200, Nikkei 225, DJ Eurostoxx, Hang Seng and NASDAQ. In the first 14 months, the option will register the growth of the best performing index. The index will then be taken out of the basket. This is repeated every 14 months.

There is a concern that distributors of the product (whether agents tied to the insurer or as part of a bancassurance arrangement) are not trained to sell such complicated products. Even an actuary could be hard pressed to explain how the product works in layman terms. What is the rationale for having 6 indices in the example above?

To be fair however, there are some products that use derivatives in a creative way to present a simple yet appealing proposition to the customer. The author is aware of products that give full exposure to a particular market but with a profit share on upside scenarios and a guarantee on downside. Such products are unfortunately not the norm in Asia.

How do capital guaranteed products become potential time-bombs?

The time bomb issue is that the client thinks that he is getting a better deal by taking some equity exposure or participating in a hybrid index and yet not losing out from the guarantees (capital or income) from his or her fixed deposit arrangement. In truth, only a small percentage of the investment goes into the "risky" element. A large part of the investment is used to meet the cost of hedging the guarantee. If an income guarantee is present, the portion that gets exposed to "risky" assets becomes even smaller.

In most cases, the equity participation rate is never disclosed explicitly.

The problem will only arise at maturity when the client is paid either his capital protected value or not very much different from it, exposing the myth of potentially higher returns from equity exposure. How will the customer feel especially if the equity market enjoyed a boom in the year before maturity?

Is this a product design issue? It could be when complicated designs are used and the investment strategy is not transparent. However, it could be argued that the product meets the needs of those customers who are risk adverse and yet who felt that they wanted some upside. The issue here is "how much upside?". If it was revealed at the point of sale that the “upside” will only be through a 5% exposure in “risky” assets, would customers get excited? Should there also have been a disclosure that the “risky” portion had to deliver Y% returns to break even with the option of leaving the monies in the bank deposit?

Capital guaranteed products could also present a mis-selling risk if the product is structured with a capital guarantee below 100% in order to get a higher equity participating rate and the product is then sold to illiterate housewives or risk-adverse pensioners.

4.6 Selling methods of ILPs

“Past performance is not necessarily a guide to future performance”. This statement is invariably in all ILP illustrations. Alongside this statement, it is then common to find a table of actual performances. Customers are then guided to compare the league tables of a company’s investment performance against others and to choose a certain fund or fund manager based on the company’s ranking in the table.

Another common marketing slant for ILPs is the advantages of dollar cost averaging for regular premium savers. The example provided for this typically uses an equity index or unit prices that are on an upward trend so that at the time of exit, the final price is well above the average price of purchases.

Now consider the scenario where a newly launched fund manages to achieve superb performance (far exceeding those of its peers) by virtue of a small fund size, some fortunate stock selections or just pure good timing in the launch of the fund.

This keeps the company high in the performance measurement tables for a significant period of time (permanently in the case of “since inception” performance figures). Customers are sold on the continuity of this initial outperformance without appreciating that it is hinged on a single year’s performance. Subsequent year on year returns may then be sub-par, but this is explained away by saying that under the “dollar cost averaging” concept, when returns are low, more units are created.

The time bomb potential is then what happens when the exit price is lower than the average price of all previous unit purchases under the dollar cost averaging principle? This scenario is possible if the equity market enters into a bear run phase and the customer has to make an involuntary exit from the product.

The heart of the problem here is not so much the selling method because customers could reasonably be educated about volatility of returns and relative fund performance. Perhaps there is too much emphasis on the investment freedom and investment potential of an ILP that customers forget, at the end of the day and in most cases, the product is really an insurance product and no different from traditional products.

Perhaps the regulator and the industry could try to steer customers away from fund performances for regular premium ILPs. As these are long-term products, it would serve the customer better if performances are measured over a longer period than 1 month, 3 month, 1 year periods which are common.

In the sales illustration, perhaps a computation of the “net return” should be shown – “net” in this instance implies the internal rate of return of premiums invested taking into account the insurance and policy costs of ILPs. In this way, a bridge can be built between ILPs and traditional insurance products.

5 Customer Relationship Management

It is usual to assume that it is the behaviour of distributors that will cause "time-bombs" for the company in the future. Increasingly, regulators are tightening up each step of the sales process to ensure there are proper training, disclosure and advice given to the end customer.

Consider what this typically evolves into:-

- Minimum education standards for recruitment
- Minimum training standards
- Mandatory Fact-finds and product recommendations
- Justification of Best Advice
- 20 page benefit illustrations and product descriptions

Much as the theory suggests that the needs of customers are to be taken into account (which is the universal truth), in most Asian countries unfortunately the sales processes are still mainly product-focused. What this means is that agents are taught emotional trigger words such as "children", "sickness" or "financial freedom" to connect to the prospective customer. An "off-the-shelf" or favourite product is then offered and justified to meet the mandatory requirements.

From the customer angle, this is what typically happens:

- Customers do not have much time or even desire to go through the "paper-work"
- After a few months, let alone a few years, customers will probably not remember what was explained to them during the sale process
- Customers do not know enough to ask the correct questions
- Customers are unlikely to read any of the voluminous disclosures until triggered by the need to claim or by external events e.g. newspaper articles

There is a practical limit to what can be achieved by increasing requirements on distributors, much as the above is necessary. How should enlightened companies (and actuaries!) look at this?

