PrimeInvestor
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ALL YOU NEED TO KNOW ABOUT TERM INSURANCE

A PrimeInvestor Guide

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GETTING TERM INSURANCE RIGHT

Term Insurance is one of the most important product in every person's financial portfolio. Most people buy it just once in their lifetime. Choosing it right is therefore vitally important!

Life insurance, at its core, is simple. You pay a fixed sum to the insurer for a certain number of years and your beneficiaries receive an assured amount in the event of your untimely death. Life insurance is meant to give your dependants an income to rely on in your absence. Term insurance plans best meet this fundamental need.

Buying a term life insurance policy, however, has become complex. Chiefly, this is because of the variety of plans, the way these plans are structured and worded to make certain features look attractive, and the lack of actionable, unbiased information available publicly.

In this e-book, our aim is to address this gap and explain the key points you should be aware of before you buy a life insurance policy. Your commitment in a life insurance policy is long-term and it plays a very important role in your dependants' lives. Therefore, you need to choose right from the start.

This e-book contains five sections that will help you make the best choice:

- **How much life insurance should you take?** We do away with thumb rules and tell you exactly how to calculate your insurance requirement personalised to your situation.
- **Until what age should you take the cover?** Very long covers involve exponentially higher premium payments and are not always worth it.
- **Do you need life insurance?** Before committing to a plan, check if you even need one. Not everyone does.
- **What options do you go for in a plan?** A term plan has several options on sum assured, benefits, and premium payments. There are very few that are useful.
- **What add-on riders are useful?** Some may sound useful but the fine print and increase in premiums changes the picture.

Additionally, you will find useful links to help you make the decision. These include:

- Our insurance calculator
- Our insurance selection tool, to help you filter term insurance plans on metrics (apart from premium) that you find important.

To make the choices even easier for you, we have Prime Term Insurance. This is a ranking system for term insurance plans that our research team has developed system in-house. An explanation of the ranking methodology and metrics used makes up the final section of this e-book.

ABOUT THE AUTHOR

Aarati Krishnan is a leading voice in the Indian financial services space. She has been tracking and writing about the entire gamut of financial products and regulations for over 25 years now. She is currently Editorial Consultant for the Hindu Business Line and was earlier a consulting editor for Value Research Online.

For her pioneering work in writing on financial services and the economy, she was awarded the Shriram Sanlam award for excellence in Financial Journalism thrice. She has always been a strong voice speaking out on behalf of the retail investor and saver and a passionate advocate for greater transparency and customer-friendly innovations from financial product manufacturers.

Aarati leads the insurance and investment products verticals at PrimeInvestor as a consultant.

Aarati is a cost accountant and management graduate.

> *Fun is like life insurance; the older you get, the more it costs.*
>
> Kin Hubbard

CHAPTER 1

HOW MUCH INSURANCE COVER DO YOU NEED?

An easy way to figure out how much insurance cover you need to purchase - with a calculator!

- **Thumb rules like 10x or15x your income may leave you underinsured**
- **Instead, think of a term insurance plan as replacement for your income in your absence**
- **This involves estimating family expenses and adjusting for family goals, outstanding debt and assets**

One of the very first questions you'll be faced with after deciding to buy a life insurance plan, is – What's the size of the term cover (what insurers call the sum assured) you'll need?

Most folks don’t put much thought into this and go for the nice round number suggested by their insurance agent, which is usually Rs 1 crore. You can online calculators, but they can throw up widely diverging numbers.

For a 45-year old woman with Rs 15 lakh annual income, one insurer’s website suggested a term cover of Rs 1 crore, while another plumbed for as much as Rs 3 crore. Such numbers are based on the thumb rule which says that you simply need to multiply your annual income by a factor of 10, 15 or 20 to get to your desired insurance cover.

But given that your term insurance is unique to your life situation and family needs, it pays to put a little more thought into it. A very small number may leave your family under-prepared. A gargantuan one will be a needless drain on your savings, given that annual premiums you pay won’t come back.

If you are willing to put a little bit of maths into it, here’s a three-step process to arrive at a customised cover.

You asked and we have delivered – Now, there is a term-insurance requirement estimation calculator based on the process in this article. Check it out here: Term Insurance Calculator

Replacing income

The primary purpose of a term life cover is to replace your contribution to your family finances. The lumpsum that the insurer pays out needs to be sufficient to ensure that your family or dependants miss you, but don’t miss the money you were bringing home in the event of your death.

The first step to calculating the size of your term cover is to estimate the monthly expenses your family or dependants need to maintain a reasonable standard of living in your absence.

Therefore, the first step to calculating the size of your term cover is to estimate the monthly expenses your family or dependants need to maintain a reasonable standard of living in your absence. Here’s how you can arrive at this number:

- First, reduce your own contribution to the household expenses. If your household presently gets by on Rs 1 lakh a month and your personal spends are Rs 30,000 a month, you should budget to replace Rs 70,000 a month through a term insurance plan.
- If your spouse or other family member is contributing towards those expenses, you can deduct that from the required amount.
- Multiply these annual expenses by the number of years left in your working life, to arrive at the cover. This is the period for which you are looking to replace your income.

