Why I Cancelled My ILP (Investment-Linked Policy)

Description

How should I read the numbers on my Investment-Linked Policy (ILP)?

I lost more than 2 months worth of salary to learn this important lesson: when insurance and investments are bundled together into a single product, the consumer is often left worse off.

A few years ago, when I was a naive fresh graduate in my first job, I met a friend of mine to understand more about financial planning and insurance. My knowledge then was limited – I knew I needed to invest and buy insurance, but I didn't know what was essential to get. Furthermore, at that time all I wanted to focus on was to put in my best effort at work so that I could get promoted and climb the corporate ladder.

Insurance was the last thing on my mind. So I went with my friend's advice, thinking that as a financial advisor, they'll probably know better than I. He recommended me an ILP, I briefly read through the policy and asked some questions, and then I ~~stupidly~~ thought I knew everything. I didn't quite know how to read the benefits and premiums table, so I simply took him at his word.

A few years passed and my career reached a more stable stage. I then decided to take a second look at my policy, and was shocked when I learnt how to read the numbers and realized the hard truth of what I had signed up for.

Client(s) Acknowledgement of Product Summary:

I / We acknowledge that I / We have received all pages of the following:
1. Product Summary for the basic plan and riders listed above, if any (107 pages, excluding this page); and
2. Product Highlight Sheet (applicable only to investment-linked plan);
and I/ We have read and understood the features and benefits of the policy and riders, including the applicable fees and charges. The terms and conditions of the policy and riders, if any as set out in the Product Summary and Product Highlight Sheet have been clearly explained to me/ us.

I signed on the above, but did not *truly* understand what I was committing myself to. The terms and conditions were NOT clearly explained to me in the way I've dissected it below, and if I had known these earlier, there was no way I would have signed up for such a plan.

Regular readers will know that I announced on my blog sometime back that I had cancelled my ILP policy, but I've never gone into details to explain why I did so. Part of the reason was also fear – I was worried that if I reveal this, I'll get screwed over by insurance agents on my blog or even sued by insurance companies for ruining their rice-bowls. Back then, there weren't as much people writing about ILPs as there are today. But despite more information, there still isn't a resource from a consumer point of view on what these ILPs really mean to an individual, so I've decided to finally share my story about why I cancelled an ILP plan that didn't work for me.

For confidentiality, I will not be sharing the name of the plan I bought.

End of Policy Year	Annualised Premium(S$)	Total Premium(S$)	Total Distribution Cost(S$)	Non-guaranteed Surrender Value(S$) 4%	8%	Effect of Deductions (S$)
1	1,800	1,800	2,682	138	141	1,803
2	1,800	3,600	3,483	448	463	3,580
3	1,800	5,400	3,751	1,191	1,239	5,072
4	1,800	7,200	3,898	2,804	2,935	5,825
5	1,800	9,000	3,927	4,441	4,722	6,682
6	1,800	10,800	3,970	6,101	6,605	7,656
7	1,800	12,600	4,027	7,785	8,589	8,757
8	1,800	14,400	4,100	9,495	10,682	9,995
9	1,800	16,200	4,189	11,227	12,886	11,390
10	1,800	18,000	4,294	12,982	15,207	12,955
11	1,800	19,800	4,418	14,760	17,652	14,707
12	1,800	21,600	4,561	16,560	20,226	16,665
13	1,800	23,400	4,723	18,381	22,937	18,850
14	1,800	25,200	4,906	20,220	25,787	21,287
15	1,800	27,000	5,111	22,078	28,785	23,999
16	1,800	28,800	5,339	23,955	31,941	27,009
17	1,800	30,600	5,592	25,846	35,260	30,350
18	1,800	32,400	5,870	27,756	38,757	34,046
19	1,800	34,200	6,175	29,671	42,429	38,142
20	1,800	36,000	6,508	31,589	46,283	42,679
25	1,800	45,000	8,646	40,973	68,406	73,712
30	1,800	54,000	11,715	49,850	96,328	123,895
35	1,800	63,000	15,973	57,956	132,021	202,963
40	1,800	72,000	21,732	63,792	176,561	327,045
AGE 55	1,800	57,600	13,259	53,241	109,581	151,330
AGE 60	1,800	66,600	18,078	60,693	148,737	246,032
AGE 65	1,800	75,600	24,534	65,153	197,207	394,243

This table above is the benefits illustration table. If you compare columns 2 and 6 (where my agent pointed me to), the policy looks good, doesn't it?

Put in $72,000 over 40 years and get $176,561 back! That's $100,000 FREE!

What I didn't know then was that if I put my money elsewhere, at 8% I'll be getting $500,000 instead – FIVE TIMES MORE! (Remember this figure, I'll come back to this later.) But of course, my agent didn't tell me this. To give him the benefit of doubt, I'm not sure if he even knows such an alternative (easily) exists?

Why such a jarring discrepancy?

The answer lies in the high costs charged to the consumer for the ILP. Aside from paying your agent their commissions, you also pay a lot of money just for them to manage the funds for you. Over 40 years, this works out to be $327,045 on my plan, leaving me with only $176k for myself.

Add up both figures and you'll get $500k. Now do you know why I said earlier that I should be getting $500k back instead for the same amount of money invested?

EFFECT OF DEDUCTIONS

The deductions relate to all charges taken out from the policy. These include distribution costs, expenses, mortality and morbidity costs, surrender penalty, expected transfers to shareholders and expected tax payments. The figures illustrated relate to the effect of deductions based on the Projected investment rate of return of 8.00% p.a.

The Effect of Deductions column in the Benefit Illustration shows the difference between the accumulation of the premiums paid (accumulated at the Projected Investment Rate of Return) and the Total Cash Surrender Value or Projected Maturity Value.

