Expat Financial Advice: Life Insurance Savings Schemes—Not Always What They Seem

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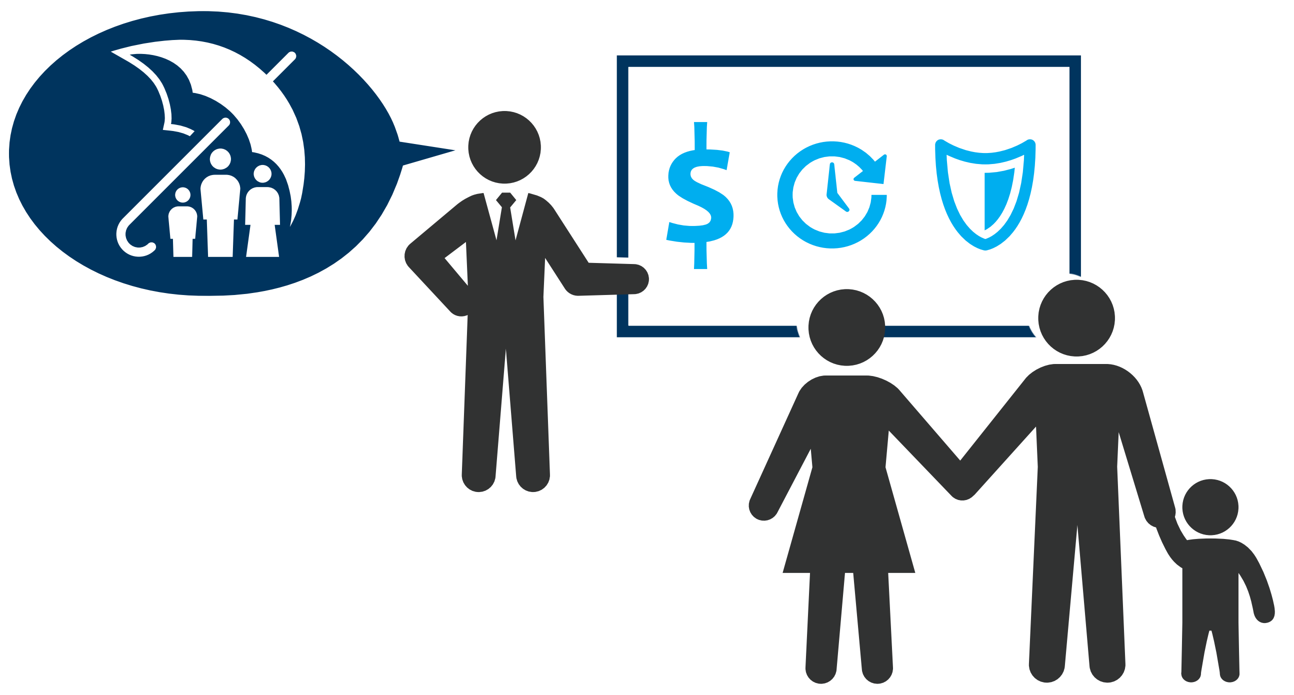
If you have lived in Asia for a while, chances are good that either you or someone you know has been offered the chance to purchase a life insurance savings scheme. Sold by independent financial advisors, armies of commissioned insurance agents, bank branches, and other financial institutions, insurance-linked savings and investment schemes seem like the Herbalife of finance. Many local insurance products are heavily marketed by "agents" of varying degrees of training and professionalism who, attracted by limited employment qualifications and lucrative commissions, pitch their friends and acquaintances in ways that mirror multilevel marketing schemes.



In Thailand, glossy marketing brochures, backed by the endorsement of agents who are often friends and relatives, seemingly offer attractive savings rates, tax deductions on premiums paid, and enhanced life insurance cover. At first glance these products can look like a pretty good deal for someone who is serious about saving for the future and protecting their family. A closer look, however, shows this may not be the case for everyone.

Looks Like a Good Deal: Many insurance products, if bought and sold in an informed manner, can meet the legitimate needs of individuals and families. Insurance products are complex, however, which means consumers often do not understand what they are buying. This complexity, coupled with ill-informed consumers and the lack of a strong regulator, can lead to predatory sales practices.

In one particular product sold by a Thai bank that we looked at recently, the investor commits to paying THB 80,000 per year for a period of 10 years for a life insurance product with an insurance value of THB 400,000 that is in force for a period of 15 years. The following features are attached to the product:

- 15-year term insurance product.
- **Face value:** THB 400,000.
- **Premiums:** THB 80,000 per year for a period of 10 years, no premiums in the remaining five years.
- **Death benefit:** The beneficiary receives 100% of the face value if the insured dies in years 1–3, 140% of face value if death occurs in year 4, 180% in years 5–6, and 200% in years 7–15.
- **Interest credited:** The policyholder receives interest on the face value of THB 400,000 based on the following schedule: 3% for years 1–5, 4% for years 6–10, and 5% for years 11–15.
- At the end of 15 years, the policyholder receives 185% of the face value, or THB 740,000, in addition to the interest that has been paid along the way.

