When term insurance can be a rip-off

Insurance companies have introduced complicated options that are not very helpful to the buyer. A regular term policy is the best option.

BY PREETI KULKARNI

Buying a term plan online used to be child's play. Not any more. Now, given the complicated payout choices on offer, you can go horribly wrong. Some of the options are quite a rip-off, though they might appear very attractive to the buyer. For instance, the return of premium plans, which give back the entire premium paid if the policyholder survives the term. The premium for such a plan will be much higher than what one would pay for a regular term policy. ET Wealth looks at three such term plan variants that don't really add value to the buyer.

THE STAGGERED PAYOUT OPTION

Your nominee can earn more if the money is put in a simple bank FD

Most insurance companies are offering a staggered payout option on their term plans. Instead of a lump sum payment on death, the nominee gets 10% of the insured amount and the balance is paid in monthly instalments over the next 10-15 years. If the sum assured is ₹1 crore, the nominee will get ₹10 lakh on death and ₹50,000 per month for the next 15 years.

If that sounds cool, just consider these numbers. If the ₹90 lakh was put in a simple bank fixed deposit to earn 8%, the family would get a monthly income of ₹60,000. That's 20% more than what the insurance company gives out every month. Besides, the principal remains intact for the family to use for any other purpose.

One may argue that the payouts from insurance companies are tax free under Section 10(10d). Yes, but this will make a difference only if the nominee has a high income. In the 30% tax slab, the post-tax income from the FD would be lower at ₹42,000. In case the nominee is a homemaker or earns less than ₹2 lakh a year, the post-tax returns will still be higher than what insurance companies are offering. Also, as mentioned earlier, the principal remains intact when invested in the bank FD.

This staggered payout option is targeted primarily at families which may not be financially savvy to manage the lump sum they receive on the death of the policyhold-

SIMPLE BANK FD WILL OFFER MORE

Monthly income from ₹90 lakh invested in a bank FD that offers 8%

Monthly income	TAX SLAB OF NOMINEE
₹60,000	Nil
₹54,000	10%
₹48,000	20%
₹42,000	30%

HOW MUCH DOES IT COST

Annual premium for a cover of ₹1 crore till the age of 60. Though the monthly income option is cheaper, it does not offer very high returns

	Lump-sum payment of ₹1 crore	10% paid on death and ₹50,000 per month for 15 years	Lump-sum ₹1 crore paid on death and ₹50,000 per month for 10 years
25 YEARS	₹7,617	₹6,398	₹10,283
30 YEARS	₹9,024	₹7,580	₹12,183
35 YEARS	₹10,729	₹9,012	₹14,484

er. This is important in a country like India where financial literacy is low.

The premium of the staggered payout option is lower than the regular lump sum payout option, which may seem like a plus point. But the lower premium still does not justify the low returns being offered under this option. "Your own money is paid out to your nominee in instalments. Even if the premium is lower or the total payout higher, the returns are not comparable to what the lump sum amount could earn from other investment avenues," says certified financial planner Pankaj Mathpal, founder, Optima Money Managers.

Go for the staggered payout only if you fear that greedy relatives and unscrupulous financial advisers will cheat your nominee of the insurance money. Otherwise, stick to a regular term plan that offers a lump sum payment on death. Your nominee will earn more if the money is put in a simple bank FD or a Post Office scheme.

THE RETURN OF PREMIUM PLAN

You pay a much higher premium to get back a pittance at the end of the term

Then there are the return-of-premium term plans aimed at people who think that buying a pure protection policy is a waste of money. So, insurance companies have devised plans that will return to the policyholder the entire premium paid by him on maturity. For gullible buyers, this is a great way to insure themselves for free. After all, they get the entire sum back at the end of the term. For intelligent buyers, this is a big lemon that should be avoided.

Let's look at how it works. The premium of such plans is quite high compared to what a regular term plan costs. Basically, the policyholder is paying a high premium to get back a pittance. If he invests the difference, he can accumulate a far bigger corpus than what the insurance company promises to return at the end of the term.