(The following discussion presents one possible customer interaction model. There is of course no one correct answer and whatever is the final solution must take into account a win-win-win for companies, customers and distributors)

By definition, the relationship between the customer and the insurance company is a long one. At the beginning, most customers would want a sales process that is simple, quick and feel that the product purchased is worthwhile. Admittedly, these are desires that vary by each customer. Perhaps one solution may be to model customer behaviours as being represented by a probabilistic set of outcomes. Companies who are organized to think in a very logical behavioural model will find it very difficult to re-think in this manner. Enlightened companies are those that can balance the need to demonstrate compliance (to regulators who also think in the same logical way) with how the customer wants the sale to be conducted.

Another method may be to look at customer management from a risk-based approach. From the customer's perspective, if the benefit illustration is important in the sense that it is a guide towards meeting his long term savings goal, perhaps companies can assess those events that could invalidate the benefit illustrations and upon occurrence, advice and inform the client appropriately.

Most companies do not invest enough resources to deal with post-sale customer relationship management. Good companies would analyse the need for opportunities and at intervals that are comfortable to the customer to renew the relationship. In many ways, this is not rocket science – like any relationship (e.g. between friends and between family members), it must be nurtured. Most customers do want to be kept informed and have the assurance that someone (whether this is the original agent, a new agent or even a company representative) is there to look out for their long term goals. A successful relationship is one where the trust between the customer and the company (or the agent) is strong enough to be able to withstand the fallout from any time-bombs that may be exploded.

6 Closing Remarks

This paper has considered the various time-bombs in relation to ILPs. It has also stressed on the use of customer relationship management techniques as a preferred method to manage these time-bombs instead of increasing volumes of disclosure.

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Appendix

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Insurance 'time-bomb' set to explode

Lorna Tan , Finance Correspondent
12 February 2005 Straits Times

Investment-linked policies incur rising costs which buyers may not be aware of
WHEN engineer Kelvin Yee bought an investment-linked policy (ILP) eight years ago, he thought he had done the right thing: it gave him life insurance, while at the same time his savings worked harder by being invested in unit trusts. But Mr Yee, 37, now finds that the investment product he purchased has been described as a 'time-bomb' by one financial adviser - one which is set to explode as a new scandal on the insurance industry scene. Mr Yee, along with potentially tens of thousands of others who bought the hugely popular policies over the years, has found out that, as he gets older, hidden increased insurance charges mean that the premiums that are meant for investment purposes are being eaten up just to keep the policy going. Under most ILPs, premiums are invested in securities such as unit trusts and pay for life insurance coverage as well. But Mr Yee's annual insurance charges are set to escalate at such a rate they will one day outstrip the annual premium he pays. When he turns 67, the charges work out to double that of the annual fixed premium of $3,600 for coverage of $100,000. At 73, the charges are expected to climb to $11,500 and when he turns 81, they will surge to $20,000. Mr Yee said: 'This policy does not meet my needs. My impression was that it was a savings plan that gives decent annual returns of 2 to 3 per cent guaranteed, at least.' He alleged that he was unaware of the existence of the increased charges until a financial adviser whom he consulted did the sums. The higher charges result from the increased costs of insurance cover, as people age and the likelihood of illness increases. In some cases, the costs could end up soaring so much that they eat into the 'investment' part of a person's policy, resulting in it lapsing altogether. The problem is emerging now as people who bought such ILPs several years ago are seeing charges leap now that they are older. Once a policyholder hits 40, an ILP's annual insurance charges typically rise 'exponentially', says Life Insurance Association (LIA) president Mr Raymond Kwok, who is calling for greater transparency on the issue. The problem lies in the small print. Most people's eyes would have gone to the policy's 'benefits' table, illustrating how much their investments would increase each year based on growth rate projections of 5 and 9 per cent. No doubt they would have been tantalised by the big figures their lump sums grew to at those rates - even though many financial advisers nowadays say such high percentages are unrealistic. What people probably glossed over were figures in a column generally labelled 'effect of deductions'. With no breakdown given of the 'deductions', few, if any, policyholders would have realised these contained the costs of coverage for death, disability and critical illness, say financial advisers. The older you get, the more of a risk you are to the insurer, so it costs more to cover you. In industry jargon, these costs are 'non-guaranteed', which means they don't stay fixed, unlike your premiums. In fact, they rise - astronomically in the case of ILPs that have regular premiums with high protection elements. People may have assumed the costs were included in the fixed premiums. But in reality, they needed to break down the costs from the effect of deductions column to get a complete picture. Billions of dollars worth of ILPs have been bought here, many with Central Provident Fund savings.In echoes of the 'critical-year' controversy which rocked insurers in 2003, at least a few reckoned they were mis-sold the product. In that scandal, policyholders were shocked to find that, due to the fall in value of an insurer's investments, they had to keep paying premiums longer than expected. That controversy largely involved one big-name insurer. This time, all except UOB Life offer the so-called regular premium ILPs. Prudential Assurance was the first insurer to launch the first regular ILP here in 1992. As for Mr Yee, his financial adviser from Cornerstone Planners, Ms Evelyn Seah, who did not sell him the original policy, noted that there may come a time when the pool of units in the

investment part of the policy will be depleted. This is because 'units will be deducted from this pool to pay for the increasing non-guaranteed insurance and administrative charges when the annual premium is not sufficient to cover these charges. 'When it happens, the policy lapses. That's the time when you may need the cover most.' Hidden charges may eat into investments THE higher charges result from the increased costs of insurance cover as people age and the likelihood of illness increases. The costs could end up soaring so much that they eat into the 'investment' part of a person's policy, resulting in it lapsing altogether. 'That's the time when you may need the cover most,' says financial adviser Evelyn Seah.