To illustrate, take the case of Mr Rao who is currently 40 years old, has 20 years to go to retirement and has estimated his family's expenses at Rs 100,000 a month, Rs 30,000 of which goes towards his own expenses. A good starting number for his term cover would be Rs 1.68 crore (annual expenses of Rs 8.4 lakh multiplied by 20 years of his remaining earning capacity). If he were only 30, he'll need a larger cover because he'll need to replace more years of income. If Mr Rao was 50, he'd need less.

While the above calculation assumes that Mr Rao's family can get by on their current level of expenses for the next 20 years, you have to admit this is unrealistic, because he's not budgeting for inflation. To get to a realistic term cover, therefore, it would be desirable to adjust your family's expenses for inflation for the period for which they need income replacement.

In the above example, if Mr Rao budgets for 5% annual inflation, his family would start at Rs 8.4 lakh a year but end up spending Rs 21.22 lakh a year 20 years from now. Adding up the likely expenses for the family over the next 20 years after budgeting for inflation, leads to a term cover requirement of Rs 2.77 crore to replace Mr Rao's contributions.

The above number can further be reduced if Mr Rao expects any of his dependants to stop relying on him in future. Suppose his 10-year old daughter can be expected to become financially independent by the time she's 25, Mr Rao can budget for his family expenses to shrink by say, 20%, after year 15. If he has dependant parents with a remaining life expectancy of 15 years, that could call for downward revisions too.

Even without getting into such nitty-gritties, you can arrive at a reasonable term cover by simply extrapolating your family' expenses for your remaining working years, using an inflation assumption.

Meeting goals

The above exercise takes care of your family's living expenses, but what about their financial goals that you were hoping to fund with your future savings? These need to be funded by your term cover too.

Let's assume Mr Rao was investing towards a Rs 30 lakh education fund for his daughter Mridula's graduate and post graduate degrees when she turned 18. His early demise will leave this goal unfulfilled. That's clearly not acceptable. So, this risk must be mitigated by adding in the unfunded portion of Mridula's education goal into his term cover too.

Suppose Mr Rao had Rs 10 lakh already invested in his daughter's education fund, he first needs to estimate how much this would grow to, at a conservative rate of return when the goal comes up. Assuming Mridula needs the money when she's 18, there are 8 years to go to this goal.

At a 6% rate of return, the Rs 10 lakh Mr Rao has already invested would grow to about Rs 16 lakh in 8 years' time. Should Mr Rao pass away today, Rs 14 lakh if his daughter's education goal would remain unfunded. This should be added to his term cover requirement. Including this, his term cover need is now Rs 2.91 crore.

Outstanding loans

Having planned so meticulously to take care of your family's lifestyle and goals, you would surely not want your family to be faced with unpaid loans on your behalf after your passing. This makes it important for you to include the outstanding portion of all your loans – home loan, vehicle, durable, personal and credit card loans – in your term cover requirement.

While estimating your outstanding dues, it is enough to have accurate estimates of large liabilities like your home or car loan. For smaller loans such as personal loans or credit card debt, you can use a ballpark estimate of the likely dues.

This will ensure that part of insurance pay out your family receives can be used to settle debts and start off with a clean slate. While estimating your outstanding dues, it is enough to have accurate estimates of large liabilities like your home or car loan. For smaller loans such as personal loans or credit card debt, you can use a ballpark estimate of the likely dues.

In the above illustration, let's assume Mr Rao has a home loan outstanding of Rs 40 lakh and a car loan of Rs 5 lakh that he's been repaying out of his income. This would jack up his term cover need by Rs 45 lakh.

But then, in the event of his demise, Mr Rao's beneficiaries would probably stand to receive his provident fund dues and other payouts from his employer. They would also receive control of his investments and the cash in his bank accounts. These can be used to partly or fully settle Mr Rao's debt. Therefore, these assets on Mr Rao's balance sheet need to be netted out from his liabilities before assessing his term cover requirement.

Suppose Mr Rao had total PF and other savings of Rs 35 lakh to his credit (excluding his daughter's college fund), his net dues after adjustments for assets would be Rs 10 lakh. Only this needs to be added to his term cover requirement. Overall, Mr Rao's family would be well covered at a sum assured of about Rs 3 crore. This is the size of the term plan he needs to sign up for.

The above illustration also makes it clear that the quantum of term cover you need is not frozen in time. It needs to change with your life situation, number of dependants, income levels and liabilities.

Therefore, it's not enough to buy a term insurance plan once in your life and pay premiums faithfully. You need to re-visit and add to your life insurance after significant life events, to ensure that you have enough cover to keep your family protected.

CHAPTER 2

UNTIL WHAT AGE SHOULD YOU GET COVER?

Are you buying insurance for too long, and paying too much?

- **Your term plan should only cover your working and earning years**
- **Many insurers now offer term covers until 85, 90 or 99 years of age**
- **Buying a cover that extends far beyond your working age can be quite expensive**
- **Premiums rise exponentially as you stretch your cover beyond 75, due to higher mortality risks**
- **Get term cover up to 65-75 years, and invest saved premiums if needed**

When buying life insurance, most good advisors recommend that you go in for a pure term plan. A pure term plan is an insurance policy that offers life cover (with no investment component, bells or whistles – we'll tell you why you don't need those in a later article) for a specific 'term' or period of your life.

So, one of the key questions that insurers ask you when choosing a term plan is the length of coverage you seek. Would you like the plan to cover your life until you turn 60, 70 or 80? How about getting covered until the age of 99? The latter are called whole life plans.

