CHAPTER - 2
Consumer Awareness and Consumer Perception

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2.1 The Indian Psyche

Traditionally, the psyche of the Indian insurance seeker has been such that they have been averse to term insurance plans. Term plans require regular premium payments to be made throughout the tenure of the policy; the sum assured is paid only upon the unfortunate death of the policyholder during the policy tenure. If the policyholder survives the tenure, he is paid nothing; in other words, there are no survival benefits. The absence of survival benefits makes these plans rather unpopular among policyholders, as they like to receive a return as a reward for investing. They fail to appreciate that insurance is about ‘insuring’ and not ‘investing’, so typically there should not be any expectations of a return. A mediclaim policy or car insurance or home insurance or factory/warehouse insurance doesn’t offer returns. Similarly, there are no returns from a term plan. To worsen matters, insurance advisors weren’t interested in educating insurance seekers about why term plans are a must-have for every individual regardless of age.  

2.2 Consumer Awareness

India accounts for 16% of the world population, but accounted for only 1.68% of the world life insurance market in 2006. India is also far behind world averages in terms of insurance penetration, and insurance density (see figure). A mere 20% of the insurable population aged 20 to 60 years is currently covered by life insurance.  


Low penetration of insurance in India, as elsewhere, has varied explanations, economic and sociological. One basic factor that puts a brake on growth is low propensity to consume: low propensity for life insurance, not necessarily because of considerations of affordability nor because of inadequate range of insurance products and services. The major determining factor is lack of awareness of life insurance per se, and this phenomenon is not confined to rural and semi rural segments of society: it pervades urban populace as well. Surprising, isn’t it- but true.

Lots of people go through their entire lives before understanding what life insurance is all about. There are several reasons for this; the most common is that no one really informed them about it.

Another common reason is when insurance agents informed customers then they give half baked information so that they can sell insurance product that fetch higher commission rather than the insurance product that best suits to clients.

It is an acknowledged fact that Insurance, especially in India, is more sold than bought. Since life insurance is meant to cover potential losses in future and not to cater to immediate consumption needs, there is always a tendency to postpone or avoid the
purchase of life insurance. The low awareness levels in the society further add to the difficulty in selling life insurance.

If someone knows that he would die tomorrow how much insurance would he buy today? What would happen to his family if he never made it home from work today? If he was to die, would his family be able to continue to live in the same house, and still be able to make the rent or mortgage payment? How can he be sure that he can provide for his family even after he has left this planet?

Many people talk about life insurance and why it's important, but there are still many misunderstandings regarding life insurance policies. Many people aren't sure if they need life insurance, and if they do- how much insurance is necessary? What kind of insurance? There are lots of consumers who have insurance, but they do not exactly understand whether the content and scope of insurance meets their need or not. The fact is they forget to evaluate their income and future financial planning before they make decisions. The consumers might terminate this agreement because they are not able to pay the insurance premium. This becomes an investment loss or waste to consumers.

A high rate of policy lapse has alarmed the Insurance Regulatory and Development Authority (IRDA), which have begun to stress on renewal premiums. Although most insurance companies decline to give exact insurance lapse ratios, industry estimates put the figure at around 30-35 per cent. The problem of lapsed policies is a serious concern for IRDA, which feels certain amendments need to be incorporated into the structure of the agency commission to ensure only viable applicants are given policies. Linking of agency commission to lapse of insurance policies is being currently probed into.
2.3 Policy Lapsation

Lapsation of life insurance policies is the most disturbing feature of Indian life insurance business, which is very high by international standards. Life Insurance Corporation’s lapsation ratio was around 25 per cent, while it was around 40 per cent for private insurers during the last 3 years. One of the major causes for the growing lapsation ratio is forced selling by agents to achieve their targets. Agents also sell policies without taking customers’ needs into account. After ensuring that the customer paid premium for the first year, insurance agents would not remind policyholders to pay their subsequent premiums as the commission was not attractive.\footnote{Padmavathi.V, Costs of lapsation of life insurance policies – A case study of LIC of India}

