Your guide to buy Life Insurance cover

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Even before you venture to buy a life insurance cover, know whether you need it. The purpose of a life insurance cover is to safeguard your dependent's financial needs when you are not around. Hence, if you have dependents such as spouse, children and parents, you should have a life insurance cover. In case no one is dependent on your income, you don't need a life insurance cover. Now if you have established that you need a life cover, you must know that in the market there are at least four types of life insurance policies—term plan, unit-linked insurance plan (Ulip), traditional insurance policy and pension plan. From these broader set of covers, how do you decide to buy the one that works for you? To understand which plan works for you, let's deep dive into each of these life insurance products:

Term plan

In a term plan, the money that you pay as an insurance premium is used to buy only an insurance cover. After the term of the policy expires you don't get your money back. The good thing about a term plan is that you get a bigger sum assured for a smaller premium. For instance, a 30-year old can get ₹1 crore cover for Rs 7,800 annual premium. "Term plan is the first financial asset you should own," said Karthik Raman, head of products, IDBI Federal Life Insurance Co. Ltd. This is a pure protect cover and is the cheapest option to get a cover. How to choose the right term plan? "Look at the duration, coverage, price and claim settlement ratio. You shouldn't buy a term plan just by looking at the cost. If the claim settlement ratio is not as healthy as it should be then the whole purpose of buying a term plan from that company is questionable," said Raman. Claim settlement ratio is an indicator of whether the insurer will pay you the money—higher the ratio the better it is for you. Next you need to know the sum assured amount you require. "You could follow simple thumb rules—at age 30 years, sum assured equal to 20 times annual income; at 40 sum assured equal to 15 times annual income and at age 50 sum assured equal to 10 times the annual income," said Vineet Arora, managing director and chief executive officer, Aegon Life Insurance Co. Ltd.

Unit-linked insurance plan

A Ulip will have two components—investment and insurance. The premium that you pay on your Ulip plan is divided—a part of it goes towards your insurance cover and the remaining for your investments. "In the last 10 years, Ulip has gone through a transformation. Until 2013, the product had very high charges. Post-2013, it started giving value for customers. In the 2019 regulation, the life insurer can increase their charges upfront. We are yet to see how the insurers will respond to the regulation. In the last few years, zero charge products have been launched and now we need to see how the industry will react," said Mohit Garg, head of products, PNB MetLife India Insurance Co Ltd.

Right now, a Ulip can charge you up to 1.35% for the fund management portion of the Ulip in the form of expense ratio in the equity portfolio. If it is not equity, you will be charged lesser, said Garg. A certain portion of the premium you pay that goes to your insurance attract charges. "The risk charge for your mortality varies according to age and is determined by Irdai. Risk charges are small component. For instance, for a Rs 1 lakh cover, the mortality charge could be around Rs 250 annually while the premium could be Rs 10,000. Besides the expense ratio and mortality charges, there is a policy administration charges in the Ulip structure," said Garg.

Who should opt for a Ulip plan and how to sift through it and find the right one? "The investment part can range from 100% equity to 100% debt and everything in between. You need to invest based on risk appetite. You can look at the past performance to understand it. You also have the option to move from equity to debt within the same Ulip product," said Garg. Depending on how much you understand the product, you may want to consider a financial planner.

Traditional plans

A traditional plan has a larger component going towards savings and the remaining for insurance. There are two kinds of traditional plans—endowment and money back. How do you choose which one to buy? “It depends on the purpose of my investment. In an endowment plan, you get a lump sum amount at the end of the plan. For instance, if it is a 20-year plan, you will get the money at the end of the tenure. In money back plans, you get money at regular intervals—4th year, 8th year and so forth. If you need money at regular intervals — for instance, your child’s fees — then you might want to consider cash back. If you want to accumulate money for your retirement or for child’s marriage, then it could be endowment. Endowment is always more beneficial than money back because the returns are higher as the money stays with the insurance company for a longer period,” said Karthik Raman, head of products, IDBI Federal Life Insurance Co. Ltd.

However, the returns on your traditional insurance policies are usually low. Also the commissions attached to it are steep. “The money available may not fetch you the desired cover and there is a possibility that the cover may fall short,” said Raman.

Pension plans

Life insurers also provide pension plans. Here the money that you invest goes towards building a corpus for your retirement and you can streamline it to get a monthly pension during your retirement by buying an annuity plan. Pension plans may come with or without insurance cover. Who should opt for it? “Pension plans in the life insurance industry have been available for a long time now. Some of the limitations that pension plans have are the component of annuity--they have to buy annuity at the time of maturity. The payout is fixed in nature. Pension is taxable at the time of maturity. Any product that gives you flexibility of payout after you retire in a tax-efficient manner and during your saving years is able to take care of your life cover would be probably a better way to look at it,” said Dheeraj Sehgal, chief institutional officer, Bajaj Allianz Life Insurance Co. Ltd.

How to choose the right one? You may need to take help from a financial planner if you want to include a pension plan in your portfolio. It works for those who want a guaranteed monthly payout during their retirement period.