Most folks, when offered the choice of stretching the term of their life insurance policy are quite tempted to jump at it. They think – ‘I have a good probability of hanging up my boots by the time I turn 99. So why not ensure that my family gets guaranteed pay-out from my term insurance plan? If I opt for a cover up to 60 or 70 or 80, they may end up getting nothing, because I may outlive these milestones.’

Well, opting for a very long term cover or a whole life plan is not a very smart idea because life insurers are very well aware that the probability of your dying before you hit 99 is far greater than at 60,70 or 80. They budget for this probability by sharply bumping up the premiums they charge you.

The longer your stretch your term insurance cover, the more you’ll be paying by way of annual premiums throughout the policy term. The premium increases for extra cover are not small; they can really pinch your pocket.

Costly extra cover

Here’s a real-life illustration of how much your premiums can shoot up, if you add more years to your term cover.

Take ICICI Pru I-Smart Protect, a pure online term plan from ICICI Prudential Life Insurance. If you’re a 45-year-old woman who doesn’t smoke and is looking for a Rs 1 crore term plan to cover you until the age of 65 (your working years), the annual premium (for buying the plan online) works out to Rs 20,124.

Stretch the policy term until age 75 and the premium jumps to Rs 25,976 a year, a 29% increase in your outgo. Extend the term to 85, and you’ll end up paying Rs 35,056, 75% more than what you would pay for the cover up to age 65. Tweak this into a whole life plan that covers you until the ripe old age of 99, and your premium shoots up to Rs 46,813, a whopping 230% of what you would have paid for a normal term cover upto age 65.

Clearly, premiums for life policies go up exponentially the longer you seek to stretch them beyond your working years. ICICI Prudential is certainly not alone in pegging up your premiums steeply for longer coverage. Every insurer does it; in fact some charge you even steeper premiums.

Based quotes from different insurers, PrimeInvestor found that stretching the length of your term policy upto 65 by another ten years costs you about 30% extra in annual premiums today. Extending the term by 15 years (to age 80) or 20 years (to age 85) costs you 46-47% extra in premiums.

If you go the whole hog and opt for whole life policies that cover you until the age of 99, premiums shoot up to anywhere between 2 and 8 times those charged by term plans that cover you until 65.

Why the additional costs

Why do term insurance premiums show this hockey stick rise with age? The answer lies in the mortality tables that insurers use to calculate the premiums they charge on term plans. As you know, every insurance contract is essentially a play on probability. By promising to pay your beneficiaries a large lumpsum (far higher than the premiums you paid the insurer) in the event of your death, the insurer is betting on the probability that the risk he's covering (your death) is unlikely to materialise during the policy term.

To assess the probability of individuals dying at different ages, insurers use what are called mortality tables. In India, since April 2019, insurers have been using the mortality tables compiled in 2012-14 approved by IRDA.

The above mortality table for males shows the probability of people who have completed the respective age dying within a year. This is based on a study of data from insurers between 2012 and 2014.

As you can see from the above, the risk of mortality is less than 1% for folks upto 60, less than 5% for folks upto 75, but then escalates rapidly with each milestone. Given that life insurance premiums are priced to deliver a profit to the insurer after settling claims, premiums for folks in their mid-80s, nineties or later are pegged steeply higher to account for a higher mortality risk.

No matter if you are running marathons and in the pink of health at the age of 80, the insurer will still peg your premiums high based on the general experience of high risk at your age.

The right term

All this suggests that when it comes to deciding the term of your life policy, longest isn't the best. You need to make a trade-off between protecting your family against income loss for a sufficient length of time, while at the same time ensuring that the annual premiums don't burn a hole in your pocket.

Based on premium comparisons, we at PrimeInvestor think that you should:

- Get a term policy to cover you upto age 65 to 75 at most, for a good balance between good coverage and reasonable premiums.
- To supplement this cover beyond age 75, invest the sums (on premium) you have saved by not opting for a longer cover and leave the resulting corpus to your dependants.

For instance, if you are a 45-year old woman who's signing up for a term cover upto 75, you'll be paying a premium of roughly Rs 19,000-20,000 a year for the next 30 years. Coverage upto the age 99 would have cost you roughly 3 times this sum.

This allows you to save and invest Rs 40,000 a year for the next 30 years in alternative avenues. At a modest 7% return this would lead to a corpus of about Rs 41 lakh by the time you turn 75. If you take on more risks for a 12% return, you'd have accumulated a little over Rs 1 crore. You can leave this to your dependents. If you live on until 99, think of this as a small addition to your retirement kitty!

CHAPTER 3

DO YOU REALLY NEED INSURANCE?

There are 4 categories of people who don't need life insurance. Are you in one of them?

There's a myth that everyone needs a life insurance policy. Here are four categories of investors who don't!

Most Indians harbour the notion that they cannot do without life insurance. One of the first 'investment' products that young Indians are encouraged to buy, on landing a job, is an insurance policy. But this is based on a flawed understanding of life insurance as a product.

Life insurance isn't designed to enrich someone on your death. Its primary purpose is to compensate your dependants for the loss of your income in the event of your untimely death. So yes, there are many categories of folks who simply don't need to buy life insurance. Here are the main ones.