2.4 Buying Life Insurance

Very often it is said that before you let the worry get into your head, buy Life Insurance. Why? Life Insurance provides protection to your family - your family gets a specified sum in a lump sum when they need it the most i.e. when you are not around. While the emotional loss cannot be mitigated, the lump sum received from an insurance company can help take care of your family’s financial future. Life Insurance policies also offer tax benefits though tax saving should not be the primary reason an individual should look at a Life Insurance policy. Finally, Life Insurance contracts allow an individual to save money in a tax efficient manner and allow savings to grow to help meet our future financial obligations. The most important question is what is the value of your life? Heard of this Yaksha question: What is the greatest mystery on earth? Yudhisthir answers, “Every one has to die. But no one thinks that for himself. This is the greatest
mystery. That is the paradox that makes people avoid life insurance! That also makes agents take the wrong line of selling Insurance as a tax saving and/or Investment product.\textsuperscript{13}

\textbf{2.5 You Need To Know about Life Insurance}

We all hope to live a full life till a ripe old age. To do the very last for our parents and watch our children stand on their own feet. But what if fate cuts life short? Who would pay for our children’s education? their marriage? Ensure life’s continuity for them. Why not plan for life’s adversities? What if a sudden disability or illness puts us out of action if we were unable to attend office for a while? Who would take care of all the medical expenses? Who would pay the mounting household bill? Should these adversities occur, are we equipped to face the situation? Where would we get the money to face the crisis? Would life continue smoothly for our children? Why not plan to protect and provide for them? Since we have no control over life’s ebbs and flows, why not do something over which we do have control.

When you buy life insurance, you want coverage that fits your needs. First, decide how much you need-and for how long-and what you can afford to pay. Keep in mind that major reason you buy life insurance is to cover the financial effects of unexpected or untimely death.\textsuperscript{14}

\begin{thebibliography}{99}
\bibitem{13} Bimaquest - Vol. VIII Issue I, January 2008 pp 41
\bibitem{14} Life insurance buyer’s guide, National Association of Insurance Commissioners
\end{thebibliography}
The more you know about life insurance, the better equipped you will be to purchase the appropriate type and amount for your situation.

- Who needs life insurance?
- How much do you need?
- For what duration you need life insurance?
- What type of policy should you purchase?

When you are ready to purchase life insurance, select carefully. You and your loved ones could be paying for insurance premiums that are inappropriate for your needs or face financial hardship by being underinsured.

### 2.6 Life Insurance Needs

Life is most valuable asset. This is easily proved if we were to assign a monetary value to life. This value depends on income-earning potential or Human Life Value. Our income supports our family. Help them to get the most out of life. Month after month, year, we and our dependents live the best way we can using the money we earn. This money enables our household to run smoothly, our children to go to college, take care of the medical bills, our vacations and help maintain our life style.

**Protecting Our Most Valuable Asset**

If something were to happen to us, here are a few possible ways of dealing with the financial implications:

1. Draw from our savings: but how long would the funds last? A lifetime of savings could be used up in few months.
2) Borrow from others: who will lend us the money? Even family and friends can only help to an extent. And anyway, this would only be a short-term solution.
3) Sell our assets: what price will we get for our assets? Would we like to sell our home? Our car?
4) Transfer the risk to an insurance company.

This recommends that we have to transfer the risk to an insurance company. It’s cheaper, safer and smarter in the long run. If we insure the risk our money outflow is actually miniscule. For the sake of illustration, an annual premium payout of approx. Rs25 for 15 years guarantees our family will receive Rs1000-if something happens to we in that period. A smaller sum is payable for transferring the risk of disability. Another advantage of transferring the risk is that we remove the uncertainty. So do take steps to protect our most valuable assets, our Life!

Usually, someone who is dependent on a wage earner or a caregiver, such as a child, spouse or elderly parent, creates a need for life insurance. To help you decide on your family needs, check your circumstances against the following situations.

- **Families** with children need life insurance.

If both spouses earn income vital to the family, then both should be insured. When both spouses work, but income is limited, term insurance can provide adequate coverage less expensively. If this still exceeds the family budget, the couple may choose to adequately insure the primary wage earner first and the other when it is economically feasible. Or they may spread the risk with smaller policies on each spouse.

In families where one spouse does not work outside of the home, life insurance may be necessary to replace services such as child care and housekeeping. Generally for housewife life insurance is not needed.
• **Working couples** without children or dependent parents must consider their lifestyle when assessing life insurance needs.

