What is the Right Life Insurance?

The answer will surprise you, given what the media, the agents and ads tell you. Debashis Basu and Aaron Rodrigues offer some plain truths about life cover

The year was like any other; but, for Rajeev Malhotra, 1964 was different. His wife delivered a two-pound baby boy. He was a happy man and, after a week at home, he went back to work. After the *pedas* and congratulations, Mr Malhotra made a stop at the accounts department of his office. He didn't like the accounts staff very much except for Shankarji. Shankarji congratulated him, took a *peda*, asked him the usual questions about the baby (name, health, whether he resembled the husband or the wife) and then told him about life insurance. He explained the need for life insurance. Mr Malhotra agreed with his view about potential dangers at the workplace—in fact, three weeks back, a worker had fallen from one of the railings and died. Stirred by Shankarji's eloquent advice, Mr Malhotra brought a life insurance policy—a term plan which would pay money to his dependents if he died prematurely.

Fast forward to the present: Mr Malhotra passed away after living a long and happy life leaving behind his aged widow and Sanjeev Malhotra, their son. Mrs Malhotra did not receive anything of the Rs4,500 premium her husband had paid to the insurance company every year for 20 years—for a Rs20 lakh cover in case something were to happen to him. But Mr Malhotra lived a normal life and passed away. His life insurance premium was considered 'wasted'. He had lived a good life, saw his son grow to become an accountant and marry a nice girl. Malhotra (Jr) has now become the man-of-the-house, taking all the family decisions. His wife, Shalini, is about to have a child. On one fine holiday, when he was sitting before the TV watching a 20-twenty match, an insurance advertisement (he hates them, but changing channels is a bigger pain) about saving money for children's education popped up. Then there was another ad about holding your head high even after retirement. He became worried watching the ads and decided to buy some insurance for his family. The insurance agent had a knowing smile when he saw Malhotra (Jr) and introduced him to the world of insurance-cum-investment plans. What a great way to make money and secure a family, thought Malhotra (Jr) as he signed on the forms and wrote a cheque of Rs15,000—the premium for the first year. Now, he could get the right cover if something happens to him—like his father did. And, if he lived long enough, like his father did, he would get his money back with good returns—which his father didn't.

Here's the key question: Between the two—Malhotra (Sr) and Malhotra (Jr)—who bought the right insurance policy? Way back, when the father had bought his policy, knowledge about insurance products was low. You were introduced to insurance plans by a friend, relative or that accountant from the office—who knew exactly what you earned and what you needed, especially to save tax. The options then were mainly 'term insurance' or a 'money-back' policy. The government-owned Life Insurance Corporation (LIC) had a monopoly and insurance was tax-free (up to a point) to encourage people to insure themselves.

Net Asinine Value

How 'highest NAV guarantee' schemes fool you

First, there were term plans and endowment plans. Then came 'money-back' plans. Then came unit-linked insurance plans (ULIPs). Now come 'guaranteed plans', plans that guarantee the 'highest net asset value'. Virtually every insurance company has hit upon a new goldmine to dig out money from your pockets for a scheme that is just too tempting to refuse. Life Insurance Corporation has Wealth Plus, ICICI Pru Life has Pinnacle and Reliance Life offers Highest NAV Guarantee Plan. If an investment can 'guarantee' a net asset value, what else do you need in life? Well, you need adequate protection from your insurance plan, but then Indians want 'returns' from their 'investment' in insurance. So, let's focus on what is being guaranteed and at what returns (costs).

First, how do guaranteed NAV plans work? The most important point to understand is that insurance companies are guaranteeing NAVs, not returns! Are the two different? Yes. NAV is a number ***at a point in time*** and returns happen ***over a period of time***. For instance, your 10-year plan may have hit an NAV of Rs14, after five years. At that point, it is the highest NAV. This Rs14 is guaranteed for the next five years. What if the NAV remains at Rs14 for the next four years or goes down to Rs13? You would still get this NAV of Rs14. But Rs14 simply happens to be 4% over 10 years! Not worth the trouble. There is no free lunch in life.