Wanted: More transparency in investment-linked policies

Lorna Tan , Finance Correspondent
12 February 2005 Straits Times

Buyers unaware of growing fees 'due to way products are packaged'
LIFE insurance industry players yesterday called for greater transparency when selling certain types of investment-linked policies (ILPs), as they said the products' escalating charges were a time bomb for policyholders. People purchasing 'regular premium' ILPs may not be aware of the increasing insurance charges because of the way most ILP products are packaged, said Life Insurance Association (LIA) president Raymond Kwok, who is also UOB Life's managing director. He was speaking after The Straits Times told him about the plight of 37-year-old Mr Kelvin Yee who bought a regular premium ILP eight years ago without realising that the costs of the insurance portion of the policy increase dramatically as he gets older. For regular premium ILPs - which typically have a high protection cover - part of the premium goes into investments and some goes into life insurance. For single premium ILPs, some have no mortality charge as the protection is given free. But after doing his sums recently, Mr Yee learnt that the insurance charges to cover death, disability and illness will rise to outstrip the premiums he pays, and could even eat up the value of his investments. LIA's Mr Kwok said that the problem with such ILPs is that the cost of insurance cover for eventualities such as death or critical illness is not clearly disclosed to the client in the illustration of benefits at the time of sale. Some insurers provide a 'mortality' factor table which shows death and total permanent disability charges as a dollar factor for every $1,000 of the sum insured each year. However, the actual charges are not worked out and shown specifically in the separate and more widely studied benefit illustration, so policyholders may be ignorant of these escalating charges, said Mr Kwok. He proposed enhancing the illustration table to spell out these charges clearly so that policyholders can see how these fees increase with age. Mr Patrick Lim, associate director of financial advisory firm Promiseland, gave the thumbs-down to regular premium ILPs, saying they are a 'time bomb waiting to explode'. He pointed out that there are 'no absolute guaranteed values' to be found in any regular premium ILP and the product comes with 'layers of charges and fees'. 'Both the protection and investment elements come with humongous costs to the policyholder and these costs may not be viable to continue keeping the policy in force, say when the policyholder reaches his golden years.' He added this was why the benefit illustration of such ILPs comes with this warning: 'After age 65, if your units are insufficient to pay for the elected sum assured, the plan will lapse.' Goodwins Law Corp managing director Stanley Jeremiah said: 'Many policyholders do not realise that as they get older, the cost of insurance is going to accelerate. The converse is that when you are younger you are actually paying a lower premium than you would if the premium had been level.However, the experience of one policyholder may hold some hope for others whose ILP clock is ticking. The unnamed man complained to his insurer, the insurance industry regulator and the Consumers Association of Singapore (Case) alleging that he was misled due to the lack of disclosure when purchasing a regular premium ILP. His insurer then decided to return all his annual premiums 'out of goodwill'. When contacted, the insurer - which did not want to be named - emphasised that the decision to refund premiums did not mean it was admitting liability for any misconduct. The insurer also pointed out that its benefit illustrations are no different from those of other insurers and that it had followed LIA guidelines. The consumer watchdog emphasised the importance of transparency in the insurance industry. Said Case executive director Seah Seng Choon: 'Insurers owe a duty to the insured to disclose all costs involved before the transaction. 'Failure to disclose material information such as charges is not acceptable as it would mislead consumers into believing that the benefit offered is more than what it actually is.'

Elderly and the sick face highest risk of hidden costs in policies

Lorna Tan , Finance Correspondent
15 February 2005 Straits Times

Charges will rise whether they stick to existing plans or take up new ones.
THE 'hidden charges time bomb' lurking in certain investment-linked insurance policies (ILPs) is leaving older people and those who fell ill since buying policies most at risk, said experts yesterday. They were responding to startling revelations in The Straits Times on Saturday of the way costs associated with some of these plans can escalate as the policyholder ages, to the point where the policy becomes unviable. Those disclosures have also prompted many concerned policyholders to contact their insurers, demanding to know more about charges built into their policies - hidden or otherwise. Financial experts believe that certain policyholders - older folk and the ill - face a worrying dilemma if their charges escalate. They may have to surrender their policies and pay sky-high premiums for a new one or bite the bullet and fork out an extremely high cost to continue with their existing plans. And those who have developed medical conditions could find it impossible to get another insurance firm to cover them. The ST report highlighted the plight of Mr Kelvin Yee, one of potentially tens of thousands of people who have been buying the hugely popular policies since 1992. Mr Yee, who has been making regular premium payments, became alarmed that his annual non-guaranteed insurance charges were set to escalate in later years. These would eventually outstrip his annual premium of $3,600 for insurance cover of $100,000. These charges relate to his coverage for death, total and permanent disability and critical illnesses. He also realised that units would be deducted from the investment part of the policy to pay for the increasing non-guaranteed insurance charges when the annual premium became insufficient to cover these charges. If the pool of units runs out, the policy would lapse. Mr Yee's story has sent ripples throughout the industry. Insurance advisers who market certain types of ILPs with high insurance coverage have been fielding calls from worried policyholders demanding to know if they are affected. Mr Chong Kok Peng, a manager at financial advisory firm New Independent, said: 'The worst-hit individuals are those who developed medical conditions after they bought the ILPs. While the costs of their ILPs are escalating, they cannot switch to traditional whole-life policies as potential exclusions would likely be imposed. 'These individuals can only stick to their ILPs because they would be without coverage if their existing policies are terminated,' he added. The associate director of financial advisory firm Promiseland, Mr Patrick Lim, said those who bought at the age of 40 and are now in their 50s 'should be very, very concerned', because they would be facing higher insurance charges soon. Goodwins Law Corp managing director Stanley Jeremiah agreed, saying that the worst-hit were those who bought regular-premium ILPs when they were older, say after the age of 45. 'This is because the fund does not have enough time to accumulate value before the higher mortality begins to impact the cash values. This is especially so if he has opted for high protection and smaller investment,' he explained. However, he urged caution and said terminating the policy without consulting a competent financial adviser would be 'a knee-jerk reaction'. Mr Lim and Mr Chong both pointed out that while some regular-premium ILPs guaranteed cover based on the original sum insured until at least the age of 65, even if the pool of units is depleted, this is not the case for all ILPs with protection. Said Mr Chong: 'As the assurance costs escalate as an individual ages, the annual premium and the accumulated investment gains, if any, might not be sufficient to cover costs. 'Two situations can arise - either the sum assured is reduced dramatically or the annual premium is increased tremendously.' Mr Tan Kin Lian, chief executive of the insurance cooperative NTUC Income, yesterday said that not all ILPs are structured in the same way. Its Ideal Plan, an ILP, is configured so that the single and regular premiums are used entirely for investment. Mr Tan said the charges 'are modest and are clearly disclosed in the policy'. For insurance riders that provide death, accident and medical protection, a separate premium is collected. This is usually fixed at a level rate for the entire duration of the rider and does not involve the deduction of units from the investment.