Life insurance would be helpful to couples who spend most of what they earn, have significant outstanding loans and balances on credit cards, or who would not want their savings to be depleted if one spouse dies.

• **Single adults** can have a need for life insurance, especially if they are a single parent or supporting another individual financially. Another reason for coverage is if they have outstanding loans or want to protect their future insurability by buying life insurance while they are young and in good health.

• **Children** does not require life insurance if they are studying and not earning for family.

### 2.7 Calculate Insurance Need

Here are questions to ask yourself:

How much of the family income do I provide? If I were to die early, how would my survivors, especially my children, get by? Does anyone else depend on me financially, such as parents, grandparents, brother or sister?

Do I have children for whom I’d like to set aside money to finish their education in the event of my death?

How will my family pay final expenses and repay debts after my death?

How will inflation affect future needs?

As you figure out what you have to meet these needs, count the life insurance you have now, Add other assets you have, savings, investments, real estate and personal property. Which asset our family sell or cash in to pay expenses after your death?  

15 Life Insurance, The USAA Educational Foundation
a) Annual Income Objective

Your annual household income objective is the amount needed for your survivors to live comfortably. Since few individuals want to accept a lower standard of living, this amount will need to be carefully considered. In addition to the usual living expenses, include any unique personal expenses — for instance, financial obligations for a disabled dependent or elderly parent.

b) Other Sources of Income

Other sources of income include your surviving spouse’s annual income, annual investment earnings, Social Security benefits, pension payments and income from such investments as rental property.

c) Calculating Expenses

Some expenses will be immediate, such as those for funeral costs. Some expenses are ongoing, such as living costs. Others are for future needs, such as a child’s education or household emergencies.

When life insurance companies compute these future expenses, they use inflation-adjusted calculations to account for future costs.

d) Existing Assets/Other Insurance

You may have assets your surviving spouse could liquidate, if necessary. These include savings, securities (unless you have assumed they will be an income source) and existing life insurance.
2.8 Methods for estimating Insurance quantum

There are various methods to calculate an individual’s need for life insurance. They are:

a). Rules of thumb
b). Human life value approach
c). Needs approach

Let us look at these in more detail:

a) Rules of thumb

Most people rely on the rules of thumb since it is a simple guideline that helps to calculate a basic amount of insurance coverage. The rules of thumb do not consider many of the factors used in other methods of insurance-need analysis. However, since they are easy to use, they will provide a starting point for insurance-need evaluation.

Some of the common rules of thumb are:

- Income rule
- Premiums as percentage of income
- Multiples of salary method

Income rule

The income rule provides a guideline to assess the insurance need of an earning individual. It uses a basic multiple of Income, which has a direct bearing to the age of the individual seeking the Insurance cover. The income to be taken is the net income only (i.e. after deduction of personal consumption expenses of the income earner)
The basic chart is depicted below:

<table>
<thead>
<tr>
<th>Age Profile</th>
<th>Minimum Multiple</th>
<th>Maximum Multiple</th>
</tr>
</thead>
<tbody>
<tr>
<td>Below 35 years</td>
<td>12</td>
<td>15</td>
</tr>
<tr>
<td>35-50 years</td>
<td>10</td>
<td>12</td>
</tr>
<tr>
<td>50 years and above</td>
<td>8</td>
<td>10</td>
</tr>
</tbody>
</table>

Thus if you are below 35, you need to multiply your net annual income with 15 to determine the insurance requirement. Under this rule, if your net annual income is Rs. 1,00,000 and you are 30 year old, you must have a life insurance cover of around Rs.15,00,000.

**Premiums as percentage of income**

This rule is based on the premium amount rather than the amount of life insurance coverage. Under this rule, 6 percent of the breadwinner’s gross income plus an additional 1 percent for each dependent should be spent on life insurance premiums.

Example: Mr. Kumar has a gross salary of Rs. 2,00,000. His wife is a homemaker and they have two children. His premium allocation by this method would be

\[(Rs. 2,00,000 \times 6\%) + (3 \times 1\% \times Rs.2,00,000) = Rs. 18,000.\]

**Advantage of using Thumb Rule**

*Simple to calculate and easy to understand*

The rules of thumb are easy to understand and calculations are also simple which one can do oneself. They are useful as a rough starting point in assessing one’s insurance need.

