Low interest rates and projected bonuses have prompted more policy holders to switch to investment-linked products. Financial adviser David Choo shares his views on the change.

Times they are a changing

"The times they are a changing" best describes the financial services scene in Singapore.

For the first time in Singapore, the sales of investment-linked products exceeded those of non-linked or traditional products – 53 per cent in 2005 compared with 47 per cent in 2004.

And for the first time, the bancassurance share fell instead of increasing – from 29 per cent in 2004 to 24 per cent in 2005.

What caused these changes and what do they forebode?

Traditional cash value insurance like whole life and endowment provide a guaranteed cash value which is relatively low and a projected return which depends on the bonuses declared year by year which are not guaranteed. The investment decisions are undertaken by the insurance company.

In contrast, investment-linked products (ILPs) combine insurance with investments selected by the policyholders and the risks are borne by the policyholders. The sales benefit illustration shows investment returns of 5 per cent and 9 per cent per annum which obviously look much better than the projected returns of traditional policies. We have to accept that by now policyholders know that these returns are illustrations and not guaranteed. ILPs are viewed as more flexible than traditional insurance because the policyholder can decide either to switch between insurance protection and investment at any time, or to switch between a few funds also. ILPs may, indeed, give better returns when the underlying equities or bonds are doing well. But the main reason for the ILPs' greater share of the market for agents is that the majority of agents are not licensed or able to distribute unit trust, unlike licensed financial advisers.

The pros and cons of purchasing ILPs vis-à-vis purchasing unit trust and insurance separately have been covered before. The only key factors in favour of ILPs are the convenience (i.e. getting two benefits in one policy) and flexibility of switching from protection to investment. On the other hand, unit trusts offer more choices, lower fees and lower charges. Distributors who are able to market both ILPs and unit trust have generally voted in favour of unit trust for clients' interest.

The fact that ILPs feature so prominently in the sales statistics of life insurance companies is because the majority of agents are not able to distribute unit trust. Given today's low interest rate and low projected bonuses by insurance companies, many policyholders are taking a chance with ILPs.

The increasing proportion of business in financial adviser firms contributed by unit trust similarly reflects clients' desire to get better investment returns, whether be it from their CPF or cash

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investments. This growing interest is good news for fund managers and distributors but is also a cause of concern because many Singaporeans are moving into investments even before they have provided adequately for their insurance needs.

The average life insurance claim in 2005 is below $40,000, which is a low figure. It can be envisaged that many of the claimants would face financial difficulties had their breadwinner been the ones who passed away.

Besides inadequate death or critical illness cover, Singaporeans would do well to learn from the problems faced by America and much of Europe. The January 2006 issue of the Economist featured the serious problems of rising medical cost in America and many millions not having medical insurance or inadequate insurance. The problem in Europe was the poor state of many state pension plans which offered defined benefits, because of poor investment returns and longer life spans. Singaporeans have to grapple with these two issues of rising medical and retirement costs, especially since here the onus is on the individual and not the employers or the state.

Fortunately, more and more Singaporeans are wising up to their need for adequate medical insurance and to provide more for their retirement. I remember how one client put aside $1 million in a guaranteed life annuity several years ago and secured a guaranteed return of more than 5 per cent per annum. It was a conservative action then but it turned out to be a wise investment, given the much lower interest rate today. With annuities giving 2 plus per cent per annum only, many Singaporeans have opted to let their CPF minimum sum remain with CPF.

Low interest returns simply means that we have to save more to have a bigger retirement fund to see us comfortably through our retirement years or be prepared to take higher risk with a portion of our savings. For those who can only set aside small amounts for savings, having a good return on their money is essential to generate the required capital sum for retirement, but they must be extremely careful. Great investment successes are still the exception rather than the rule if the CPFIS statistics are anything to go by. The majority of investments do not even yield the guaranteed 2.5 per cent per annum given to funds in the Ordinary Account, much less the 4 per cent per annum in the Special Account.

For investors with money, the good news is that more and more types of investments are being made available. The well to do are now able to purchase overseas investments like UK investment-linked products and REITS, and US life policies of certain minimum sums assured. These products are priced competitively and are attractive in themselves besides offering diversification. Financial advisers now have more products to offer their clients and to serve the expatriate market as well. Clients who traditionally have been served by banks are now able to get alternative advice and service from the financial advisers who offer personal advice and service. This is one reason for the fall in bancassurance share of the business from 29 per cent in 2004 to 24 per cent in 2005. The share of business attributed to licensed financial advisers and exempt advisers is increasing steadily for both insurance and unit trust. The decrease in the number of tied agents from 13,029 to 12,803 from 2004 to 2005 is balanced by the increase in Financial Advisers of a few hundreds.

"FOR THE FIRST TIME, THE SALES OF INVESTMENT-LINKED PRODUCTS EXCEEDED TRADITIONAL PRODUCTS - 53 PER CENT IN 2005, COMPARED WITH 47 PER CENT IN 2004"

Times they may be a changing, but for the entrepreneurial financial adviser firms that have set up in the last few years, the change is not fast enough. For the 30 odd FA firms today housing more than a thousand advisers, the 6 per cent market share of the life insurance has shown an increase but could be more. Consumers are only now wising up to the differences between the different channels of distribution. FA firms have done better in unit trust sales since tied agents have little part in it, but overall consumers are still new to this new investment product. Consumer education is obviously of paramount importance to spur further changes. **SI**

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