Two Kinds of Wisdom

By David Choo

There are two kinds of wisdom – wisdom of foresight and wisdom of hindsight. No prize for guessing which is more common.

The most heart-rending story in 'Mind Your Body' on March 21, 2007 was the one with the ominous headline: IF ONLY WE HAD INSURED OUR LITTLE BOY. I am sure all readers would have sympathised with Madam Lim and her husband because their Medisave accounts were wiped out to pay for their son's kidney transplant operation.

This couple is not alone in learning the value of insurance after that fact. Statistics show that the vast majority of parents do not insure their children. Worse, they have not even insured themselves, or, even if they have, most inadequately at best. Not surprising then that The Straits Times' March 30, 2007 issue carried this alarming headline in the Money Section: 'Singaporeans are grossly under insured: LIA survey'. In another survey in 2006, while 64 per cent of Singaporeans believed that they should bear personal responsibility for their retirement costs, yet 42 per cent of them have not even started saving for their retirement.

Sample surveys are becoming the preferred way of drawing attention to problems and the financial services industry has good reasons to point to surveys to drive home their point, and to drive their sales as well. But what is vastly more important is: why this state of affairs?

Why is it that couples like the Lims and the three in 10 who were surveyed did not take up insurance? Why is it that, of those who did take up insurance, a quarter did not know how much they have taken? And of those who believed they are well-covered, the average protection sum was only $173,000 even if all their insurances (individual, employer-sponsored and CPF Dependants Protection Scheme) were added? The article stated that for an average household monthly income of $5,400, the advisable protection sum is $480,636. I have a beef with using average figure to draw conclusions (see Smart Investor October 2006), but I will agree that Singaporeans are grossly underin-

sured. For that matter, which nationality in the world is adequately insured?

Surveys only show the state of things. I like to delve more into the whys and wherefors.

There are many reasons for the poor take-up of insurance and the first reason is that many are poor and have more immediate events to prepare for than for probable eventualities. This is where using average figures of household income as the norm is deceptive. If only about 20 per cent plus of earners pay income tax, more than 70 per cent would be below the average household income. Truth be told, many households have a problem with paying premiums. This does not mean that they do not need insurance – in fact, the poor need insurance more than the rich, and the super rich do not need insurance at all and are insurers. Perhaps the best way to get everyone insured is through a national scheme like the CPF. The Dependants Protection Scheme is an opt-out scheme and can be "tightened" further to be compulsory. Better still, if the protection sum can be increased or a few options of different protection sums can be offered (for example, $50,000, $100,000, $200,000).

The second reason for Singaporeans being underinsured is the perception of risks. In my article entitled 'Risks, What Risks?' in Smart Investor July 2004, I elaborated on this subject. Sad to say that many people only learn about the reality of risks after a tragedy. Where risks like premature death and catastrophic medical expenses are concerned, it is not wise to learn from one's experience. Wiser it is to learn from other people's experience. A low probability of occurrence (for instance, the probability of a person dying in a given year) is not good reason for not insuring. It is, in fact, the only reason why there can be insurance, that is, the many covering the few. The question to ask is: what the financial impact of an occurrence is and not the probability per se because premiums are low and affordable when the probability is low.

The third reason for underinsurance is the still relatively bad image of insurance as not being fair or being worth it. Sometimes, it is described as a necessary evil that is not complimentary at all. Life insurance is not a necessary evil, it is a win-win if you purchase the right insurance. Term insurance, which is the cheapest form of life insurance protection but which pays only during the period of cover, is the subject of much misunderstanding. Many people who buy term insurance do not carry on with it or buy short-term policies only and the vast majority (estimated more than 90 per cent) do not get to claim on their policies. It is all right if you understand its nature, but many forget and lament the "loss" of premiums.

On the other hand, those who purchase cash value policies and who do enjoy a cash benefit, are not happy with the cash returns because they do not get an attractive return. Why is it that CPF can give a guaranteed return of four per cent per annum on the Special Account when insurers cannot guarantee four per cent return on their endowments? Is it because of the high distribution costs of the multi-tiered agency system? If so, a more economic distribution system should be brought on. Only consumers can bring this about, not through doing away with the intermediaries, but encouraging competition among the insurers and choosing only the more competitive products.

A fourth reason for the poor take-up of life insurance by the general population is that insurance products are not easy to understand and the insurers have, instead of simplifying products, made products more complex to create market imperfections. That is, insurers do not wish to have their products compared so easily and clients will know quickly which is better. Market competition is said to be a good thing, but product differentiation and introduction of differences between products and their terms can make consumers confused and undecided. Insurance policy contracts are not the easiest to understand. When "guaranteed" values differ so much from projected values, how much confidence can clients have in the projections?

I am for simplifying of products. Consumers could bring this about by rejecting products that are complex and confusing and, worse, have hidden or only half explicit terms known only to the initiated.

...the poor need insurance more than the rich, and the super rich do not need insurance at all and are insurers.

My last point is that Singaporeans need motivation to do the right things. When the government identified the problems of Singaporeans not producing more babies, it came up with incentives – tax relief, baby bonus and so on. Assuming that our government wants all Singaporeans to be well insured (and so it seems when we see the government's initiatives with CPF-DPS, Eldershield, CPFIS being allowed for single premium insurance), what more can it do?

The tax relief of $5,000 for insurance premiums, which was introduced decades ago and is meaningless for the majority with CPF contributions, could be granted on top of CPF. It also does not benefit the majority who do not pay tax. If a national insurance scheme cannot be implemented for political reasons, one alternative is to encourage the lower income families to purchase insurance with their CPF savings and the government could top up their CPF with an equivalent or proportionate sum. This can be an alternative or additional benefit to the existing top-ups.

These are just some issues and there is much more that can be done to promote insurance – school education, continued Money Sense programmes, greater media coverage, greater competition leading to better products and so on. The key point is that Singaporeans must learn from others' experience and not wait for tragedy to strike first.

"Death is the destiny of every man – the living should take this to heart." The wisdom advocated in this Biblical saying is for the living to so live their lives with the knowledge that death is his destiny and to prepare for eternity. In the same way, we must have the wisdom to plan our life and our family's affairs, knowing that death and disability can strike anytime. **SI**

David is the managing director of PromiseLand Independent Pte Ltd, a licensed financial adviser. He is the president of the Association of Financial Advisers Singapore. He can be contacted at: davidchoo@promiseland.com.sg or 6294 2461.