**Disadvantage of using Thumb Rules**

*General and fail to consider unique aspects of each case*
Though the rules of thumb method is quite simple, it uses very basic considerations that are generic for every case. It does not factor the needs and circumstances of each family. Also, it does not account for the age of the insured or dependents or any special needs that may arise later in their lives. Thus while it’s quick, it doesn’t account for your specific situation and you could end up overinsured or underinsured.

b) Human Life Value (HLV) Approach

The HLV concept focuses on the earnings of the individual that would have been lost in cases of premature death. The concept has been pioneered by S.S. Huebner in his famous title *The Economics of Life Insurance*. Simply put HLV is calculated based on the individual’s income earning ability. It is computed as the present value of the income lost by dependents as a result of the person’s death. Any attempt to measure the human life value must necessarily consider **present value**.

c) Needs Approach

The Needs approach is also called the family needs approach, the total needs approach, or needs analysis. It is based on the assumption that the goal of life insurance is to cover the surviving family members’ immediate expenses after the insured family member’s death, as well as their ongoing expenses into the future. Thus Needs Approach determines the amount of life insurance required by an individual based on deep analysis of needs that would have to be met by his dependents, should the income producer die. While HLV focuses on the income that would be lost, the needs approach attempts to identify the allocation of that income and to determine the purposes to which it would have been put. The effect of the income loss occasioned by premature death depends on the circumstances. These circumstances include how important the income is to the survivors and whether the same can be replaced from other sources. If the income is not replaced, the survivor’s standard of living may decline. The basic function of life insurance is
therefore to replace the income that is lost by dependents if the bread winner dies. The primary reason for the purchase of life insurance is to prevent a decline in the standard of living of dependents, and to permit the dependents to live in a manner that matches their basic life style in case the bread earner does not survive.

Under this method, the family’s needs are divided into three main categories:

1. Cash Needs - Immediate needs at death
2. Net income needs - Ongoing family needs
3. Special needs – lump-sum needs occasioned by certain specific events like child’s tertiary education or marriage

**2.9 Preferred Type of Policy**

Once you have determined how much life insurance you need, you are ready to consider the type of policy to purchase.

**a) Term** insurance generally provides a death benefit only. Coverage is usually for a specified number of years. The insurance company will pay your beneficiaries the death benefit of your policy only if you die during the term. Because it is “no frills” insurance, term insurance generally gives the largest immediate death benefit for the lowest premium dollar, particularly for adults under age 45. After age 45, premiums begin to rise sharply.

All life insurance was originally term insurance. However, because term life insurance only pays a claim upon death within the stated term, a number of term insurance policy holders became upset over the idea that they could be paying premiums for 20 or 30 years and then wind up with nothing to show for it.

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16 Risk Management and Insurance Planning, Chapter 16
In response to market pressures, actuaries conceived of an insurance policy with level premium payments that were higher than traditional term insurance contracts. These contracts would offer a "cash value", which was designed to be cash reserve that would build up against the known claim - the death benefit. These policies would also credit interest to the cash value account and upon maturity of the contract (usually at age 95 or 100), the cash value would equal the death benefit.

This produced a benefit to both the policy owner and the insurance company. By guaranteeing the death benefit, the policy owner was assured that insurance coverage would be in force when the insured died. The insurance company benefited because with every premium payment made, 30% is overcharge and pure profit, and thus the cost of insurance, is able to increase, while premiums remain the same.

b) **Permanent** insurance combines a death benefit with cash value. Part of your premium is diverted into a cash value element. This cash value accumulation can help you avoid the need to pay higher premiums as you get older, as is often the case with term insurance. The specified period of coverage is usually up to age 121. You can cancel your coverage and redeem at least part of your accumulated cash value at any time. It may be possible to borrow or withdraw some of your cash value and still keep the policy in effect as long as the premiums are paid.

**The disadvantages of permanent insurance are:**

1. It is far more expensive than term insurance. This means that you can usually afford far less permanent coverage than you can afford term. If you start a permanent policy and then must drop it because you cannot afford the premiums, you will have lost a great deal of money.