If you want to know how the schemes would work in practice, take a look. In the above-mentioned example, when the NAV goes up to Rs14, all that the manager has to ensure is that this amount remains intact at the end of the next five years. What he would do is simply invest X amount of money in the bond market so that it fetches Rs14 at the end of six years. Now, whatever happens, getting Rs14 at the end of six years is ensured. In the second year, if the market goes down, the NAV will also go down. But your Rs14 is 'guaranteed' for five years (at a pathetic rate of return). If the market goes up, the NAV also goes up—say to Rs16. Now, more money will be shifted from equity to bonds to retain the NAV of Rs16 at the end of the balance period. Notice that more and more money gets shifted to debt to lock up the highest NAV. This is because, to get a guarantee on anything, you must get a guarantee on the principal. And it is debt alone that protects the principal amount. So, in effect, what you are buying is a progressively-timed debt fund. But ask yourself what a debt fund will do to your returns. We don't think you will get more than 6%-7% returns on the guaranteed NAV schemes. And, most important, what will a debt fund do to your insurance/risk protection? Surely, when you want an insurance plan, you don't want to end up with a bank fixed deposit with some insurance thrown in! — ***D.B.***

But times have changed. Many private companies now offer insurance. And LIC itself is no longer offering 'protection' alone; it sells 'savings & investment' products. Since some expenses need long-term planning and investment, insurance companies offer to meet those needs. Investing in children's education? There is an 'insurance' product for that. Need post-retirement income? There is an 'insurance' product for that too. Advertisements to sell these products seem to assure, if not guarantee, a financially-secure future. This is what happened to Malhotra (Jr). He saw an advertisement that tugged at his heartstrings and there were billboards everywhere to remind him of it. He fell for the marketing blitz and bought the plan, since everybody was buying these products. If you think Malhotra (Jr) bought the right product, you are wrong. But how do you decide what is the 'right' insurance product? Simple. Ask yourself: What is insurance? What is it supposed to do? The answer offers perfect clarity. Life insurance is a way to provide for your dependents in case of your untimely death. It's a method of transferring your financial responsibility to someone else (the insurer) when you are no longer around. This protection comes at a cost—the premium. If you live a long and healthy life, just count your blessings and forget the money that you paid as premium. That is insurance in its purest and best form.

But that is not what the insurance companies are selling aggressively. They are wrapping the protection in a variety of investment products which are sold through agents who earn large commissions on your premium payments. They want to sell you endowment plans, children's plans, pension plans, unit-linked insurance plans (ULIPs) and even pure equity investment plans. All these products give the insurer access to substantial funds; but none of these is a reason for you to buy the products. The first thing to understand is that, in their current *avataar*, you are not dealing with an insurance company but with an investment company. So when Malhotra (Jr)'s main purpose was to insure, he was actually led to invest. Are these insurance-cum-investment products good for you? Or should you separate investment from insurance? If so, under what

Should Insurance Ads Be Banned from TV?

They pull at your heart strings to make you open your purse strings

I am cynical by temperament. My first instinct is to be suspicious about things, events, people and, more importantly, promises. And thank god for that. Perhaps,

this negative mindset has helped me hold on to my hard-earned savings. The gullible and the so-called 'positive thinkers' have had terrible experiences. Especially because they leaped into insurance plans before they looked, falling prey to misleading advertisements, not bothering to ask important questions.

Which brings me to the main issue: Shouldn't it be mandatory for insurance ads on television to clearly spell out the exact deals they offer? Along with the exact rates of return, the risk factors, the hidden downsides, etc? Sure, they can make all sorts of promises of a dazzling future, but they must also state the not-so-good news.