THE HOME LOAN INSURANCE COVER

If the loan is pre-paid the term cover is not of much use

When someone applies for a big-ticket home loan, lenders try to sell him a term plan to cover the loan. In case something untoward happens to the borrower before the loan is repaid, the insurance company will pay the outstanding loan to the lender. Loan cover plans are single-premium policies, but the borrower does not have to shell out the amount at one go. The premium is added to the loan amount and repaid in EMIs.

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Before you think this is a good way to cover liabilities, take a closer look at how such plans work. Firstly, the cover is linked to the outstanding home loan and progressively comes down over time. This means if a loan is pre-paid, the cover will not be of any use. Statistics show that most borrowers tend to prepay their home loans as incomes go up. A 20-year home loan is usually foreclosed in 12-14 years.

In case the loan is foreclosed, the insurance company is supposed to refund the premium as per a pre-defined formula (*see graphic*). However, some insurers fob off policyholders citing vague rules and clauses. If your insurer is also making excuses, you can approach the IRDAI for redressal of your grievance.

Another problem is when you switch lenders or refinance your loan. You might be asked to terminate the existing policy and buy a fresh one through the new lender. This is hogwash. You can continue with your existing home loan cover even if you have changed your lender. All this requires is an endorsement in the policy which will remove the previous lender and name the new lender as the beneficiary. "The insured person has to inform the master policyholder (lender) and get the insurer to pass the endorsement in the name of the new lender," says Atrey Bhardwaj, principal officer and head, insurance, Probus Insurance Brokers.

HOW MUCH IS THE REFUND

$$\text{50\% OF SINGLE PREMIUM} \times \frac{\text{BALANCE TENURE}}{\text{ORIGINAL TENURE}} \times \frac{\text{OUTSTANDING LOAN}}{\text{ORIGINAL LOAN}}$$

Many borrowers buy the cover out of fear that their loan application might be rejected. "The sales staff push insurance products once it becomes difficult for the customer to move to another lender or when the customer is in a hurry to get the loan," says Mahavir Chopra, head, health, accident and life insurance, Coverfox Insurance Brokers.

Covering a big-ticket loan is advisable because your dependents will not have to repay the loan if you are no more. A lender may take over the asset if your family is unable to repay the loan. However, a regular term plan that is not linked to the outstanding loan is a better way to cover this liability. It can continue even after the loan is repaid.

If your bank forces you to take the loan, deal with it firmly. "Ask the lender to give in writing that a home loan cover is a pre-condition for the loan getting approved. This usually works, as no representative can give this in writing," says Chopra.

Finally, if you have been sold such a policy without your explicit consent, you can take it up with the various grievance redressal channels. "Home loan insurance is a solicited product and not mandatory by law. If you are forced to buy a bundled loan cover, you can take up the matter in writing with the senior management of the lender. If this doesn't yield a resolution, you can the matter to the banking ombudsmen and IRDAI Grievance Redressal cell," says Bhardwaj.

PAY MORE TO GET IT BACK

Cover of ₹1 crore for a 40-year-old male for 20 years

REGULAR TERM PLAN

TOTAL PREMIUM PAID ₹2.85 lakh

RETURNED ON MATURITY Nil

ANNUAL PREMIUM **₹14,270**

RETURN OF PREMIUM POLICY

TOTAL PREMIUM PAID ₹6.9 lakh

RETURNED ON MATURITY ₹4.1 lakh

ANNUAL PREMIUM **₹38,865**

If the additional ₹24,595 paid every year is put in an FD to earn 8%, it would grow to ₹12.4 lakh in 20 years.

A REGULAR TERM PLAN WILL BE FAR CHEAPER

Cost of ₹50 lakh cover for a 35-year-old for 15 years

SINGLE PREMIUM OF HOME LOAN COVER	YEARLY PREMIUM OF REGULAR TERM PLAN
₹66,500	₹6,107

If the money is put in an FD at 9%, the interest alone will be able to pay for the yearly premium while principal remains intact.

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