This is intended to indicate the costs you might incur with this policy. This is done by comparing these Projected values to the amounts you would receive if you were able to invest all your premiums(incurring no costs) in a hypothetical investment plan that pays a rate of interest equal to the Projected Investment Rate of Return.

I then decided to calculate **how much I'm paying for these distribution costs**. Divide $24,534 by $75,600 and that works out to be **32.4%. These are fixed expenses – no matter whether my policy makes money or not, the insurance company still gets paid.**

32% is a LOT of money. That's like me telling someone, "*hey give me your money to invest for you. Whether or not you make or lose money, you still have to pay me 1/3 of the total capital though!"*

Would you take up this business proposal? Probably not. I don't know why I was stupid enough to say yes to this back then, and paid a price for this naivety.

The Total Distribution Cost is not an additional cost to you; it has already been allowed for in calculating your premium.

My agent pointed this clause in the T&Cs for me. When explained this way, it does seem like a good proposition – "it is not an additional cost to you!"

In preparing this Benefit Illustration, it is assumed that the Projected Investment Rate of Return that [redacted] will be able to earn throughout the term of your policy (before paying any costs of investing) will be 8.00% p.a. The Projected Investment Rate of Return is not guaranteed.

The policy benefits are calculated so that they are consistent with the Projected Investment Rate of Return assumption.

Please note that if you select a money market fund or a fixed income fund, then returns of 4% to 8% could be considered high in many cases and unlikely to be achieved if the current low interest rate environment persists. You are strongly encouraged to speak to your financial adviser who would be able to provide further information on these funds - both for your initial fund selection and subsequently.

But even if they earn 8%, you will NOT be getting that much, so don't be fooled by your agent into thinking that you will. Take a look at the clause below to understand why.

REDUCTION IN YIELD

This Benefit Illustration shows that at age 65, the effect of the total deductions could amount to $394,243.

The total deductions would have the effect of reducing the Projected Investment Rate of Return upon surrender at age 65 from 8.00% to 4.02% p.a.

The difference between the Projected Investment Rate of Return of 8.00% p.a. and the rate of return you will receive(based on this Benefit Illustration) is called the Reduction in Yield.

Both 4% and 8% are used, and the inclusion of the 8% column does make the benefit illustration table so much more appealing (and an easier sell). My agent focused more on this, saying that leaving my money in the hands of experts who know how to invest will probably be better than if I invested myself.

In reality, what are the REAL investment returns by these experts? Less than 8%. Check out the data reported by the Straits Times here.

Now let's examine what happens if my policy makes a more plausible 4% p.a. instead. Since my money is growing, I should be benefiting, right?

WRONG. This gets even more shocking: **I get back LESS of my total capital even if my money grows at 4% p.a.** To be exact, I'll stand to lose $10,447.

Back then, I had asked my agent about this $10k loss. He explained that it was because some portion of the money needs to be paid for the insurance portion, which I'll incur anyway because I need to get protection whether or not I'm on this plan. I trusted him and accepted his advice, but it was only later on that I realized there's a cheaper way of getting the same amount of coverage which he hadn't told me about.

I love MAS for launching [CompareFirst] because now I don't have to go through any agents to get a quote anymore, exposing myself to be misled in the process.

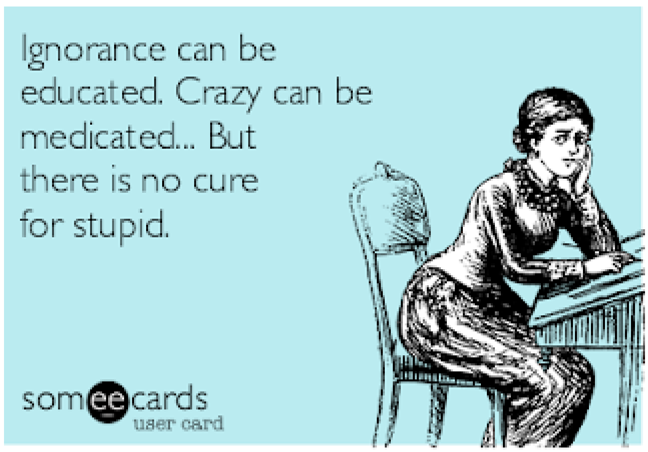
My ILP policy protects me for $215,000 TPD benefit. I can get a similar level of coverage for much cheaper – AXA Term Lite is the cheapest in the market and will cost me $5700 instead. The $4747 I save as a result can easily buy me a trip to Paris, which I've yet to visit!

In fact, here's something even better. Instead of giving away that $10k+ to get insurance coverage on this plan, I can easily get a $300k protection plan for even cheaper ($8550).

I then questioned the outcome if I were to invest in a stock yielding me the same level of returns instead. After running through the numbers, I realized that I would get back $179,687 through this method. On my ILP, I stand to only get back $63,7912.

Where did that $115,895 go to? (You should know the answer by now.)

Seriously, if I have to pay $115,000 for them to invest my money, I'd rather learn how to do it myself.



—

So that's my full story of why I cancelled my ILP and decided to **buy term, invest the rest.**

I don't know how many people will see this, but at least now the Internet has gotten one more resource from a consumer point of view why I personally think ILPs are the worst financial instruments ever created. The consumer, like what I've experienced myself, only stands to lose in almost every circumstance.

If you’re thinking of buying an ILP or know of someone who does, I hope this resource has helped you understand a little more. Unfortunately for me, I had to forgo 2+ years of premiums to learn this lesson because this didn’t exist before.

With love,
(a poorer)
Budget Babe

Category

1. Insurance
2. Investing