Insurers need to be more upfront about 'hidden' costs

Lorna Tan , Finance Correspondent
16 February 2005 Straits Times

Policyholders would then be able to better gauge impact of charges in relation to premiums
THE controversy stirred up in these pages over insurance plans might seem complex at first - charges, non-guaranteed costs and so on - but the issue boils down simply to one thing: transparency. People buying investment-linked insurance policies (ILPs) typically expect security in time of need and skilled money management. Most are not well-versed in financial matters. The jargon confuses rather than clarifies. What they see is what they want to get. What they do not want or expect is the shock that hit Mr Kelvin Yee, who featured in a Straits Times report on Saturday. Mr Yee, who bought his ILP eight years ago and made his regular premium payments, learnt that his plan could be in jeopardy because of unseen charges he claims were not disclosed at the point of sale. As The Straits Times revealed, the costs associated with his plan will escalate as he ages to the point where they will outstrip his annual premium. The insurer can then liquidate units from the investment part of the policy to pay the charges. If the annual premiums and investment gains cannot cover costs, the policy may lapse. Other alternatives include lowering his sum assured or coughing up the higher charges in cash. Mr Yee found to his horror that when he reaches 67, these non-guaranteed annual costs will be double the $3,600 annual premium for life cover of $100,000. At 81, the charges will leap to nearly $20,000 a year. At least his insurer guarantees the original sum assured until he reaches 65 - as long as he pays premiums and even if the units in the investment part of the plan are depleted. But how many people know that not all insurers provide such a guarantee? How many insurers are upfront about the costs over the life of a policy? One hint lies in a clause like this: 'Please note that this plan will terminate whenever the cash value is zero or negative'. It signals the guarantee Mr Yee has is not provided in this particular plan. Policyholders not attuned to searching out such details, however, tend to fall through the transparency gap. The AIA 'critical year' fiasco in 2003, while also centring on insurance policies, differs in one crucial point: AIA agents made written promises in some policies that could not be met. AIA sold plans that featured a critical year - the point, usually after 12 or 13 years, at which the policy would become self-funding because of accumulated investments. Investment returns, however, fell and aggrieved policyholders were advised to keep making payments. But many want compensation and with AIA having spelled out in black and white the 'critical year' benefit, lawyers believe some have a solid case. Things are less clear over 'hidden charges'. The issue is not faulty products or insurance agents making promises they cannot keep; it is transparency and, in some cases, the mismatch between the product and the customer's needs. Insurers selling ILPs with protection typically provide a mortality factor table which gives the cost per $1,000 sum assured. The lack of transparency kicks in when they do not calculate the actual sums for policyholders unless asked to. As well, costs, including annual insurance charges, are lumped in the 'effect of deductions' column in the benefit illustrations. That column sits next to figures showing projected annual investment returns of 5 per cent and 9 per cent, which could lull policyholders into a false sense of security. Unless actual annual insurance charges are broken down and listed in a separate column, it is difficult to gauge the impact of these charges in relation to annual premiums. However, for people caught up now - perhaps tens of thousands - there is not much recourse. Without evidence, it is difficult to accuse an insurer of deliberately misleading a client or issuing wrongful advice. But there may be cases where the evidence shows that an inappropriate ILP was sold to a customer, who could bring an action for negligence against the agent. Some would argue that this could be why one insurer has refunded all the premiums to an ILP policyholder who alleged he was misled into buying the plan because the escalating charges were not disclosed at point of sale. The client was 48 when he bought the regular premium ILP and expected he would enjoy insurance protection for many years to come. But his age meant he was probably too old for such a product. In this case, the insurer had stated that the move to refund premiums was out of goodwill and not an admission of liability. As in most investments, it is not a case of one size fits all. For some, regular premium ILPs are worthy products. They provide an option for disciplined savings and the regular premiums mean investments are not subject to market timing. For young people, the premium for the insurance cover is lower than traditional insurance products, so more can go to investments. But for Mr Yee, expecting long-term protection with some investment gains, his ILP may become an umbrella with holes just when he needs it most - in his golden years. Putting a premium on clarity. The issue is not faulty products or

insurance agents making promises they cannot keep; it is transparency and, in some cases, the mismatch between the product and the customer's needs.