If this sounds complicated, it is. Most people just focus on the interest paid, which is higher than bank deposits paid today, and on the THB 740,000 that is paid out at the end. The life insurance is a bonus that appears to pay out multiples of the original insured amount if you happen to die at the right time. Based on this, many people conclude that the product is a good deal. But first impressions can be deceiving.

Not Much Life Insurance Value: You are getting very little insurance value for your THB 80,000 per year in premiums. Generally, the annual premiums for a 15-year term policy will be only a fraction of 1% of the policy's face value. This is less than THB 4,000 for a THB 400,000 policy. The insurance company can easily offload the mortality risk for a fraction of the THB 80,000 premium and, after some administrative expenses, use the remaining funds as it sees fit. Of course, like a whole life insurance policy, the insurance company is crediting interest to your account as compensation. Unlike whole life insurance, which is meant to be permanent and ultimately self-funding, this policy terminates after 15 years. It is not permanent insurance.

The point is that the product is not really sold (or bought) on the basis of hedging mortality risk. There are cheaper and more effective ways to do this. After five years of premiums, you have already paid in THB 400,000 to the policy. After 10 years of premiums, you have paid in THB 800,000. Now the payout of 2x face value, or THB 800,000, if the insured happens to die in years 7–15 does not look so much like your beneficiaries have won the lottery since you have already self-funded the payout. Presumably, if you had the ability to self-insure, there would be no need to pay the insurance company for the privilege.

Clearly this product is designed primarily as a savings vehicle.

Savings Rate Not as Good as It First Looks: With interest rates that exceed deposit rates and step up over the life of the product, this must be a good deal. If you hold for the full 15 years, it looks at first glance as though you are averaging 4% based on the rate schedule. Additionally, you are being paid interest on the THB 400,000 face value, rather than your "deposit" of THB 80,000.

There are several problems with this, however. First, you are paying in THB 800,000 over 10 years but receiving only 185% of the face value, or THB 740,000, at the end of the 15-year period. The 185%, which at first looks like a bonus, is actually a discount on your total premiums paid.

Second, while you are receiving interest on THB 400,000 in year one when you have deposited only THB 80,000, you are still receiving interest on THB 400,000 in year 10 after you have deposited THB 800,000 (THB 80,000 in premiums x 10 years).

To calculate your actual annual rate of return, you would need to calculate an internal rate of return (IRR) like in the table below:

Return on Investment (Units: THB '000)

Year	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
Annual Premium	-80	-80	-80	-80	-80	-80	-80	-80	-80	-80					
Dividend	12	12	12	12	12	16	16	16	16	16	20	20	20	20	20
End Policy Payout															740
Net Cash Flow	**-68**	**-68**	**-68**	**-68**	**-68**	**-64**	**-64**	**-64**	**-64**	**-64**	**20**	**20**	**20**	**20**	**760**

IRR: 2.59%

It turns out that if you hold the product over the entire 15-year period, your annual rate of return would be only 2.59%—far below what looked to be 4% at first glance.

This leads to the next problem. To get that 2.59% annualized return, you would have to hold the product for 15 years (and the insured needs to still be alive). On some money market investments, Thai asset management companies currently offer returns on cash of more than 2.5% tax-free with no lock-in period. So maybe a return of 2.59% on 15-year money does not look like such a bargain, especially given where we are in the global interest rate cycle.

(Failure to hold the product or pay in the required premiums results in disadvantageous payout schedules with annualized returns significantly less than 2.59%.)

Thai Tax Deduction Can Change the Math: In the case above, the person did not qualify for a deduction of the premiums against their Thai taxes. For some working expats, however, who pay Thai tax and are in an upper marginal tax bracket, the tax deduction can change the math. Consider the following example: If you are already making full allowable contributions to tax savers such as Thai Retirement Mutual Funds (RMFs) and Long-Term Equity Funds (LTFs) , and you could reasonably expect to earn THB 5.2 million or more each year for the next 10 years, you could shield up to THB 100,000 in additional funds in an insurance policy and receive a Thai tax savings of 35% of the premium paid each year. In that case, the internal rate of return of our previous example would rise to 8.52%. However, given the high annual salary and the length of time required, this return may apply to only a very small percentage of working expats. U.S. expats would need to carefully consider whether it would still make sense due to the additional U.S. tax that may be due, as well as the reporting requirements.

Good Deal for the Insurance Company: Basically, this product is a great deal for the insurance company. There is very little mortality risk to hedge, since the premium payments pretty much fund any death payment paid. The slight mismatch is easily and cheaply offloaded. The biggest benefit is that the insurance company gets to use your funds for 15 years while paying you well below market for the privilege. They can then use those funds to invest in higher-yielding investments, earning a relatively low-risk profit.

It Pays to Do Your Homework: Insurance products can be complicated and the marketing is typically pitched to highlight benefits that may not tell the whole story. For investors who cannot deduct the premiums against their taxes or are in the lower tax brackets, locking up funds at below-market rates for 15 years may not make sense. The next time you are tempted to buy a product that you may not fully understand, take the time to analyze it carefully to ensure it is suitable for your situation.

Note: *This is an updated version of an article that we originally published on January 13, 2014.*

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