# Top 10 Common Mistakes in Protection Planning

By Eng Tiang Chuan

Making a mistake in buying an insurance product can result in **huge financial consequences.**

In ocean navigation, lighthouses and buoys serve as important reference points and indicate hazardous spots to avoid. Similarly, this second article on Proper Protection Planning will attempt to serve as a lighthouse or buoy in the navigation to financial well–being by having a discussion on the main class of insurance polices available in Singapore and the common mistakes and misconceptions to avoid. Due to the complexity of the different class of products, consumers often use the incorrect type of policy to meet their needs or purchased them with the wrong concept. Making such mistakes can result in huge financial consequences. The following is a brief discussion.

### MISTAKE NO. 1
### THINKING THAT PREMIUMS ARE "WASTED" IF THERE IS NO CLAIM

Consumers have a common misconception that premiums paid for insurance policies are "wasted" if there is no claim. As such, with–profits or participating plans are very attractive as the premiums can be "recovered" with profits. Under the 4W of financial planning, namely; Wealth Protection, Wealth Accumulation, Wealth Preservation and Wealth Distribution, Protection is the primary consideration. In the case of Whole Life Plans (WL), it is incorrect to view the policy as a form of savings/investment vehicle and to surrender the plan at retirement for the cash value. Probability of claim increases with age. Surrendering the plan at retirement age would mean letting go of the plan when you need it most. WL should be viewed as a form of Wealth Protection. The returns generated should be viewed as a way of keeping pace with inflation. For Term plans, the premium paid is for pure protection without any returns and thus, cheaper than WL or Endowment plans.

### MISTAKE NO. 2
### USING WRONG PLANS FOR LIFE PROTECTION

As discussed above, with–profits or participating plans are very attractive to consumers. Thus, endowment plans are favored when getting an insurance policy. Endowment plans are essentially saving plans (Wealth Accumulation) with some protection. They are not meant to provide a good protection as the coverage is low compared to a WL or Term plan. A lot of consumers still do not see the need to start preparation for coverage in retirement years early. The thought of reaping a return after a fixed number of years is very appealing to them. So, instead of getting a WL or Term plan, many go for an endowment plan.

Similar to using endowment plans for life protection, using PA plans as the primary protection is also rather common. PA plans can provide a big coverage at very low premiums. However, such plans' coverage is only valid when it is due to accidents only. That is why the premiums can be so low at such a high coverage. Consumers might get the impression that they are well covered when in fact they are not.

## MISTAKE NO. 3
### THINKING THAT YOU CAN GET BETTER RETURNS BY GETTING ANOTHER ENDOWMENT PLAN AFTER AN ANTICIPATED PLAN

When selling endowment plans, some advisers will propose anticipated plans first. When the first coupon is due, this adviser will propose getting another endowment policy by "just topping up slightly more" to the coupon from the anticipated plan. The policy holder might not be getting better returns by doing that. By drawing out the coupon, the rate of return of the anticipated plan will be affected. Simply getting a non–anticipated plan may give superior returns. Consumers have to ask the advisers what advantages does getting another endowment policy offer.

## MISTAKE NO. 4
### MISTAKEN THAT OLD AGE COVERAGE FOR INVESTMENT LINK–PRODUCT (ILP) IS GUARANTEED

ILP has been getting very popular. A lot of ILP holders know that an ILP plan consist of protection and an investment element. However, a big number do not realize how the protection part is funded and how that this protection cost increases as the holder ages. In the event that the there is insufficient cash values in the underlying unit trusts to fund the insurance cost, the plan will lapse. The policy holder may end up with no protection, no cash value and may be no longer insurable due to age or health status.

## MISTAKE NO. 5
### HAVING THE IMPRESSION THAT RETURNS OF PARTICIPATING PLANS ARE GUARANTEED

There are three different figures under the Cash Value/Surrender Value column in the Benefit Illustration (BI), Guaranteed, Non–Guaranteed and Total Return. Total return is the sum of the Guaranteed and Non–Guaranteed amount. The Total Return has normally been highlighted to consumers. Do note that ONLY the figures under the Guaranteed column are guaranteed. The non–guaranteed figures are based on projections made by the insurer. It is worthwhile to know that most Life Insurance companies in Singapore have cut bonus before.