Well, that doesn't happen. Nor does the statutory risk warning bell go off. So all we are left with are lofty claims and delirious promises. Future Generali promises you will have enough dosh to buy quartz watches for 600 *behenjis*. Max New York Life promises a sensational future for your kids, even if they grow up to be 'idiots'. HDFC Standard Life asks you to '*Sar*

This Max New York Life ad promises a sensational future for your kids

utha ke jiyo'. And the loser in their ad is a sad bald man and the smartie, a cool dude. (I protest! Baldies are known to be prosperous gents!). Canara HSBC Life Insurance wants to insure your emotions (I kid you not). ICICI Lombard promises blanket protection for your family. Quite literally. SBI Life Insurance promises you will drive a *lambi gaadi* at the age of 60, while singing conditions?

The first step is to figure out how much life insurance cover you need. "Sufficient insurance is very subjective. A family of four could have varying insurance needs depending on their total income and whether both spouses are working. Their lifestyle and liabilities, such as a housing loan, other loans and education plans for the children, would also differ. Putting a monetary value to lifestyle is the starting point," says Yogin Sabnis, a certified financial planner (CFP) at VSK Financial Consultancy Services.

"You need to calculate the monetary worth of the breadwinner of the family and then add other expenses, like marriage and education, which gives you the final figure of the insurance needed," says Sandeep Vasa, a CFP at Total Wealth Management. The requirement changes for each stage in life and based on the number of dependents. "The right age to buy insurance is when you get your first pay cheque," says Mr Vasa. The next question is what to buy.

"Go for a term plan," advises Mr Vasa. "It's important to enter early. If for a Rs1-crore plan you pay Rs10,000 a year when you are 25, a 45-year old will have to pay Rs50,000. While selecting the term plan, look for one that gives you the longest term because, after 65 years, risks will be higher. Also, go for the lowest premium, because you are committing yourself for the next 15 years. A thumb rule is that you take insurance for an amount that is seven or eight times your gross annual income. You must also have a medical insurance policy, householder policy, accident policy and disability policy."

What about insurance-cum-investment plans? Well, they are investments and, therefore, should be judged against the returns offered by other investment products. In this, they don't come out too well. Another problem with these products is that they are not generally purchased for their insurance benefits. Customers lose sight of that fact. "The basic solution of insurance can only come from a term plan. You can't bridge an insurance gap with an investment product. It's a thumb rule that insurance should be at least 10 times the income.

classic Hindi songs for your geriatric wife. TATA AIG is determined to turn your kids into superstars. Kotak Life Insurance goes a step further. Your kids could become astronauts, doctors, cricketers or rock stars. LIC's Jeevan Saral promises ice *golas* for your kids (so maybe they are being honest, *hehe*). And the list goes on.


Your kids could become astronauts, doctors, cricketers or rock stars, says this Kotak Life Insuarance ad

Now here's what ad agencies and their clients will tell you in their defence, and I quite empathise with their predicament. In a 30-second (and often less) TV commercial, it just isn't possible to load mathematics. Not just that. The non-captive and entertainment-led medium does not allow for cold facts and figures. Yup, this is true, to an extent. People will smash their LCD sets if, between the overs during an IPL match, bar and pie-charts are shoved down their throats. Fair enough. So the marketers have no choice but to use the medium to attract viewers, expecting them to do their homework later, by reading prospectuses and grilling the insurance company staffers (the ICICI dudes will patiently chat with you till the wee hours of the morning). But, as we know, that's usually not how it plays out. People get carried away with celestial promises, blindly invest their funds and get heavy shocks later (just as in the Havells fans commercial).

Maybe the time has come for the regulators to take a hard decision. Either the insurance companies find a way to spell out the good and gory details in their TV ads, or these ads need to be banned from television. And the marketers can opt for captive media such as the press and the Internet to sell their wares. With full details. Sounds harsh? It is. But it's a lot better than zillions of citizens blowing up their savings and dreams.