Case calls for more transparency

Lorna Tan , Finance Correspondent
19 February 2005 Straits Times

Such plans lack clarity and may have been misrepresented by agents, says watchdog
THE consumer watchdog has hit out at investment-linked insurance plans (ILPs), saying they clearly lack transparency and leave some policyholders confused. The Consumers Association of Singapore's (Case's) strongly worded comments are in stark contrast to the stance of the Life Insurance Association (LIA), which said this week that the disclosure standards for ILPs were comprehensive and met regulatory requirements. Case said yesterday that 24 policyholders have approached it, complaining about a lack of clarity in the details and claiming misrepresentation by agents. Case executive director Seah Seng Choon said: 'Clearly, many consumers out there are very confused about the mechanics of ILPs. There is a clear lack of transparency and standards in the presentation of the benefit illustration. 'For instance, the validity year of the mortality rate is not known. The cost breakdown is not available to consumers, resulting in them thinking the full premium is investment for returns.' The LIA's response earlier in the week came after the controversy sparked by stories in The Straits Times that drew attention to the need for greater transparency in some plans, especially in the presentation of charges at the point of sale. Case also raised concerns that the quality of advice given to consumers is 'questionable', suggesting that the industry 'will do well to review their training manuals to clean this up'. Case believes policyholders would have grounds for action if there is evidence of misrepresentation. 'The consumer can take action for misrepresentation by the agent and for negligent advice of the agent if there is evidence that the ILP was wrongly sold to the consumer,' Mr Seah said. After all, agents are expected to present 'a balanced view' of the policies they sell. 'It would not be fair practice if the agent just presents the benefits without the risks and the costs involved,' he added. Last Saturday, this newspaper highlighted the plight of a policyholder who learnt that escalating non-guaranteed insurance charges would eventually outstrip his annual premium. If the premiums and investment gains in his regular premium ILP were unable to cover the costs, the policy could lapse or his sum assured could be lowered. Case is offering free consultation to people concerned over their ILPs. It also said it planned to meet the LIA soon. Mr Seah recalled the plight of a 52-year-old policyholder who approached Case last year, alleging he was not told of the cost structure of his regular premium ILP. Case provided legal advice on the approach to negotiate with the insurer, which refunded premiums out of goodwill without admitting liability. LIA deputy president Ed Navarro defended the industry's practice this week, saying that all charges were disclosed in a pre-contract document containing the benefit illustration and product summary which, in some plans, run up to 27 pages. He also emphasised that consumers have a role to play in understanding the products before they buy them. According to LIA, there are 350,000 regular premium ILPs.

Insurers issue FAQs on investment linked plans

Lorna Tan , Finance Correspondent
22 February 2005 Straits Times

GE, Prudential and Manulife are among those to address policyholders' concerns
In response to increasing public scrutiny of investment-linked insurance policies (ILPs), several life insurers have started issuing lists of frequently asked questions (FAQs) to their frontline staff and agents. Since the middle of last week, insurers such as Great Eastern (GE), Prudential and Manulife have come up with FAQs designed to address concerns that policyholders may have regarding some ILPs. These popular products have been in the spotlight in recent weeks, with groups such as the Consumers Association of Singapore (Case) saying that some lack transparency and are confusing for consumers. GE's FAQs have been posted on its website, while other insurers have distributed their FAQs among their staff.Concerns that GE's FAQs attempt to address include what happens when the total investment value of the ILP is insufficient to pay for the insurance coverage offered by the product. It also tackles the issue of escalating insurance charges as the policyholder gets older. Case has given the thumbs-up to the latest development. Said Case executive director

Seah Seng Choon yesterday: 'Any effort put in to improve communication with consumers is good. 'It will certainly help consumers to understand ILPs better. We encourage all insurers who are selling ILPs to do the same.' Last Friday, the consumer watchdog pointed to 'a clear lack of transparency and standards in the presentation of the benefit illustration' of ILPs and said that the life insurance industry has 'a lot of room for improvement' as far as selling them is concerned. Case's comments followed stories in The Straits Times drawing attention to the need for greater transparency in some ILPs, especially in the presentation of charges at the point of sale. Yesterday, Mr Seah added that it has contacted the Life Insurance Association (LIA) and hopes to meet the association this week. LIA deputy president Ed Navarro defended the industry's practice last week, saying that all charges were disclosed in a pre-contract document containing the benefit illustration and product summary which, in some plans, run up to 27 pages. On its FAQs, Manulife said that it is 'to prepare the agents and customer should they get questions from policyholders'. At British insurer Aviva, where its products are mostly sold via DBS Bank and financial advisers, the insurer said that it has sent out a note to the sales force of DBS. 'The note says that we do not have any of the features that are highlighted in the articles,' said Mr Tim Beardsall, Aviva's chief marketing officer. He explained that the regular premium savings plan that it sells through DBS has a very transparent charging structure because there are no unit deductions to pay for death coverage or other costs, so the customer knows upfront what he needs to pay. Insurance helpline While GE has posted its FAQs on its website, other insurers have distributed their FAQs among their staff. Manulife said it is 'to prepare the agents and customer should they get questions from policyholders'. Concerns addressed include what happens when the total investment value of the ILP is insufficient to pay for the coverage offered.

Is your insurance policy a waste of money?

