Knowledge Sharing Series

FAQ - Term Life Insurance

Subramanian Venkataraman
Investment Advisor - SEBI Registered (RIA)

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Term Life Insurance

Frequently Asked Questions (FAQ)

By Subramanian Venkataraman
Investment Advisor - SEBI Registered (RIA)

(Contact Details at the End of the Document)

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Section I: Basics of Term Insurance

Who should take a term life insurance policy?

A term life insurance policy should be taken by all those who have dependents and / or have financial goals for which a sufficient fund has not yet been created.

When should a term life insurance policy be taken?

A term life insurance should be taken as soon as a person starts earning.

What is a proposal?

The application form filled up and given to the insurance company is the proposal.

What is meant by the principle of "utmost good faith"?

An insurance is a contract between the insured (i.e. the policy holder) and the insurer (i.e. the insurance company that issues the policy). This contract is based on the principle of "utmost good faith" or "highest standards of good faith" (***uberrimae fidei*** in latin).

In the subject matter of insurance there is information asymmetry. This means the insured knows more about himself / herself than the insurer. The insurer trusts the information provided by the insured in the proposal form and issues the policy based on such information. Thus the insurance is offered in "utmost good faith" assuming all material facts have been stated by the insured truly and completely.

If, at a later date, it was found that there was a misstatement or concealment relating to any material fact, the policy will become "*void ab initio"* or invalid from the beginning and no claims are payable and premiums paid are not refundable.

Why a term life insurance is needed for a young person?

- The premium cost is locked at a lower level for the entire tenure if the policy is taken by a young person;
- As a person gets older, the premium increases;
- As a person gets older, there is a possibility of developing health related complications which would make the premium further expensive;
- At a later date if any serious medical condition develops, term insurance may not be offered at all;
- Accidental death may happen even at a young age;

What is the nature of a term life insurance?

Term life insurance is an ”income replacement” plan. This means, due to untimely death, if the income ceases, the claim received from the term life insurance policy will help in creating a corpus, and, the income from such corpus will replace the income that would have been earned by the deceased person if he / she was alive. The claim received can also be used to fulfil any financial goals and needs.

Is there a maturity value for term life insurance?

No. Term life insurance is a pure insurance and protection plan. The premium is a “cost” and not an “investment”. It is a cost to get peace of mind! Unless death occurs during the tenure of the policy, no payment is made to the insured, subject to other riders (explained under the section “Riders”).

Is a key man insurance a replacement for term life insurance?

No. companies take a key man insurance for their senior employees. This is to cover the losses that the company may suffer in case such an employee passes away. The beneficiary for such a policy is the company and not the employee’s family.

Which terms in a term insurance policy can be changed later?

The following terms cannot be changed:

- Cover value
- Tenure
- Premium payment frequency

The following terms can be changed:

- Nomination
- KYC related issues like address, mobile number etc.,

As you can see none of the major terms and conditions of a term life policy can be changed once the policy is issued.

What is “free look-in” period

Once a policy is issued, the policy holder has the right to cancel the policy within 15 days of receipt of policy (or within a higher number of days if offered by the insurance company), without ascribing any reasons. The first premium paid will be refunded in full subject to deductions for processing fee and cost of pre-medical examination. This facility is provided under law as an easy exit option, in case any of the terms and conditions in the policy is not acceptable to the policy holder or it is not as per the information given to the policy holder prior to making the first premium payment.

How smoking and alcohol habits affect term life insurance?

Both the above increases health risks and therefore increases the premium. Understand clearly the disclosure needs and ensure all disclosures in this regard are made correctly and fully.

Is death by terrorist attack covered?

Yes. However, carefully read the terms and conditions of your policy.

Can I buy a term plan for my spouse and children?

Yes, if they have their own income. Term life insurance is not usually offered to anyone without an income. As you may recall, this is an income replacement product.

Can the term life plans be switched to another company?