The problem of misleading ads is as old as the hills. All sorts of brands have been pulled up in the past for misleading consumers. From health drinks to detergent powders to toothpastes to automobiles. To some degree, people can absorb those shocks. But a misleading insurance ad can cause serious damage. To one's livelihood. And to those who the insurer leaves behind. To not rest in peace. — *Anil Thakraney*

Regulatory Rot

Beware, regulators are often not on your side. Look at how IRDA functions

Financial services are being sold like soaps and shampoos. Except that, when it comes to soaps, you can be reasonably sure that while your skin may not be soft and silky as the ad promises, at least it will not leave you with rashes. This is not what you can say about financial services. They can leave you with large losses and the 'manufacturer' is simply not responsible for it. It can be a mutual fund that lost money by betting on stocks of poorly-governed companies. It can be a stockbroker whose trading skills you relied on and lost your shirt. It can be a banker who sold you a unit-linked insurance plan (ULIP) that will leave you with inadequate insurance and poor returns.

Unfortunately, you cannot rely much on the regulators either. Investors taken for a ride by stock brokers get the short shrift from the stock exchanges and the Securities and Exchange Board of India (SEBI). Bankers are never pulled up for mis-selling by the Reserve Bank of India (RBI) and the Insurance Regulatory and Development Authority (IRDA) is, of course, the worst of the lot. As we wrote in our previous issue, IRDA took the most extraordinary step to launch an advertising campaign promoting ULIPs for pensions. This is akin to the RBI hard-selling savings accounts of cooperative banks or SEBI bombarding investors with ads asking them to buy mid-cap funds.

CB Bhave, chairman, SEBI

J Hari Narayan, chairman, IRDA

Interestingly, SEBI, which does not have a stellar record of protecting investors' interests, has been very proactive recently on a number of issues such as broker-client relationship and also on how fund companies should pay the distributors. While its actions have been harsh and hasty, it has not sided with 'manufacturers'—that is the way IRDA seems to operate. There is simply no reason why IRDA allows huge upfront commissions for ULIPs; why it allows insurance companies to make term plans unattractive; why it allows celebrity endorsements for insurance ads when SEBI has banned it for fund offers and public issues.

This has serious implications. Most savers and investors automatically assume that reputed 'manufacturers' will be careful about their products. After all, if Maruti's cars break down often, it will go out of business in no time. But this assumption does not apply to financial services. There is no 'science' behind financial services that can ensure consistent performance. 'Manufacturers' may have the right intentions but, under stress, they will turn totally self-serving. That is why they have to be subjected to strong regulatory oversight in the interests of investors. Unfortunately, IRDA is far from living up to this primary requirement. You have to fend for yourself. – ***D.B.***

So, someone earning Rs3 lakh would require at least a Rs30-lakh cover. You can get this by paying Rs3,000 yearly, while an income-cum-investment plan will make you put in more than Rs30,000 a year. And, because of this, you may make a mistake. The high premium in the second option, compared to the first, may put you off. So instead of having a Rs30-lakh coverage, you may well settle for a Rs15-lakh coverage. Now, remember, you wanted to protect your dependents through insurance but you have ended up having a lower insurance cover than you need," explains Mr Vasa.

The other problem with going for something like ULIPs is that you may have committed to an unsustainably high premium. "If you go for an income-cum-investment plan, you know that the premiums will be high. So why do you want to go for something you might not be able to afford?" says Amar Pandit, chief executive officer of My Financial Advisor. Mr Vasa echoes the same view: "Many people are committing themselves to pay a very high amount for three years. But if something goes wrong and they cannot pay that sum, what happens?" Indeed, the lapse ratio for various private mutual fund companies shot up last year, when many people could not support these high-cost policies. So, an investment-cum-insurance product may lead you to under-insure, which, of course, a vast majority of people will not realise (because only a few will die prematurely). It also saddles you with a high-cost investment.