Lorna Tan , Finance Correspondent
27 February 2005 Straits Times

EIGHT years ago, Madam Chang Su Jin was attracted by a financial product that she could put money into each month which combined life insurance coverage with investment in a unit trust. The regular premium investment-linked insurance plan (ILP), as it was called, seemed a great idea. But now, she fears she may have wasted her money. Madam Chang, 66, has been shocked to learn that the apparently prudent savings and insurance plan she bought is under fire over a lack of clarity in its cost structure. Like many others, she read of the case of policyholder Kelvin Yee, 37 - whose plight was highlighted in The Straits Times on Feb 12 - in which he claimed he was not advised about the rising insurance charges for death and critical illness. These charges for insurance for death and critical illness are not fixed - in industry jargon, they are 'non-guaranteed'. Mr Yee's policy is such that when he turns 67, these charges will have soared to be double his premiums. Madam Chang then re-read her policy and, to her horror, fears that she could be in the same boat. She now realises she was also ignorant about the fact that her plan's investment gains would be used to pay for these escalating charges if they outstrip the annual premium. As well, she did not know that if the annual premiums and investment gains cannot cover costs, her policy might lapse or the sum she is insured for could be lowered.'I did not know about the charges till I read the papers. My objective was to get long-term protection and some investment gains,' she laments. In recent weeks, the controversy has drawn the attention of policyholders, the Consumers Association of Singapore (Case) and industry players. Insurance charges are present in all life policies. But many consumers, unfamiliar with insurance jargon, are confused by ILPs. Like Madam Chang, they are still grappling to understand that for most ILPs with life insurance coverage, their cost structure requires that investment units be deducted regularly to pay for the insurance charges. And unlike traditional policies, most ILPs do not guarantee a minimum return. Several industry players and practitioners now acknowledge that this needs to be explained much better when a policy is sold. Some have proposed that the benefit illustrations of ILPs reflect insurance charges in a separate column, instead of lumping them with other costs. On Thursday, Case said that 36 policyholders have contacted them, complaining about a lack of clarity in the product's costs and benefits, and claiming misrepresentation by agents. Case has also raised concerns about the quality of advice given to consumers. The Life Insurance Association (LIA), meanwhile, says that all charges are disclosed in documents given to policyholders and in annual statements, and that the insurers adhere to disclosure requirements set out by the regulator. But it agrees that the manner in which the information is disclosed can be improved. Case expects to meet LIA on the issue this week.

Five reasons why ILPs are an insurer's best friend

Lorna Tan , Finance Correspondent
3 March 2005 Straits Times

OVER the past two weeks, investment-linked insurance policies (ILPs) have attracted a storm of attention from policyholders, the consumer watchdog, insurers and insurance practitioners alike. From the controversy that has erupted from articles in The Straits Times, one point is clear - that there must be more clarity on the various costs and benefits of an insurance product. The problem, therefore, has to do with adequate disclosure - and not the ILP product. Indeed, much has been said by insurers about the advantages of regular premium ILPs as a financial planning tool. They say that these ILPs give customers the best of both worlds - allowing them to get insurance protection and participate in the growth of financial markets around the world. The product is also flexible enough to allow policyholders to vary the amount of protection and investment they want to buy, both at the point of purchase and at any time during the life of the policy. To be fair, these reasons are as good as any for a customer to buy a product - provided, of course, he is sufficiently informed of the corresponding risks and drawbacks. While a lot has been said about why ILPs are great for some consumers, hardly anything has been said about why, as a product class, they are even better for insurers. Here, if one digs deep enough, one will find that a regular premium ILP surely counts among an insurer's best friends. There are five reasons why this is so. Firstly, it is one insurance product where the policyholder bears all the investment risks. For traditional whole life and endowment plans, the insurer guarantees a minimum rate of return. So, for example, if the guaranteed rate is 2 per cent, the insurer bears an investment risk. In an ILP, the investment risks are borne by the policyholder, not the insurer. This is because most ILPs do not guarantee a minimum return. Since the values of the ILPs are linked to the investment performance of the assets they are invested in, the values can rise or fall with the underlying assets - which makes ILPs riskier than non-linked policies. The fact that insurers bear less risk makes the ILP attractive to them in a second way. Having products that are 'asset or guarantee light' augurs well for the new risk-based capital (RBC) regime which has applied to the insurance industry since the start of this year. This regime puts the onus on insurers to make sure they have enough capital to set aside as a buffer against losses. The less risk an insurer bears, the less capital they need to set aside. This means that under the regime, insurers are able to enjoy relatively lower risks from selling 'RBC-friendly' products that are investment-linked and those that require regular premiums, rather than single premiums. Regular streams of premiums are preferred to one-time payments because it is easier to match assets with liabilities on an ongoing basis. A third reason why insurers are hot on ILPs is that the mortality or death cover provided for most regular premium ILPs is actually a yearly term policy. In a normal level term policy, the mortality charges, or the costs of protecting the policyholder, for the entire duration of the policy are calculated once-off and reflected in the premiums that you pay.But in most regular premium ILPs, the protection costs are based on yearly renewable rates. So for such products, the insurer may revise the rates to compensate for the higher risk as the policyholder ages, unlike a level term policy. This reduces the risk of conducting business. Fourthly, some insurers ensure that they are paid upfront before allocating your premiums to the protection and investment portions. In the past for these insurers, none of the first-year premiums was allocated to pay for protection charges nor to investments. Instead, the entire first-year premiums are typically used to pay for the agent's commission and other administration fees. This improved only slightly two years ago when at least 15 per cent of first-year premiums were allocated to pay for protection and invested in units, with the balance paying for commissions and insurer's administration fees. The allocation rises to 50 per cent of premiums in the second and third year, respectively. Only in the fourth year are premiums fully allocated to cover protection and investment. To consumers, this means the initial three years of premiums do not buy many investment units. Finally, the reason why regular premium ILPs are a significant source of revenue for insurers could be partly attributed to something called the 'bid-offer spread'. The bid-offer spread is the difference between buying and selling prices of the investment funds. What happens in most ILPs is that each time you pay your premium, it is used to purchase fund units at the offer price. Some of your units are then sold at the bid price, which is typically 5 per cent lower, to pay for the cost of insurance protection and administration. So, in fact, you are paying a 5 per cent sales charge for nothing, paying a fee on transacting units that you do not even get to keep! Some have proposed that a more logical way is to deduct the insurance costs first from the premium, with the rest used to buy units. Better still if the spread could be reduced to say, a nominal 1 per cent. What's the moral of the story? Get the full picture before you buy any product, whether it is an insurance policy or something as specific as a regular premium ILP. Financial institutions and their sales staff are very good at telling you what's in it for you. But always find out what's in it for them, so you can better assess whether something is really in your interest to buy, or someone else's