No income

Are you a student, a college pass-out preparing for competitive exams or a person who's quit her job to pursue personal interests? Then you have no need for a life insurance policy. A life insurance cover is intended to ensure that, in the event of your death, folks who depend on your income are not left financially unsupported.

Strangely enough, quite a few insurance products (usually traditional plans) in India come with in-built insurance covers on the lives of children and other young dependants. These are completely avoidable.

There's no doubt that, in the event of any unfortunate event happening to you, your family will be bereft and will grieve deeply for you. But this emotional loss can surely not be compensated by a monetary pay-out from an insurer.

Therefore, as long as you have no income and aren't contributing to your family finances in any way, there's no need to have a life policy to compensate your dependants for the loss of your life. It is for this very same reason that many insurers don't offer life policies for homemakers as well.

The loss of a homemaker's life can leave a family broken and in emotional disarray, but her contribution to the household simply cannot be made up by a monetary compensation from an insurance company to the family.

Strangely enough, quite a few insurance products (usually traditional plans) in India come with in-built insurance covers on the lives of children and other young dependants. These are completely avoidable. As a parent, you're surely not looking to enrich yourself from the loss of a child's life.

No dependants

When thinking of life insurance policies as an investment, most folks forget that the pay-out from the policy will not come to them but to their chosen beneficiaries. If you have no dependants whom you need to support, you don't need a life insurance policy either.

Young folks who have just signed up for their first job may not need life insurance at all, as long as they are single and their parents and family members do not rely on them for financial support. Folks who are married and don't have children may not need life insurance if their partners earn and are self-sufficient with enough income to live comfortably after their passing.

Folks in their late 40s or 50s may not need a life cover if their children are already independent and their life goals- such as owning a home or the surviving partner's retirement needs – are already funded by their investments.

The only exception to the above cases is if you have outstanding loans or liabilities that your family or spouse will be saddled with, in the event of your death. In this case, a life policy that will cover your debts in full, will ensure that their finances aren't burdened by your loans after your passing.

Retirees

If you've bid goodbye to a successful career and are currently enjoying a comfortable retired life with your retirement benefits, you do not need an insurance policy. Most insurers in fact do not offer term covers for folks beyond 60 years of age.

Across insurers, term policies taken in your 50s typically cost 4-6 times more in annual premiums than those taken in your twenties.

Many people do sign up for life insurance at an advanced stage in their careers because the idea of their spouse or dependants receiving a big payout on their death seems reassuring.

But the cost of buying a new policy at a lathe stage in your career is prohibitive. Given that insurance companies are well aware of higher mortality rates beyond 60, they budget for this in your premiums.

Take the case of HDFC Life's Click2Protect, a pure online term plan. If you are male and buy this policy when you are 25 or 35, the annual premiums amount to about Rs 11,300 and Rs 18,600 respectively. But try to sign up when you are 55, on the cusp of retirement, and the premium shoots up over Rs 65,600. Across insurers, term policies taken in your 50s typically cost 4-6 times more in annual premiums than those taken in your twenties.

Therefore, while the idea of buying term cover in your fifties to ensure a lumpsum to your spouse in the event of your death may seem appealing, you need to weigh this benefit against the burden that the annual premium will impose on your finances if you live long.

If you are keen to leave your spouse a nest-egg after your passing, investing an annual sum in bonds, mutual funds or alternative avenues would be a better idea, as it would offer more flexibility than life insurance.

Comfortable net worth

The final category of folks who don't need life insurance are those who have large enough net worth to live off their investment income (or passive income). If your assets minus liabilities runs into crores, the annual income from these assets may be enough to ensure that your dependants are taken care off, in your absence.

There's no point in shelling out additional insurance premiums annually in such cases, as the transmission of your wealth to your beneficiaries will be enough to take care of their needs.

In the Western world, folks often use whole life insurance plans for estate planning, because transmission of wealth from one generation to another entails hefty estate taxes. High net worth individuals seek out large insurance covers instead which are more tax-efficient to pass on wealth.

In India though, there's no estate duty yet (though it may be levied in future). Therefore, having a Will and nominations in place ensures that dependants of HNIs get to enjoy their investments and the passive income flow from it, after their passing.

CHAPTER 4

WHAT OPTIONS SHOULD YOU CHOOSE IN YOUR TERM PLAN?

Insurers offer many add-ons on their pure term plans, but here's what you need and what you don't

marchmeena29 / iStock / Getty Images Plus

Insurers offer many add-ons on their pure term plans, but here's what you need and what you don't

- **Opting for a limited premium term costs you heavily**
- **Rising sum assured lacks flexibility**
- **Monthly benefit payouts cost less than lumpsum payouts**
- **Avoid return of premium plans, they're far from 'free'**

Pure term plans from life insurers are, at their core, very simple products. You pay regular premiums to the insurer during your working years. The insurer promises to pay your beneficiaries a lumpsum in the event of your untimely death. This may lead you to believe that buying a term insurance policy is a cakewalk.

But even after selecting a term plan that suits you, you often find yourself flummoxed by the many MCQs (multiple choice questions) you need to answer before signing up. Would you like a limited premium payment or regular payment? Do you prefer level sum assured or rising cover? Do you seek lump sum or recurring payouts? Would you like a return of premiums at the end of the policy?

Here's our guide to what these options mean and how to navigate them.

