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Buying term and investing the rest from an adviser's point of view

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Buying term and investing the rest is a popular theory that has evolved over the years as insurance companies have come up with different and new hybrid policies to suit the affluent and mass markets.

Different insurance agencies or advisers have a different opinion on this theory. However the truth is, no matter which side of the fence you sit on, the real decision maker is the consumer who decides to purchase a term plan or go for an Investment-linked insurance policies (ILPs) or traditional life insurance policy.

Is it the best income protection/ income replacement solution? Totally depends on the consumer's need at the point of his or her life stage, not the adviser. From my personal experience most people who have purchased term plans in huge amounts are those who are financially savvy and know how to beat the returns given by endowment plans, ILPs and traditional whole life plans.

These are retail investors who know how to manage their money and have a background interest in finance, stocks, property and are probably actively managing their stock/ property portfolio.

Rest of the population who may not have such an interest in self-directed investing tend to prefer a policy with surrender value.

From an adviser's point of view, what I feel about a term plan is that it has been extensively marketed over the years as the ONLY income replacement/ income protection solution. A term policy should be looked as an instrument to aid alongside the other income replacement tools such as ILP, Whole Life policies.

A term policy gives high coverage for as long as you want it with riders such as accident rider, critical illness to add on, and because it has no surrender value, the premium is cheap compared to its whole life, and ILP counterparts.

I feel that the place that term plans have to play in a financial planning portfolio is that it should be added on alongside your traditional whole life or ILP policy, whether you are in the Buy term invest the rest Camp or not, term plans don't offer you the flexibility that ILPs and traditional whole life policies do, in the event of a non-payment of premium due to sickness or lack of income, your term plan will be the first to lapse thus not giving you the coverage you need.

If you happen to be hospitalised or seriously sick and if you wish to reinstate your term policy, you might be offered reinstatement terms on a substandard life. Basically, the insurance company will have to re-underwrite your health status like it's a new policy and then reinstate your term plan with loading or exclusions. ILPs have non-forfeiture benefits in the event of non-payment of premium, whereby the unit value pays for the policy mortality costs which keeps the policy in force, traditional whole life policies will have their Automatic Premium Loan (APL) feature kicked in.

Whereby whatever payments you missed, will have to be paid back with an interest between 5% to 7% per annum. However the policy is still in force, and don't forget the liquidity that whole life plans and ILPs offer, ILPs have unit withdrawal features, which you will not have to pay-back. Whole life plans have the APL feature which i mentioned earlier, you can take a loan based on the cash value of your policy and payback slowly, the interest being charged is a quarter of the interest charged on your credit card on a per annum basis.

So how should a consumer choose between a term, whole life ILPs and traditional whole life plans. Frankly there is nothing to choose from, they all play a different part in different stages in your life.

Also, the insurance companies' products have also evolved over the years whereby all the insurers are offering traditional limited pay policies with a multiplier effect till the age of even 70 and in some companies to age 90 in others. The Premium paid for these limited pay policies could be even lower than purchasing a term policy for say 30 to 40 years.

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And because of the multiplier effect of these policies the coverage offered is high, and there is a surrender value and cash value benefit. The insurance companies have indeed come up with different products and even hybrid ones.

Whether you are a retail investor who has a track record of consistently beating the markets, and you are confident that you can beat the returns given by life insurers, or you are risk averse without the knack of investing, the suitability of a life, ILP or a term should be suggested only after a thorough fact find, understanding of your financial situation as well as a detailed comparison of the 3 different product types, ILP, term, traditional whole life before making the decision of choosing which policy to purchase.

ABOUT THE AUTHOR
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