ILP sales processes could be reviewed

Lorna Tan , Finance Correspondent
12 March 2005 Straits Times

Case handling 43 complaints on such plans; it takes up issue with industry
SINGAPORE'S consumer watchdog has managed to get life insurers to agree to consider reviewing their sales processes and documentation for investment-linked insurance policies (ILPs). This potential victory for would-be insurance plan purchasers was the outcome of a meeting held by the Consumers Association of Singapore (Case) with the Life Insurance Association (LIA) last week. Case was moved to hold the meeting when complaints about regular premium ILPs shot up after a report in The Straits Times on Feb 12 about a policyholder who was alarmed to realise that the costs of annual insurance cover would grow as he got older to outstrip the premiums he had paid. The consumers' body said this week that it has received 43 complaints. Nine people have gone on to register their details with the watchdog so that it can approach the respective insurers on their behalf. A move by insurers to make sales documents easier to understand would be a big helping hand for people seeking such products, which offer both insurance cover and savings growth in one package. Case executive director Seah Seng Choon told The Straits Times that at last week's meeting, it pointed out to the LIA that ILPs' benefit illustrations - which are tables giving breakdowns of how premiums, costs and payouts pan out over the years - were 'not extensive enough'. 'The cost of insurance was not broken down and administrative charges were not shown,' he said. 'There is certainly room for improvement in the presentation of costs to consumers.' Mr Seah also said that there is a tendency for insurance agents to sell regular premium ILPs even when consumers clearly wanted a product focusing purely on investment. Another issue that was raised by Case was the validity of the mortality table - illustrating costs of cover depending on the age of the policyholder - in regular premium ILPs. It wants insurers to state clearly when the mortality table was last tabulated. 'People are living longer and therefore the insurer's risk of payout due to mortality is lower today as compared to 30 years ago. 'With lower risk, the rate used to be imputed into the cost of insurance for each particular age group is correspondently lower,' explained Mr Seah. Case also requested that more educational programmes be carried out by the LIA to keep the public informed about insurance policies, particularly ILPs. The LIA described the meeting with Case as 'constructive'.Mr Seah said that after reviewing the 43 complaints it received, it appeared that consumers have not understood the workings of their ILPs completely. 'Most thought that they were investing a large part of their premium in a fund, and the cost of insurance was not clear to them,' he said. 'The cost of insurance was not fully communicated to consumers, resulting in them thinking that insurance was an added incentive thrown in and there was no or little cost involved.' Case said that most complainants are Prudential policyholders, with one from Great Eastern and two from AIA. According to the LIA last month, there are 350,000 regular premium ILPs. What can be done better Detailed breakdown.Case says ILP benefit illustrations - which are tables giving breakdowns of premiums, costs and payouts - should be more extensive. Mr Seah says the cost of insurance was not broken down and admin charges were not shown, while presentation of costs can be improved. Current data Case says ILP mortality tables, which show the costs of cover depending on policyholders' age, should be kept up to date. It wants insurers to state clearly when the tables were last tabulated.

Each type of plan has its own merits

Kevin Wright CEO Prudential Assurance Company Singapore
19 February 2005 Straits Times

I REFER to the articles 'Wanted: more transparency in investment-linked policies' and 'Insurance 'time-bomb' set to explode' (ST, Feb 12). They did not provide a balanced view of investment-linked policies (ILPs) and created the impression that regular-premium ILPs are not structurally sound. Regular-premium ILPs and traditional whole-life policies are equally relevant in today's market environment and serve different needs of policyholders. Traditional whole-life policies tend to offer greater guarantees than regular-premium ILPs and this is priced into the premiums. Regular-premium ILPs offer greater flexibility and control than traditional whole-life policies. For example, ILP policyholders can change their insurance coverage more easily and select the funds they want to invest in.A misconception as a result of the articles is that, unlike traditional plans, regular-premium ILPs have high assurance charges, particularly at older ages. Insurance costs increase as a person ages, simply because of the higher probability of death and illness. This fundamental insurance principle applies to all insurance products and is not unique to regular-premium ILPs. Another concern highlighted in the articles is the reference to 'hidden' charges and lack of transparency. Benefit illustrations show the projected benefits for the policies at each age in the future. These are calculated after deducting the assurance and other charges. Benefit illustrations for regular-premium ILPs are subject to similar Life Insurance Association (LIA) guidelines and Monetary Authority of Singapore (MAS) regulations as traditional products. Advisers are required to present and explain these benefit illustrations to the policyholder before the policy is taken up. Policyholders are also required to sign off on these benefit illustrations. All insurers comply with these guidelines as they are prescribed by the LIA. Furthermore, regular-premium ILP policyholders receive annual unit statements that clearly indicate total charges levied on the policy. Transparency has improved significantly as the life insurance industry has evolved over the years. The latest changes in MAS regulations have increased disclosure significantly with all essential features and charges fully disclosed. Our latest set of benefit illustrations and the attached product summary now extends over 27 pages for some regular-premium ILPs. The flexibility such ILPs offer is much appreciated by many of our customers. They allow policyholders to start off with adequate insurance coverage at a price that is affordable and in some cases significantly lower than traditional whole-life plans. They also give them the flexibility to change the structure of their plan according to their changing financial and insurance needs, as triggered by major lifestage events like marriage, parenthood and retirement. It is quite conceivable that some of our existing policyholders will reduce their insurance coverage at retirement age and convert their ILP plan to an investment plan without incurring any further front-end sales charges.

