

UNIT LINK LIFE ASSURANCE

SHOULD WE RUN AWAY FROM IT NOW?

Has there ever been a time that seems worse than now to talk about Life Assurance policy linked with investment? Lots of people, including myself, who have subscribed to such scheme for years have had a big part of our net worth wiped out almost overnight; however is it a good reason enough to surrender.

A few days ago, during a talk on Wealth Creation, a lady, who was saving money for her son's future, pointed out that she has been misled by her insurance company. Her grief was that she had lost more than 30 percent of her premium money in a matter of few months even though the agent had assured her that her premium would earn annual returns of over 12 percent. She finally cancelled the policy and subsequently made a loss of approximately Rs 35,000. This heartbreaking scenario is unfortunately very common since 2008 and insurance advisors are being flooded by queries from clients who have subscribed to Unit Link Insurance plans in the past and who are now planning to cancel their policy due to recent poor performance of their fund.

But even if the picture is not too bright, it should be clear in the minds of policyholders why the investments were made. Sadly enough, many people have bought Unit Link Insurance plan with a short-term objective in mind, and due to the prevailing volatile market conditions brought about by the financial crisis, they have the tendency to press the panic button and surrender the policies or discontinue payment of premiums. Unfortunately, such actions are detrimental to their financial health and harmful to their long term investment goals. Everyone would be happy to see their hard earned money grow quickly but there are no quick gains. An investment has to be on a long term basis in order to be really beneficial. When making up your mind to invest, make sure you are ready to keep patience as risk factor is always a companion to your investment. In addition, don't start investing until you have accumulated an adequate reserve fund as emergency cash in your bank account which, to me means enough money to cover your bills for at least 9 months.

If you have long term needs like saving money for your child's future or planning for your retirement, then you could consider investing in a Unit Link Life policy provided that you have a time horizon of at least 15 years. The time horizon is the length of time over which an investment

is made or held before it is cashed. In general, the longer your investment lasts, the more risk you can afford to take. For example, if you have many years until retirement, you may want to choose investments that have the potential to provide high growth, such as stocks. If the value of your investments falls, you may still have time to recover. If you are close to retirement, you may want to have more conservative investments, such as bonds. That way, there's a greater probability that your money will be there when you retire.

Unit-linked insurance plans offer not only a professionally-managed investment-cum-protection platform but also provide an entry point into the equity markets. On the opposite of traditional endowment life policy, it is a good savings scheme for those investors looking for a long-term investment instrument that offers transparency and flexibility. It offers a range of fund options with different asset allocations to meet the requirements of policyholders with different risk appetite. By spreading investment across different asset classes, investors can create a diversified portfolio where the loss on a certain asset class can be compensated by the profits made on another. Thus, your investments will match your risk appetite. Additionally, unit-linked insurance plans offer policyholders the option of switches between funds, so that they can effectively manage their portfolio asset allocation. Using switches, the policyholders can move their investments between various assets classes like cash, bond and equity, depending on their risk appetite, financial goals and time horizon. Moreover, to give policyholders piece of mind, many insurance companies have introduced a minimum guaranteed amount payable at maturity so that in a worst case scenario, the policyholders are sure to obtain their capital plus an additional amount as interest.

In this rapidly changing business environment and especially with the development of new life assurance products, the role of an insurance sales representative has evolved from being just a sales person to a strategic partner and advisor. Thus, they are here to support and guide their clients towards financial success. No more rush through the sales process and no selling of policies based on sales goal and commission without regard to the clients' requirements. Sales representatives have a huge responsibility on their shoulders and should give future prospects an exposure to all asset classes - equity, bond and cash and help them build a well-diversified portfolio. The two key elements a sales representative must identify are the ability of the prospect to take risk and his willingness to do so. This will help the client know in which fund to invest and how much to allocate in each fund. The policyholder's fund allocation decision will thus depend on the information provided on these two issues. Which and how much of each

asset one must own highly depends on one's risk tolerance and time horizon as well as one's perception on how each asset class will perform. Each asset has its own risk-return characteristics - equity having the highest risk and also the highest returns, and cash having the lowest risk and lowest returns over the long term. On the other hand, investment in bond gives your portfolio the certainty of returns and lessens the risks of erosion of the capital invested.

Fortunately, the good news is that despite enormous social, political and economic upheavals over the past two centuries, stock market returns have been extremely predictable in the long run. Despite two world wars and numerous other conflicts, terrorist attacks and a plethora of natural disasters, the payback provided by owning stock have been consistent and have outperformed every other asset class over time. Even after the world has witnessed severe financial crisis in the past, like the great depression of 1929 which many consider as one of the biggest crises, market has always recovered and that too at a time when there was no government intervention through stimulus package like nowadays. I usually explain to my audience in simple language that saving money to cater for long term needs through an investment plan is like driving your car from Triolet to the SSR Airport and planning to reach there in 1 hour. It might be that after 30 minutes you are still at Pailles due to traffic jam in the city centre. However, you are moving steadily and hopefully you will reach your destination on time or with some delay but the most important thing is that after 1 hour, you are have made steps forward and is approaching your destination.

So, if you have already embarked on an investment plan, here is an interesting statistic to give you some hope. An investor who put \$15 per month into good common stocks, starting in the summer of 1929, just before the start of the 'great depression' of 29-32, would have made 7.86% return over the next 20 years and 12.72% per annum over a period of 30 years. But remember, this is the mother of all crises, and you are investing 100% of your money in equity and it assumes that we are starting at the peak of the crisis. That's why it took so long, although still positive. In the same way, if you're willing and able to keep saving a part of your income towards an investment life policy for a period of over 10 years, I think you'll wake up in 2024 and see that you've done okay. You won't make the nearly 20% a year that the stocks generated during 1982-2000 bull market, but you're more than likely to make some reasonable money, much more than keeping your money in a bank account and earning low interest, typically eroding each year due to inflation.

Similarly, with the recent financial crisis, the rate of return of unit link policy, especially the equity fund, has been on the downside. We find it hard to continue with our investment when others are cancelling theirs. By nature, we are social creatures and we don't want to stand out from the crowd. But, as Warren Buffet famously said, 'the successful investor should be greedy when others are fearful and fearful when others are greedy.' So, when the crowd is full of fear and is running away, the investor has to be courageous enough to walk in the opposite direction. Investors should keep in mind that history, most probably, will repeat itself especially when it comes to money because men are cyclical human beings who are generally greedy and can't help but make the same mistakes as they are forgetful.

However, the big question that arises is that do we have the courage to go on?

Everyone is talking about this crisis but you will be the only one responsible for your own financial crisis if you haven't made enough reserves to finance your long retirement or to fund your children's education.