What about returns? "Earlier, when ULIPs carried huge entry-loads, ULIPs used to underperform mutual funds for 13 years. If you have to contribute for 13 years to outperform mutual funds, it's surely not a great investment opportunity," says Vivek Rege, managing director, VR Wealth Advisors.

One of the main reasons for poor returns is that expenses of running these portfolios are very high. "They do a lot of loading. They deduct at least 20%-25% of the premium in the first year for commissions and costs. In the second year, it is another 10%-12%. This goes on for the first few years. Then there is a mortality cost, which is the same with any insurance product. There is a fund management and administrative cost of 2%-3% every year on your funds. It's a recurring cost which steadily eats into returns," says Mr Rege. ULIPs should be purchased for a period of 10 years because, even under the new ULIPs, you need at least five to six years to break even.

Agents usually sell ULIPs by saying that you invest only for three years and after that you can discontinue. But actually the investment of your money starts after three years, when the load gets reduced to zero. If you discontinue, you make a loss. "If you look at it from the insurance point of view, you are paying a huge premium to get a cover for your required amount. From the investment point of view, most of your initial money will go in paying the agent's commission, management fees, administrative fees and mortality cost," says Mr Vasa. In fact, ULIP as a product is a bit better than endowment insurance. "In endowment plans, you don't know where your money is going; you don't know what the allocation is; and the commissions are very high," he adds. The most remarkable thing is that since insurance companies and agents make much more money on investment products, they are keener to sell these and even suppress the availability of cheaper and more useful term insurance plans which offer very low commissions. An endowment or ULIP generates more money for the insurance company as well as for agents; that is why they are likely to push other plans rather than a term plan. "Term insurance is the Cinderella of life insurance," says a financial planner.

That is why we have a situation where most people are under-insured and most people continue to buy insurance-cum-investment products. Insurers also take advantage of the fact that people see the premium paid on a simple term insurance as money lost, in case they outlive the policy term. "Everyone assumes that they aren't going to die soon, so they want insurance-cum-investment products," says Mr Sabnis.

There is a simple way to figure out if you are getting the correct insurance advice. If your agent pushes an investment product really hard, rather than a simple term policy, he is working for himself and the insurance company. A financial planner gives us the arithmetic. "If you buy a term policy for Rs5 lakh, they will make Rs1,700-Rs2,000. If you buy an endowment product for Rs5 lakh, the commission is as high as Rs22,000-Rs25,000, never mind that your returns would be only about 5%," he says. He also points out that "the underwriting is very strict for term plans. If an agent is submitting papers of a ULIP, it is almost certain to be passed. But 20%-30% of term-plan applications are usually rejected on medical grounds."

His advice is simple. "I always believe that you should keep investment and insurance separate. ULIP is an investment with lower returns. Instead of ULIPs, I would recommend a term insurance policy and putting the rest of your money in Public Provident Fund. There you get a straight 8% tax-free return, up to a point." By this logic, there is no need to pore over tables for hours together to identify the best ULIP and the relative merits of one plan over another. Save all that time and spend it with your loved ones. ■

Not a Match

Other investment alternatives yield much better returns

If insurance is sold as investment, it has to match up to the returns you get from other assets. Unfortunately, there is no historical data on the performance of ULIPs over a period of time, since these products were launched only a few years ago. As such, ULIP products can only provide an indicative return to attract investors. Even those returns are quite poor. Other investment alternatives, though, have readily available historical data that investors can tap into to gauge their performance. The best return a ULIP pension plan can provide over 15 years (assuming the rate of growth at 10%) is 8%-9%, net of charges. Compare this to the Sensex which, over the past 20 years, has provided compounded annualised returns of 14%. An average equity mutual fund, the Morgan Stanley Growth Fund, has also yielded 12% returns since inception (March 1994). Even fixed deposits have yielded better returns than ULIPs averaged over the last 15 years.