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RESPONSE : ILPS AS A RETIREMENT SOLUTION?

BY ALLEN LIM

I read with interest on the article "ILP as a retirement solution", which was published on 5th Feb 2019. While investment linked insurance policies has evolved and innovated over the years, there are some blind spots we need to understand and some hard questions we need to ask the product manufacturers.

The purpose of this article is to respond to some of the points brought up by the author of this article so as to bring about a more balance view of ILP as a retirement tool. The outcome is to have a healthy exchange of views.

First, the article pointed out the comparison of 452 unit trust (researched by Dr Wealth) annualised returns over a 10 years period of 6.83% versus CPF Ordinary Account of 2.5% per year. Therefore, if the median Singaporean puts about $9,000 a year in CPF for 30 years, he will get $405,000 compounded; if the same amount of $9,000 is being place in a unit trust portfolio of 6.83% return, the outcome will be over $800,000, hence, a whopping $400,000 more money to spend during retirement years. Such comparison can be flawed.

A The 452 unit trusts that were being researched by Dr Wealth (www.Drwealth.com) may not necessarily be available for CPFIS investments. Hence to use that figure and generalised that unit trust is better than CPF ordinary account returns is not very accurate (Interestingly, the title of the article was on ILP, but the example given was on unit trust, this is not consistent).

B Unit trust returns are based on NAV; CPF returns are cumulative. In other words, the interest earned on CPF, though looks low in comparison to 6.83%, are tangible. Whilst the 6.83% returns by unit trust are paper gains, unless one realises the profit. From the legal angle, the returns from CPF's interest has its certainty from statute (CPF Act), whilst the returns from unit trust has no legal certainty. Therefore, as much as the author expound the virtue of returns from unit trust, it is equally important to highlight the risk point of view. The bottom line is we all like to have high yield, but at what risk?

By using past returns to justify a future investment action can be dangerous. The next 10 years might not exhibit the same kind of returns in the past 10 years; and it is an accepted fact that the next 10 years of the investment market will likely to experience more volatility and even disruption than the last years.

Second, the author highlights the free bonus units on ILPs. I guess does any one actually question the product manufacturer where does these bonus units come from?

Do the product manufacturers give the bonus units (which is very attractive in numerical sense) out of good will?

Are such contractual practices sustainable in the long term?

Third, on the point on contingency plan, the author wrote about using nomination on ILP, the beneficiary will get paid much faster than traditional investment plans. However, traditional investment plans (of unit trust and ETFs) can be held jointly by the client and his beneficiary, which can even by faster than insurance nomination upon the client's death.

To add further on treatment of death on ILP versus unit trusts. ILP terminates upon the death of a client, and it is paid out as a insurance death benefit; whilst the units of unit trusts can be transferred to beneficiary upon death of the client.

Sometimes, for strategic reasons, it could be preferable to be able to transfer the units to the beneficiary instead of realizing the death benefit.

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Fourth, overly using ILP as a retirement tool could unintentionally limit the client's terminal illness cover.

Most insurance companies impose a maximum limit on terminal illness benefit to be paid out all insurance policies from the same insurance company.

As ILP is an insurance contract, during terminal illness situation, its "insurance pay-out" is also aggregated with the rest of the client's insurance policies from the same company.

Hence, the outcome could be a lesser pay-out than the client would otherwise have.

Fifth, in any investment discussion, we need to highlight the cost of investment. Maintaining an ILP or unit trust portfolio have costs; whilst money left inside CPF does not incur cost (of investment).

Mathematically the cost of investment does minus off some returns from the investment. This is one glaring issue which the author did not bring out.

In conclusion, ILP is a credible retirement product, but it has its strengths and weaknesses. It is important to understand the issued involved so that to ensure a good outcome for the client.

ABOUT THE AUTHOR

Allen Lim is licensed financial practitioner in Singapore. He holds a CLU/s and CHFC/s designations. Allen is an active member of IFPAS and is serving the association as the 2nd Vice President and heading the Education and Training department.