Limited or regular premium payment

When you sign up for a term policy, it's clear that you should opt for a cover that lasts as long as your working life. But what about your premium payments? Should you pay them throughout the term of the plan, or be done with premiums in the first few years?

To give you flexibility on this, life insurers offer you a choice between a 'regular' premium payment option and a 'limited' premium payment in their term plans. In the regular option, you pay premiums for the entire period for which you seek the cover (if you are 45 and want to be covered until 75, you'll pay premiums for the next 30 years). In the limited option, you can opt to pay premiums for say 5 years, 7 years, 10 years or 15 years. How do you choose between the two?

Let's take the case of Kotak eTerm, a pure term policy offered online by Kotak Life. If you're a 45-year old man seeking a Rs 1 crore term cover until age 75, the regular premium option in this plan requires you to pay an annual premium of Rs 26,078 (including GST) for 30 years. If you opt for limited premium payment for 10 years, the annual premium shoots up to Rs 65,254. If your shrink the payment period to 5 years, the annual premium climbs to Rs 1.22 lakh.

From a financial perspective, regular premium payment (paying annual premiums throughout the policy term) costs you far less than limited premium payment. Discounting the above plans to present value to know your outgo in today's Rupees, the regular premium payment option on Kotak eTerm (Rs 26,078 for 30 years) results in a net cash outflow of Rs 3.8 lakh. But the 10-year limited payment option translates into a cash outflow of Rs 5.1 lakh and the 5-year option into an outflow of Rs 5.46 lakh in today's Rupees. (We used a discount rate of 6% for these calculations).

While the savings on the regular premium option vis-à-vis limited premium options may differ for different insurers, regular plans are always less expensive. In the case of premature death at the middle of the policy term, the possibility of saving premium payouts on the regular option is higher than with the limited option.

Limited premium payment may therefore be useful for specific categories of folks. If you are self-employed or in a job with limited security, you may prefer a limited premium payment period so that you can be done with your payments in your most productive years.

But if you are looking for cost effectiveness, regular plans should be your default choice.

Rising or level sum assured

A second choice that insurers offer you when selecting a term cover is whether you need a level or a rising sum assured. As we discussed earlier, your life insurance cover does need to change based on your age, life situation, number of dependants, assets and liabilities. To automate this process of updating your life cover, some insurers offer you the choice of a 'step-up' term cover. Step-up covers automatically top-up your sum assured at specific milestones based on age, or life events such as purchase of a house, marriage, childbirth and so on.

The step-up option on Kotak's eTerm plan offer an illustration of how these plans work. For a 30-year old man seeking a Rs 1 crore term cover until 75, Kotak's eTerm plan charges a premium of Rs 8,925 (excluding GST) in the first year. If he opts for the step-up plan, this cover automatically rises by 25% in the 1st and 3rd policy years taking his sum assured to Rs 1.5 crore, pegging up his annual premium outgo to Rs 13,700 by the time he is 34. At milestones such as marriage or home purchase, the cover is stepped up by 50% again, with premiums rising commensurately.

The advantage of having such step-ups built into your term plan is that the size of your life cover gets topped up from time to time ensuring that your dependants get additional protection, even if you neglect to do it. You will also not be required to go through medical tests each time you enhance your cover, which you will need to every time you buy a new term policy.

However, automatic step-ups have many minuses too. They are somewhat rigid in defining the milestones at which you need additional cover. They add to your costs, as insurers may charge an additional step-up fee as a percentage of the sum assured. They may also attach conditions. Kotak for instance, does not allow step-up for eTerm plans bought online or for policyholders above 45 years of age.

Rather than subjecting yourself to such conditions, opting for a level or fixed sum assured when you buy your first policy and buying additional policies as and when your life situation warrants it, is your best bet.

Lumpsum versus staggered benefits

Traditionally, life insurance plans only offered a lumpsum payout of the sum assured to beneficiaries. But of late, many insurers have begun to offer staggered payout options, where your beneficiaries can get the sum assured paid out to them in fixed monthly instalments or even rising monthly instalments. Some plans allow you to opt for one portion of the sum assured in lumpsum and the rest in the form of monthly instalments.

Insurers usually offer substantially lower premiums on their term covers if you opt for staggered benefit payouts instead of a lumpsum. In the case of Kotak eTerm for instance, the premium for a normal lumpsum payout policy with Rs 1 crore cover for a 45-year old man is Rs 26,078 including GST. However, if you choose a recurring (staggered) payout, the premium drops to Rs 21,712 a year. While filing a claim in the event of your death, your beneficiaries get to choose between receiving a lumpsum of Rs 10 lakh and Rs 6 lakh annually, or no lumpsum and Rs 49,320 monthly for the next 15 years. Rates for other insurers suggest even sharper discounts on premium when you opt for staggered benefit payouts.

So, when do staggered payouts make sense? **If you feel your dependants need regular income and are not adept at managing money, a monthly payout will suit them better than a large lumpsum that they may not to efficiently deploy. Staggered payouts are also better to replace the income of the earning member a family has lost.** However, if you have outstanding loans that need to be settled immediately on your death, a lumpsum may be more useful to your beneficiaries.

Return of premium

Finally, many (misguided) folks think of term insurance as a wasteful product because if they survive the policy term, the premiums they've paid on the plan expire worthless. Savvy insurers have promptly capitalised on this thirst for 'returns' on insurance plans, to launch 'Return of Premium (ROP)' options on their term policies. These term plans, marketed as "no cost" or "free" term plans, essentially promise to pay back all the premiums you've incurred on a term plan if you survive the policy term.