Hidden charges? Insurers required to state all levies

John Lockyer Executive Director Life Insurance Association, Singapore
24 February 2005 Straits Times

I WOULD like to clarify some misperceptions in recent articles on investment-linked policies (ILPs). First, the Monetary Authority of Singapore (MAS) Notice 307 on ILPs sets out disclosure requirements on fees and charges payable from premiums or cancellation of units, including the charges for insurance coverage. Disclosure requirements have been in place since the 1990s and have been enhanced over the years. There are no hidden charges in ILPs. Insurers are required to state all charges, including mortality charges, in the product summary and policy contracts. Insurers also disclose the way in which mortality charges are imposed, typically via cancellation of units, and the frequency of charges. The effect of all fees and charges on policy benefits is also reflected in the benefit illustrations given to clients at the point of sale.ILP policyholders receive annual statements which clearly set out the policy's unit balance, units purchased, and units cancelled to pay for all charges. We believe that the level of disclosure is adequate and meets MAS standards, but agree that we can improve the manner in which information is disclosed. In that regard, we continue to work on transparency standards that will assist consumers in the purchase of life-insurance products. Second, it is a fact that, as we age, we face higher risks of sickness and death. The appropriate charges for these risks, based on actuarial studies, are factored into the assessment of all premiums of insurance products, whether traditional or investment linked. Thus, while charges for insurance protection may rise, policyholders may not need to pay higher premiums. Regardless of age, the premiums charged take into account the level and nature of cover sought and the corresponding risk pattern. Third, since 2001 all CPF ILPs sold have been by single premium. Even when sales of regular-premium ILPs were permitted, the level of insurance cover was strictly limited. Furthermore, since the purpose of these policies is to accumulate funds up to retirement, the question of charges in extreme old age simply does not arise. Ultimately, everyone plays a part in a disclosure-based regime. Insurers must disclose product information clearly. Distributors have a duty to ensure that customers understand the key features of the product and make appropriate recommendations. Customers should ensure that they understand what they are buying and buy products that suit their needs. The Life Insurance Association is working with the MoneySense programme to help customers make better sense of insurance products which are, by nature, complex.

Current practice adheres to global best practices

Jonathan Low Vice-President, PR & Marketing Insurance and Financial Practitioners Association of Singapore
Leong Sze Hian Chairman, Practice Standards Committee Society of Financial Service Professionals
24 February 2005 Straits Times

WE REFER to the articles, 'Wanted: More transparency in investment-linked policies'; 'Insurance 'time bomb' set to explode'; 'Elderly and the sick face highest risk of hidden costs in policies'; 'Insurers need to be more upfront about 'hidden' costs'; and 'Investment-linked plans 'meet MAS disclosure standards', by Ms Lorna Tan (ST, Feb 12,15,16 and 17). The issue may not be so much one of 'transparency' as one of the balance between clarity and understanding of ILPs on the part of the consumer, vis-à-vis the complexity of breaking down further the components of ILPs. ILP benefit illustrations already disclose all charges and their effect in total on the gross returns, with the net-returns projection on a year-to-year basis; a mortality table is typically included in the policy contract. An ILP benefit illustration and product summary can run to 27 pages; there is sufficient information and disclosure given to the consumer. The challenge lies in understanding complex technical information. A better approach would be for the consumer to seek clarity from his adviser. Ultimately, the consumer is the best judge in the determination and evolvement of the appropriate balance between 'transparency' and complexity. Meanwhile, we want to assure Singaporeans that the current practice adheres to best practices globally.

Investment-linked policies: Misconceptions in reports

Jason Sadler President Life Insurance Association
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I AM concerned that articles in The Straits Times are spreading misconceptions about investment-linked insurance policies (ILPs). In the latest article, 'Five reasons why ILPs are an insurer's best friend' (ST, March 3), advantages to insurers are portrayed as being at the expense of the consumer. That is most certainly not the case. The first point relates to the fact that ILPs transfer investment risk to the consumer. Guarantees inherent in traditional policies can limit investment opportunity. Freed from the constraints of those guarantees, ILPs offer greater freedom of investment and the possibility of higher long-term returns to the consumer. Furthermore, customers can select from a range of funds to reflect their appetite for risk. The second point raised was that ILPs require less capital. Capital does not come free. Any institution - be it a life insurer, a bank or investment company - has to charge for the cost of the capital absorbed by its business. If a product absorbs less capital, the price that has to be paid by the customer is commensurately lower. The third point relates to the fallacy that the increasing risk of mortality equates to increasing premiums in an ILP. The article correctly points out that 'in a normal level term policy' the mortality costs are reflected in the level premium paid. Exactly the same logic applies to term cover structured under an ILP. The pattern of risk can be anticipated in the premium charged. The fourth point is the assumption that 'some insurers ensure that they are paid upfront.' is different from traditional forms of insurance. A large proportion of the costs is incurred at the establishment of a policy but whether the insurer recoups this cost 'upfront' or spreads the cost does not materially affect the benefits to the customer. The fifth point relates to bid/offer spreads. The concept of different buying and selling prices is common in a range of financial transactions - buying unit trusts, exchanging foreign currency, etc. It is one way of covering transactional and other costs. Some companies increase the allocation to 105 per cent of premium, after an initial period, to neutralise the effect of the bid/offer spread. Whatever route is chosen, the effect of the charges is fully disclosed. The Life Insurance Association is committed to increasing awareness of the importance of sound financial planning and the part that ILPs can play in that process.