2. Insurance companies invest your cash value quite conservatively so it is possible that you could earn higher returns on your own if you are a skillful and knowledgeable investor.
3. The return you earn on your cash value is determined by current interest rates in money markets. So if interest rates are high, your cash value will grow much more quickly than if interest rates are low. Periodically, the insurance company deducts its expenses and a mortality charge from your cash balance. The mortality charge is the amount of money, based on a premium rate per thousands of dollars of death benefits, required to provide you with life insurance. The company will guarantee a minimum interest rate and a maximum mortality charge. Some will also guarantee a maximum expense charge.

2.10 Reviewing Your Coverage

It is wise to review your life insurance coverage annually to ensure you are properly insured. Major life events, such as a marriage or divorce, birth or adoption of a child, job promotion or purchase of a home or other real estate can significantly impact your life insurance needs.

2.11 The Big Picture

Because your life insurance needs will change over time, you may want to consider a “layering” approach to meet your needs. This consists of purchasing a permanent policy to cover your permanent insurance needs, then “layering” additional term coverage to address any temporary needs. This type of strategy will help ensure you are properly covered well into the future. Life insurance is needed during wealth creation age eg. during age 25 to 65.  

18 Life Insurance, The USAA Educational Foundation
a) The Early Years

When you are single or newly married with no children, you should consider enough life insurance to cover your final expenses and outstanding debts.

b) The Young Family Years

The need for life insurance increases dramatically when you become a parent. Both parents will want to consider coverage, if both does not work outside the home. Term insurance is a popular type of coverage during these years because it provides the most coverage at the lowest cost. Some young couples start with a permanent policy or a combination of term and permanent insurance.

c) The Middle Years

These are the years when your children leave home and your income usually continues to increase. You may consider dropping some of your insurance.

d) The Retirement Years

If you have developed income-producing assets and have a good pension, you will not need much life insurance during retirement. However, if your assets are modest, the life insurance proceeds from the first to die will still be needed to provide income to the surviving spouse. Most retirees maintain some coverage to pay funeral and burial expenses, to cover the cost of a final illness or estate taxes, to make a final bequest or to provide money for children and grandchildren.
e) Peace of Mind

Whichever stage of life you are in, remember to review your coverage annually. This will help ensure your loved ones have the protection they need.

2.12 Consumer Perception

What comes to mind when you hear the word 'insurance'? Investment, Tax rebate, Savings or Security? Insurance for the masses is a means of investment or a long-term saving mechanism and tax rebate. Why do consumers hold such perception? The concept of perception is very important in understanding behavior. What it means is that what one sees is not what there is to be seen, but what our mind makes of what there is to be seen. Looking out from the train standing on a platform, to another train in the adjacent platform, we may feel that our train is moving, a perception which is corrected only by looking at another static object outside.

2.13 Myths about life insurance

Let us delve on some of the myths surrounding Life Insurance in India. These myths will help explain why the number of individuals insured and the average amount of insurance cover per individual is so low in our country. Life insurance protects you and your loved ones in the event that you meet with an untimely demise. You are accustomed to a certain standard of living, and you would like to sustain the same standard of living for your wife in your absence.  

a) Tax saving concept

The question that we should ask ourselves is - do we believe that destiny will announce its arrival in our lives? Will destiny always allow you to complete your tax planning for the year and then strike? The answer is a resounding ‘no’. However, lack of education has made customers believe that insurance is a tax-planning tool and the protection element is only a marketing strategy. Sad, but true; this is the way Life Insurance has been largely sold in this country. Individuals buy “enough” Life Insurance to get tax breaks just before the financial year ends. The moot question is - are we buying Life Insurance to save taxes or are we buying it to protect our family’s financial future? Since people believe that nothing ever can happen to them, the decision on quantum of insurance cover and timing is made just before the financial year ends. Tax benefits have been driving LIC’s business over the years and the same will drive private player’s too, since the same incentives are available to all insurance companies. There is a large potential in rural India. As stipulated by the Insurance Regulatory Development Authority, five per cent of our new business must cover rural India and the figure must reach 15 per cent by the fifth year. All of this is very encouraging for the life insurance sector. Innovative products, smart marketing and aggressive distribution, that’s the triple whammy combination that has enabled fledgling private insurance companies to sign up Indian customers faster than anyone ever expected. Indians, who have always seen life insurance as a tax saving device, are now suddenly turning to the private sector and snapping up the new innovative products on offer.