But a more careful look at such plans clearly tell you that, far from being "free" or "no cost", ROP plans are quite an expensive way to buy insurance cover, because insurers jack up their premiums substantially to pay back your money! A comparison of premiums on pure term plans without ROP with those that offered to give your money back, for a 45-year old man showed that on a Rs 1 crore policy, annual premiums shot up by anywhere between 75 and 100 per cent when you opted for ROP.

Effectively, you would be committing to pay nearly double the normal premium amount for the next 20, 30, 40 or 50 years, incurring substantial opportunity costs in the process.

Rather than buy ROP term plans, **it makes better financial sense to opt for an ordinary term plan (without return of premium) and to invest the money thus saved in an alternative avenue over the years. Over a 20, 30, 40 or 50-year period, that can add up to sizeable sum**.

Consider the case of a Rs 1 crore term plan for a 45-year old man which covers him until age 75. In his case, a normal term cover would cost about Rs 35,000 a year in premiums for the next 30 years, while a ROP plan would cost about Rs 62,000 in premiums. Let's assume he opts for the plain vanilla option and invests the Rs 27,000 thus saved into a SIP in a debt fund earning modest returns of 6 % pa. Thirty years later he would be able to withdraw Rs 22.7 lakh from this fund, far more than the Rs 18.6 lakh he would have got back as return of premium on the ROP plan.

This makes a good case for giving ROP plans a miss and sticking to plain ‘no-return’ term insurance products!

CHAPTER 5

DO YOU NEED RIDERS ON YOUR TERM COVER?

Some riders offer useful benefits, but they can substantially jack up the costs of buying insurance

Some riders offer useful benefits, but they can substantially jack up the costs of buying insurance

- **Accidental death riders are economical but carry a lot of exclusions**
- **Disability benefit riders kick in only 180 days after accidents**
- **Critical illness riders are useful, but among the most costly additions to your term plan**

Apart from allowing you to structure your term plan in different ways through options, life insurers also tempt you with another set of add-ons – rides on your term insurance. Riders allow you to cover additional risks to your income, for an extra premium added to your base term plan.

Term plan riders- basics

Term insurance riders can be bought either at the same time as the original plan or added on later, based on the rules set by the insurer. There's no limit on the number of riders you can buy. The risk cover provided by the riders ends at the same time as your term plan.

But IRDA rules do impose certain limitations on these riders. They are as follows:

- The sum assured on any individual rider cannot exceed that on the base policy.
- The total premiums you pay on health and critical illness riders cannot exceed 100% of the premium on your basic term cover.
- Premiums on non-health riders are capped at a lower 30% of the basic premium.
- The premiums you pay on riders enjoy the same tax breaks as your term policy.
- Non-health riders get section 80C benefits, health riders get section 80D benefits and the maturity payout is exempt under section 10(10D).

Here's the low-down on choosing them.

Accidental Death Benefit Rider

If you choose to add this rider to your pure term policy, the insurer promises a higher payout to your family in the event of your death due to an accident. Most insurers allow you to choose the amount of extra cover you'd like to buy under this rider subject to 100% of your basic policy. That is, if you are buying a basic term insurance for Rs 1 crore, you'll be able to add on an accidental death benefit rider that promises another Rs 1 crore to your family in the event of your death by accident.

Most folks get tempted to sign up for accidental death benefit riders because they seem to carry very nominal premiums compared to the basic term cover. For a 45-year old male seeking a Rs 1 crore cover until age 75, we found that a pure term cover cost between Rs 22,000 and Rs 38,000 a year depending on the insurer. Accidental death benefit riders for another Rs 1 crore (100% of the base plan), cost extra premiums of between Rs 5,500 and Rs 8,500 a year.

You should be aware that all accidental death benefit riders come with loads of fine print. The payout is made only if death occurs within a specific number of days after the accident (120-180 days) and not after that.

However, do note that this is largely because the probability of accidental death does not go up with your age and is a function of your occupation. Personal accident covers can be bought separately from general insurers under very similar terms, for more reasonable premiums. While accidental death riders that you sign up for in your term plan last throughout the policy term, those from general insurers must be renewed a year at a time.

You should also be aware that all accidental death benefit riders come with loads of fine print. The payout is made only if death occurs within a specific number of days after the accident (120-180 days) and not after that.

The bodily injury that causes death should be direct and only from the accident – caused by ‘external, violent and visible’ means. Claims can be refused if the accident is due to self-injury, insanity, immorality or occur under the influence of drugs or alcohol or the person committing an illegal activity.

Some insurers also exclude accidents suffered while participating in strikes or industrial disputes. Accidents arising from hazardous occupations (such as military or security organisations), riots/terrorism/civil commotion, pursuing adventure sports and nuclear contamination are usually excluded.

Accidental Disability Benefit Rider

An add-on to the above, this rider compensates you for inability to work or earn an income if an accident results in a permanent disability. Most insurers make monthly payments (to make up for loss of income) for 10 or 15 years on this rider getting triggered. The payouts are specified as a percentage of the sum assured (1% or 2% a month). This rider usually costs less than the accidental death benefit rider. For a 45-year old man seeking coverage until 75, HDFC Life offers the accidental disability benefit rider at an annual premium of Rs 319 for Rs 10 lakh sum assured.

