Insurance Goof-Up

- An investor investing in insurance policies has been the most preferred option. Investment in insurance policies leads to a compromise on insurance cover as well as investment returns i.e. the policyholder remains underinsured since a part of the premium gets allocated towards insurance and the rest goes towards investment which is the reason why to get a decent insurance cover under plans like Endowment, Money Back, ULIPs, Whole-Life Plans, Pension Plans, Children Plans, Guaranteed NAV Plans etc. the premium is very high. The policies which promise you a decent life cover plus market linked returns fail to do both. More often than not, these policies provide a very low cover (which is actually useless as compared to what the dependants will need in reality) and low returns due to the number of charges which combined together are very high (premium allocation charges, policy administration charges, fund management charges, commission to the agents, guarantee charges in case of guaranteed NAV plans) or due to poor performance of the investments. The investor does not have an option to opt out of the policy due to its low performance but in mutual funds as far as investments are concerned, the investor can opt out of a fund that does not perform well. The overall charges for mutual funds are very low as compared to the insurance policies.
- Many people have multiple life insurance policies and do not know which policies to retain and which of them are to be discarded. They land up taking multiple policies such as Endowment, Money Back, ULIPs, Whole-Life Plans, Pension Plans, Children Plans, Guaranteed NAV Plans etc. due to incomplete knowledge or mis-selling of products by the agents. Many times, these policies do not solve the purpose of the person insured and only result in filling the pockets of the agent who sold you that policy. Mixing investments with insurance is a bad idea.
- Let us understand the concept of insurance with an example. A businessman has taken insurance for his manufactured products that are kept in his factory for which he pays a regular premium. Unfortunately, the factory catches fire and the products get damaged. Now, the insurance company pays out the claim amount to the businessman due to the loss of

manufactured products that were already insured. It is clear that only in case of an unexpected event the insurance company pays out the claim. If the products had not been damaged, the company would not have paid the claim amount neither it would have returned the premiums paid. The same concept applies for life insurance as well. If an individual buys a pure life insurance plan i.e. a term plan then upon his demise the nominee gets the claim amount, so in this way the dependants do not face a financial problem after the demise of the individual who had taken insurance. Pure life insurance is taken to secure the dependants or family members. It is not bought for the purpose of investment or making any profit. This is the way pure insurance works. Individuals are unable to understand that by paying premiums for a term plan they are getting insurance from the company and making their dependants or family members financially secured. They only tend to consider the fact that how much will they get on maturity? Buying insurance is not an investment to get something on maturity. Nowadays, the premiums for term plans are very cheap and easily affordable to anyone.

- If one has accumulated sizeable wealth for his family, probably he doesn't need any insurance because he has already saved enough or created enough wealth for his family. The insurance would be more important for those who have dependants and do not have enough corpuses for their family in case of their demise. If an individual has dependants he should go for pure insurance i.e. a term plan so that the dependants / family members do not have to face any financial problem in case of an unforeseen event and then make the necessary investments in other asset classes. Generally, people fail to understand this aspect.
- Investors also face an issue of how to identify whether the life insurance policy is a mix of insurance and investment. If the agent informs you that after a certain period of time or on maturity the policyholder will get an amount back means that the policy is a mix of investment and insurance. Pure life insurance policies do not contain a feature to pay an amount on maturity rather the company makes payment of a claim to the nominee in case something happens to the policyholder. Returns are calculated only for investments and not for insurance.
- Insurance means in case something happens to the policyholder, the dependants would get the claim amount. If you buy an insurance policy in

your wife's name and something happens to her, you will get the claim amount and if something happens to you i.e. the earning member of the family, your wife won't get anything. Insurance is supposed to be bought to protect the dependants / family members from any financial difficulty in case of an unfortunate incident with the earning member of the family. The goals of investment and insurance are totally different. A lot of people buy insurance policies with a view of making investments.

- But, due to competition and an objective of earning more and more profits, insurance companies have launched policies with the combination of extra features which naturally exists in any other investment products. Unfortunately in India, the investor education regarding what type of insurance to buy is very low.
- Let us take a look at a comparison of premium for different categories of insurance policies. The data illustrated below is for an individual aged 28 years earning Rs.5 lakhs per annum having two dependants for an insurance cover of Rs.50 lakhs. The cover is roughly taken as Rs.50 lakhs since an individual earning Rs.5 lakhs having two dependants should at least have a cover of Rs.50 lakhs to secure his family. The figures mentioned below are overall figures and not exact figures as the objective is just to have a basic comparison between various categories:

Type of Policies	Annual Premium Amount
Term Plan	Around Rs.7,000
Endowment Plan	Around Rs.2,30,000
Money-Back Plan	Around Rs.4,00,000
Ulip	Around Rs.2,00,000
Whole-Life Plan	Around Rs.3,50,000
Pension Plan	Around Rs.80,000
Guaranteed Highest NAV Plan	Around Rs.2,50,000

- From the above table it is very clear that term plan is the cheapest option to buy insurance. As stated above, for a requirement of a cover of Rs.50 lakhs, the other plans will be costlier than a term plan. An investor should adopt such an approach where he should determine how much cover he needs and then buy a term plan for the same while investment of the balance amount can be made in other asset classes providing better returns than the policies with a mix of investment and insurance. A detailed explanation about misunderstanding regarding insurance has been mentioned in our articles 'Investing Mistakes' and 'Inaccurate Notions about Insurance' under our 'Articles' section. Do not forget to read it.