Insurance products are sold rather than bought, as most people do not realize that insurance is for the security and benefits of their dependants. While the objective of life insurance is to provide a lump sum amount in the eventuality of untimely death of the insured, most Indians buy insurance to save taxes. This is evident from that around 40 per cent of the insurance business of any insurer takes place in March, which marks the deadline for submission of investment details for computation of income-tax liabilities.
b) Guaranteed Returns

The question we need to ask is - how much is the guaranteed return that a Life Insurance contract can give. The answer is, “I do not know.” Unfortunately, individuals expect life insurance companies to give “high guaranteed” returns. What most individuals fail to understand is that life insurance contracts are long-term contracts. The way in which the contract works is that the premium that each of us pays gets invested after deducting for the cost of mortality and other administrative expenses of the insurance company. Since the premium is paid over a period of time, the investment return that the insurance company can generate on our savings depends upon the prevailing investment opportunities at the time when the premium is paid. With volatility in interest rates and capital markets, the level of investment return that an insurance company can generate can vary substantially. In such a scenario, where is the scope for the insurance company to offer a fixed return to their policyholders but have an earning stream that is highly volatile and variable? Interest rates on Government of India securities have fallen by over three hundred basis points in the last three years. Given such an economic environment, it is foolhardy to expect that the “high guaranteed return” policies can continue for very long. The classic example is Japan where with interest rates at sub zero levels, insurance companies that offered guaranteed return policies to their policyholders are going down. Again, if you are buying Life Insurance for the “high guaranteed return” the policy offers; please examine the company and the product again. Your insurance company may not be able to pay you the promised return when your family needs the money most.

2.14 Insurance policies don’t make good investments

Any attempt to assess insurance policies in order to determine the best on offer inevitably encounters a curious paradox: unlike with most other investments, the underlying expectation in buying insurance is not the maximization of returns. That’s because insurance, in its purest form, is fundamentally a hedge, a shield against various risks— of
death (in the case of life insurance), ill-health (with medical insurance) or damage to property (with other variants of non-life insurance). Therefore, returns on insurance policies are “maximized”, so to speak, only in unhappy circumstances. But then if insurance were marketed purely as a risk cover, there would be only one class of policies, in both the life and non-life insurance arenas: term insurance plans, which provide the least-cost risk cover for a specified period but offer no returns if no claim is made. True, most non-life policies are, in fact, term plans that offer pure risk cover for a year, after which they are renewable. Life insurance policies, on the other hand, come in a handful of variants. Significantly, they are marketed not just as risk cover, but as investments that additionally offer the allure of attractive returns.

Do these claims stand up to quantitative scrutiny? How does one assess various classes of insurance policies and determine which is the best on offer? 20

a) Term insurance

These are, as we’ve seen, insurance covers in their purest form. You pay a premium, every year or in a lumpsum, and you get a life cover for a specified sum assured for a specified period. If you survive the policy, you get no returns; in the event of your death during the specified term, your nominee will get the sum assured. For a given age and life cover, term plans offer the least-premium insurance cover. A comparison of term insurance plans from two insurers, therefore, boils down to a comparison of the premiums you pay for the cover they offer for a specified term. Determine the extent of cover you want, and the number of years for which you want it; once that’s done, the best term insurance plan for you is the one that offers you that extent of cover for that many years for the least premium.

20 Intelligent Investor issue dated 1 July 2002
b) Return-of-premium plan

A variant of the term insurance plan, with one difference: if you survive the policy, the entire premium you pay is returned at the end of the term. Some insurers also offer a guaranteed addition; TATA-AIG, for instance, offers a plan in which the policyholder gets a survival benefit of 125 per cent of the sum of the premiums paid. The premiums you pay on return-of-premium plans are higher than on term plans that offer pure risk cover and no returns. That’s the price you pay for a ‘return on your investment’. Are the returns worth the additional premium you pay?

The best way to measure that is to look at the ‘internal rate of return’ (IRR) on your investment, because IRR factors in the ‘time value of money’ and therefore offers a more accurate assessment of the return on your investment. In the context of insurance plans, ‘investment’ is the premium you pay, and ‘returns’ the maturity benefit, including the sum assured, ‘guaranteed additions’ and bonuses (if any), or return of premium. On a pure-risk term insurance plan, therefore, the IRR is negative if the policyholder survives the policy term. But here you’re not concerned with returns; you’re just trying to cover a risk for a specified period at minimum cost. And that’s what it is–a cost, pure and simple.