Disability riders carry the same conditions and exclusions as accidental death benefit riders, but with two additions. The claim becomes payable only for disabilities that occur within 180 days of an accident. The claim may also not be paid immediately after an accident, as insurers usually specify that the disability should last for 180 consecutive days for it to be considered permanent. Exceptions may be made in severe cases. Insurers also have a list of disabilities that they will cover, while the rest are excluded.

For an additional cost, some life insurers also tag on a Waiver of Premium Rider with the Accidental Disability rider. This rider allows you to skip premium payments for the remaining policy term if affected by disability, with the insurer footing the bill. But this may cost you extra in annual premiums.

Critical Illness Rider

This rider pays out a lumpsum amount as a proportion of your basic sum assured, on your being diagnosed with a critical illness. The specific illnesses that will be covered are listed out at the outset by the insurer and you have no choice in the matter. Critical illness riders from popular life insurers covered anywhere between 20 and 60 critical illnesses, with heart attack, cancer, kidney failure, paralytic stroke and cardiac surgery being the ones the commonly covered.

This is among the most expensive riders you can choose to add on to your pure term cover. It substantially hikes up your premium payout for the entire term of the plan.

Like other riders, critical illness riders also carry many escape clauses for the insurer. First and foremost, the lumpsum amount is payable only if you survive for 30 days past the diagnosis of a critical illness or the performance of a critical surgery. Illnesses that had cropped up prior to the taking of the policy, those resulting from diagnosed congenital/childhood conditions, self-harm or surgery that is not medically necessary, are excluded.

Do note that this is among the most expensive riders you can choose to add on to your pure term cover. It substantially hikes up your premium payout for the entire term of the plan. Evaluating term plans from six leading insurers we found that adding just a Rs 10 lakh critical illness rider to a basic term policy, jacked up its annual premium by anywhere between 30% and 70%! Given that your probability of contracting critical illnesses rises sharply with age, the premiums on this rider accelerate with age.

Premium quotes from one insurer showed that a Rs 10 lakh rider taken in the early 20s costs Rs 800-900/year, going up to Rs 1500-2000 in the early 30s, Rs 5000-8000 in the early 40s and shooting up to Rs 15000-23000 in the early 50s. But as there seem to be no standard norms how much an insurer can charge for this rider, there are wide variations.

While a lumpsum compensation on critical illness is a useful thing to have, there's no compulsion to opt for this as an add-on to your term insurance plan. Health insurers offer standalone critical illness policies that offer greater flexibility on choosing the amount and period of cover, while offer wider coverage.

Yes, in a critical illness rider with your term plan, the premiums are fixed throughout the policy term and you don't have the hassle of renewing the policy annually. But once you opt for a critical illness rider with your term plan, you'll need to pay premiums for the entire policy period to retain the cover. Whereas with a standalone policy from a health insurer you can take the cover when you near the age when you are at high risk and terminate it when you don't need it.

Overall, while riders do offer some utility, if you want to keep the cost of your term insurance plan to a minimum, they can be safely given a miss. The benefits offered by them can be obtained from standalone policies from general or health insurers when affordable.

CHAPTER 6

HOW DO WE RANK TERM PLANS? - THE PRIMEINVESOR METHOD

Why you can trust our independent, expert analysis of term insurance products. Here's how we rank them.

Life insurance must surely figure among the most misunderstood financial products in India. Some folks think of their insurance policy as an investment, others as a compulsory portfolio component and yet others as an estate planning vehicle.

At PrimeInvestor, our approach to life insurance is simple. We think that a life insurance policy is a must-have protection product for certain kinds of income-earners. It must generously compensate their dependants for the loss of income in the event of their untimely death.

But while insurance is necessary, it isn't easy for anyone to commit to fixed payments for the next 20, 30 or 50 years given the uncertainties around one's financial situation and career. Pure term life plans do the best job of fetching you the maximum risk cover at an affordable cost. PrimeInvestor's ranking of pure term plans is therefore the centrepiece of our insurance coverage.

Indian life insurers bundle many "innovative" features, bells and whistles to their pure term covers. We think most of these are unnecessary, as they add to your costs. Generally, it is best not to view insurance plans as investments. The insurance payout will be made not to you, but to your beneficiaries and an investment needs to be evaluated on multiple parameters – not just safety and tax efficiency, but also returns, flexibility and liquidity.

Gating criteria

So how did we arrive at these rankings? Most folks, when presented with term plans from different insurers are inclined to go for the one with the lowest premium. But at PrimeInvestor, we think that the ability and willingness of the insurer to settle your family's claims in full, in the event of your death, is the most important attribute to look for.

As you are signing up for this product for 30/40/50 years, the key thing to look for is if the insurance company will be around and remain financially sound to settle your family's claims. Private life insurance is also a relatively nascent industry in India, with a lot of churn.

We therefore first shortlisted insurers based on their pedigree, stability and financial soundness. We used three elimination criteria to gauge these:

#1 Assets Under Management: Insurance is a rare business where the product seller collects payments from customers in advance, promising a payout in the distant future. The premiums collected are invested to generate surpluses for future claim payouts.