## MISTAKE NO. 6
### INSUFFICIENT COVERAGE

Singaporeans are awfully under–insured. In a Consumer Survey carried out by Saffron Hill commissioned by Life Insurance Association[1] (LIA), it was found that 46% of the surveyed respondents think they are well covered. Their coverage ranges from \$100,000 to \$200,000. In another separate study commissioned by LIA and carried out by Nanyang Technological University (NTU), it was reported that the average working Singaporean has an estimated \$118,639 of life insurance. This is just 25 per cent of the required \$480,636 of needed coverage. This translates into 11.3 times of the average annual income of \$42,427, which is not far from a commonly accepted recommendation of 10 times annual income of life coverage. Even by taking the higher range of \$200,000 coverage of those who feel they are well insured in the Saffron Hill survey, it translates to less than half (42 per cent) the required amount of coverage concluded from the NTU study.

## MISTAKE NO. 7
### ASSUMING YOU CAN GET INSURED ANY TIME YOU WANT

Procrastination is a common "problem" for many. The normal argument being: "I can get the policy later or when I really need it". The main issue here is Insurability. The consumer is putting his/her insurability at risk by holding up the policy application. If any medical condition develops, the insurer might exclude the condition or even reject the application! A medical condition may appear minor to you but not to the Insurer. Insurance companies look at the applicant's health not 2 years, 3 years down the road but at a 20, 30 even 50 years time frame. It is important to lock in one's good health as early as possible.

## MISTAKE NO. 8
### THINKING COVERING THE CHILD IS MORE IMPORTANT

It is understandable for parents to want the best for their child. They are commonly willing to get protection for their children while neglecting their own. Other than getting a good Hospitalisation & Surgical plan for the child, the priority is actually on getting coverage for the parents as they provide the income and care needed. The child does not have income generation ability and could instead cause financial strain from medical expenses. Having adequate coverage for the parent would help preserve all or part of the earning potential or the cost of a caretaker if the parent is not working. The payout would enable the parents to have proper medical care and not worry about affecting the future development plans for the child. The whole family would be able to continue living at the usual lifestyle. Other than Protection Planning, Retirement planning is also often neglected. Parents are often willing to build up a savings plan for their children's education while not putting much aside for their own retirement. It is not safe to rely on the children to provide for the parent's retirement. According to the Department of Statistics, the average number of children born to ever–married females had declined from 3.9 for the pre–1950 cohort (age 50 & over) to 1.8 for the 1961–1970 cohort (age 30–39) in year 2000. In 2005, the number has declined to 3.3 (age 50 & over) and 1.6 (age 30 – 39)[2]. It would be more taxing for children in small families to provide for the parents' retirement as there are fewer siblings to share the load. Planning for your own retirement will be for your benefit and your children's benefit.

## MISTAKE NO. 9
### TAKING AUTOMATIC PREMIUM LOAN (APL)

For par policies, in the event that the premium is not paid, premium will be deducted from the cash value that has built up over time. This is known as APL. Many policy holders of WL plans with premium term of up to age 65 or older have an incorrect notion of using APL to enjoy the protection without paying premium. There are a few problems with this plan. First of all, an interest is charged when taking APL and may range from 5.5 per cent to 8 per cent per annum, depending on the Insurer. Secondly, the effect of inflation is not considered. Inflation will "downsize" the coverage as the time goes by. An inflation rate of 3 per cent a year will half the coverage in 24 years (when considered in today's dollar). The returns generated in the WL plan should be treated as a means of keeping pace with inflation. Furthermore, the average Lifespan has been increasing.

The average life expectancy has increased from 64.1 years (Males) and 67.8 years (Females) in 1970 to 78 years (Males) and 81.8 years (Females) in 2006[3]. A longer lifespan would mean a greater impact of inflation on the coverage and a greater need of the WL plan to generate returns to "maintain" the coverage.

### MISTAKE NO. 10
**THINKING DISABILITY INCOME IS TOTAL PERMANENT DISABILITY (TPD) COVERAGE**

DI coverage is often mixed up with Total and Permanent Disability (TPD). A common definition for TPD is "... disabled to such an extent as to be rendered totally unable to engage in any occupation, business or activity for income, remuneration or profit...". The insured need not suffer such an extent of disability to claim from DI.

### SUMMARY

Lighthouses and buoys can be of great assistance to the seafarer. However, it would be of little use if the seafarer does not understand the significance of the structures or do not know how to navigate around it. Policyholders and their family members who got the wrong plans as a form of protection may suffer when they could only claim a relatively lower amount or worse, can't even claim from the policy! Others might lose their coverage at old age when they need the coverage most. Sadly, many of the active seekers of protection planning are those that have developed medical conditions and may not be insurable anymore due to procrastination when they were still healthy. Seek professional help if you want to fully utilize the strength of each type of policy and to avoid the pitfalls.



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