The premium that a 30-year-old would pay for a 15-year, Rs. 500,000 cover from TATA-AIG (the only insurer to offer pure-risk and return-of-premium policies for similar terms, which facilitates a comparison) is Rs. 7,690 a year. On the total premium (Rs. 7,690x15=Rs. 115,350), he gets a survival benefit of Rs. 144,187, including the guaranteed addition of 25 per cent of the premium. That translates into an IRR of 3 per cent.

If, instead, you opt for a pure-risk cover for the same term and the same sum assured, you’ll pay a far lower premium –Rs 2,225 a year. If the investible surplus of Rs 5,465 a year (Rs 7,690-Rs 2,225) is now invested in a 15-year PPF plan, which currently yields 9
per cent compounded interest, the investment would grow to Rs 174,898. In other words, without compromising on your insurance needs or the safety of your investment, you can earn an additional Rs 30,000 over 15 years.

Buy for cover, not for profit

c) Endowment plans

The calculations get a trifle more complicated with endowment plans (including money back and whole-life plans), which offer more than just a life cover. These endowment policies may be offered as ‘with-profit’ or ‘without profit’ plans; in the former, you get a share of the insurer’s profits each year, in the form of bonuses. These bonuses are not guaranteed, and you can’t, therefore, determine at the time you’re buying a with-profit plan what the maturity value of the policy will be, say, 20 years down the line. You can at best project an estimate based on an insurer’s record of declaring bonuses, and then calculate the possible IRR on the investment in the plan. Life Insurance Corporation (LIC), which has been around the longest and has a fairly good record of paying bonuses, typically pays about Rs. 65-80 per Rs. 1,000 sum assured on its with-profit plans. On a 30-year with-profit endowment policy with a sum assured of Rs. 100,000, a 30-year-old pays a premium of Rs. 3,200 a year. Assuming an average bonus rate of Rs. 70 per Rs. 1,000 sum assured for 30 years, the maturity amount works out to Rs. 310,000; this translates into an IRR of 7 per cent. However, if the bonus rate falls to, say, Rs. 50 per Rs. 1,000– and it well may–the maturity amount would be Rs. 250,000; the IRR in this case, at 6 per cent, may seem only marginally lower, but over a 30-year period, it makes a difference of Rs 60,000 in absolute terms. Our calculations show that while the precise IRR will hinge on your age, the term, and the maturity value, on most with-profit plans it varies in a range of between 6 per cent and 8 per cent. However, each incremental gain in the IRR, however marginal, may mean a substantial difference in the absolute value of the returns.
d) ULIP

A typical ULIP-based insurance product would involve a life cover of just about Rs 10 lakh for an annual premium of around Rs 1.25 lakh. Now think of an urban family with one 32-year old bread winner who earns perhaps Rs 6 lakh a year.

The annual premium of Rs 1.25 lakh would about saturate the savings capacity of this family. Yet, if this family’s earning member were to be hit by a truck tomorrow morning, the cover of Rs 10 lakh would sound like a joke. The reason is that of the premium paid, only a fraction goes to provide life cover, the rest is frittered away in high commissions.

In reality, the premium that this family could have afforded can easily pay for adequate life cover. For about Rs 25,000 a year, this 32-year-old can buy Rs 40 lakh worth of term cover, which sum would definitely be meaningful if he dies.

2.15 Buy Term and Invest the Difference

The long ranging between proponents of permanent insurance as an investment and the advocates of insurance for the sake of pure protection will probably never be settled. There is a considerable amount of literature—much of it generated by vendors of competing investment classes. The issue however is much more complex than just stating that “life insurance is a poor investment”.

The controversy between the advocates of permanent insurance as an investment and proponents of insurance as a pure risk protection tool will probably never be settled. We have already seen that there are two separate risks that can be met through life insurance:
premature death and superannuation. If the individual dies before reaching retirement age, there is no need to have accumulated a fund for retirement income. On the other hand, if he survives to enjoy his retirement, the death benefit will become unnecessary. As future is uncertain, an individual has to prepare for both contingencies.  

21 Risk Management and Insurance Planning, Chapter 11