In this context, the Assets under Management of an insurer shows the size of its customer base as well as investment book. After taking stock of the AUMs across the 24 life insurers in India, we used a minimum AUM of Rs 10,000 crore as the cutoff to make it to our shortlist. We used the AUMs from insurers' latest public disclosures for this exercise.

#2 Solvency ratio: The biggest risk to any insurer's survival is that it will receive a flood of claims that it is unable to service with its available investments. The Solvency Margin is a metric designed to ensure that this doesn't happen.

It is the amount by which an insurer's assets exceed its policy liabilities. Assets for an insurer usually consist of its investment book and fixed assets. Policy liabilities are the present value of future claims plus its own future expenses, minus the premiums it is likely to collect. Solvency Ratio is the insurer's actual solvency margin measured against the required margin.

IRDA prescribes a minimum Solvency Ratio of 1.5 times for insurers in India. To ensure a more comfortable cushion, we applied 1.8 times as a cutoff on solvency ratio.

LIC has a lower ratio, but we made an exception for it, as its policies are sovereign-guaranteed. Solvency ratios are again sourced from the latest quarterly disclosures of insurers.

#3 Vintage: To be doubly sure, we only considered insurers who have successfully completed at least 10 years of operations in India.

Applying these three elimination criteria left us with 14 life insurers in our shortlist. PrimeInvestor's term insurance rankings only cover the pure term plans from these 14 insurers.

Ranking criteria

To rank the term plans of the shortlisted insurers, we compiled further details of their pure term products. Rather than consider premium alone, we decided to use a mix of stability, size, claims settlement and premium metrics and suitably weighted them to arrive at the ranking list. The weights were based on our assessment of how critical each metric is, in the decision of choosing a term policy. Here are the key metrics we considered:

- **Solvency ratio (Times):** The measure of how much cushion an insurer has in the form of assets to meet future liabilities. IRDA specifies a minimum ratio of 1.5 times. A higher ratio is better, but new and very small firms can sometimes show high solvency ratio because of the nascent stage of business. For this, we compile data from insurers' quarterly public disclosures.
- **Market share (%):** Size confers disproportionate advantages in every financial business and more so in the insurance business where the size of premium income and investment book decide the financial strength of an insurer. Given that AUM has already been used as an elimination metric, we used an insurers' market share in premiums for the latest financial period as a ranking metric. The market shares used relate to the insurer's share in total premiums collected for the latest fiscal year-to-date information available.
- **Persistency ratio (%):** Insurance is one of the most mis-sold products in India. What's more, it's a product with very little flexibility for customers to exit, switch or otherwise vote with their feet. Persistency ratio, which measures the proportion of customers who have stayed with their policies for a specified length of time is thus a good proxy for an insurers' service standards and its selling practices. We used persistency ratios at the end of 3 years and 5 years (37th month & 61st month) given the tendency of Indian insurers to see a sharp drop off in customer stickiness within 3 years. For the ranking, we use persistency ratios based on premium value from insurers' public disclosures, for the latest fiscal year to date information available.
- **Claims settlement ratio (%)**: An insurer's settlement of a death claim represents the moment of truth for the customer and is THE most important metric on which to gauge a life insurer. To give this metric adequate significance, we have used claims settlement ratios both based on number of claims settled and value of claims settled.

Given controversy about calculation of this ratio, we sourced the claims data submitted by insurers to IRDA and disclosed in the latest IRDA annual report.

- **Management risk:** Insurance being a relatively nascent industry in India, ownership and management are in a constant state of churn for private insurers. A change in the ownership or management of an insurer whose policy you've bought can mean a period of uncertainty and possible changes in the key metrics (such as claims ratio, solvency and persistency) on which you've based your decision. To budget for this, we have negatively weighted insurers whose promoters/management/key shareholders are in talks for the sale of a substantial stake or those who are likely to consider such a sale in the near future**.**
- **Annual premium (%):** Buying a life policy entails making a lifelong commitment to pay premiums. It is therefore desirable that those premiums are cost-effective and competitive. We deliberately refrained from assigning a very high weight to premiums, because these are based on the card rates of insurers. The actual premium that customers shell out when they approach an insurer can differ materially from card rates based on their health and risk assessment. For the purpose of these rankings, we used the premium quoted by insurers (including GST) for a specific age and gender for online, direct purchases of term plans.

For comparability, we have compared premiums for the regular annual premium option (that is, you pay a yearly premium throughout the policy term), for a fixed insurance cover. The quotes are also for a final lumpsum payout to beneficiaries. Insurers offer other options on their menu – such as limited premium payment terms, staggered benefit payouts instead of lumpsum and rising cover, which you may opt for at your convenience. We have used age 75 as the default age for the end of cover, except where individual insurers don't permit you to select this option.

Our final rankings for each age/gender are a culmination of normalised scores that combine all the above.

Stay Safe!

Useful Links

PrimeInvestor Term Insurance Calculator

Find out how much term insurance you need to get adequate cover for your family. Use the PrimeInvestor Term Insurance Calculator

PrimeInvestor Term Insurance Rankings

Premium subscribers of PrimeInvestor will instantly know how the term plans in the market stack up against each other - Expert ranked Term plans in India.

PrimeInvestor Term Insurance DIY Tool

Premium subscribers and trial subscribers of PrimeInvestor will be able to analyze insurance companies' data abut their term insurance policies by accessing the PrimeInvestor Term Insurance DIY Tool