No. If you wish to switch, stop paying the premium under your current policy and take a new policy with another company. But the premium payable for the new policy will be determined by the age and health conditions at the time of taking the new policy.

Which type of death is not covered?

Other than suicide in the first year of insurance (depending upon the terms in the policy), death due to any reason is covered.

Is there a possibility that a death claim will be paid only partially?

No. Term life insurance is an “assurance” policy and not an “indemnity” policy. Assuming all documentation is done correctly and there were no misstatements of concealment of material facts in the proposal, the claim will be paid in full. Otherwise, the claim will be fully rejected. There is no possibility of partial claim settlement.

What is the difference between “assurance” and “indemnity”?

In an assurance policy, the policy amount will be paid on the happening of the insured event. Life insurance is the only policy that is based on the assurance principle.

In an indemnity policy, on the happening of the insured event, the costs incurred in rectifying the damage caused is reimbursed (the policy holder is “indemnified”) subject to the value limit of the policy. Health insurance and motor vehicle insurance are examples of indemnity policy.

Why term life insurance is not actively recommended and sold?

The reason is very simple. Term life insurance plans offer low commissions and incentives. Even for the insurance companies, their profits are not in insurance but in investment. Hence they offer insurance-cum-investment plans (explained in the next section).

Section II: Combination of Insurance and Investment

Why some life insurance policies have a maturity value?

Any life insurance policy that has a maturity value, is a combination of insurance and investment. Such policies are not recommended as they offer very low level life insurance and the return on investment (ROI) on those policies is quite low. A combination of insurance and investment is always a bad idea.

How can I identify a combination life insurance product?

Any product that offers life insurance and a maturity value is a combination product. Some of the typical names given to such products are:

- endowment
- whole life
- money-back
- ULIP
- return of premium

What is the life insurance value offered under such products?

As per law, the minimum life cover should be ten times the annual premium. Almost all plans offer only this minimum value, which is highly inadequate as a life cover.

Why such plans have no / low surrender value in the early years?

Usually in the first 2 or 3 years the surrender value is zero. Thereafter, the surrender value is quite low. The reason for this is, in the early years, especially in the first year, a major portion of the premium is paid as commission / incentive to the agent / broker / advisor. Various other charges are also deducted from the premium.

Should I buy such combination products?

Combination of insurance and investment is a bad idea. In such products the insurance cover is low, the returns on the investment component is sub-optimal and the premiums are high. At times, after paying the premium, not much is left to invest. Therefore, it is better to completely avoid such products.

What returns are offered by such plans?

It will be difficult to state how much return these plans offer but they are quite low and, at times, not even comparable to the pre-tax interest on bank deposits. Of course, the returns under such plans are tax-free. Usually these plans never clearly indicate the rate of return but only give an indication of return with a lower and a higher rate assumption.

Do they offer a guaranteed return?

Most plans do offer a guaranteed return but such returns, at the best , may be equal to or even lower than the premium paid.

Why are such plans offered then?

To a great extent, the general public's approach should be blamed. Somehow, most look for a return from life insurance policies, without understanding the difference between insurance and investment.

Which company offer such plans?

LIC as well as private insurance companies offer these plans. As a matter of fact, almost all plans of LIC, other than term insurance plan, fall under the category of combination product.

Section III: Tenure of Term Insurance

What should be the tenure of term life insurance?

Term life insurance is an income replacement product. It should be taken until such time a person is earning an income. Therefore, the term life insurance should be taken until the age of retirement, say 60 or 65 and not longer.

What about term life insurance offered until age 99 or 100?

In such policies the premiums are significantly higher than the term life insurance offered until the age of 60 or 65. When a policy issued for such a long term, the chances of a death claim is almost certain. Therefore the risk to the insurance company is high, which is mitigated by charging a higher premium.

Moreover, such long term / whole-life policies beyond "actively earning" age goes against the basic principle of term life insurance being an "income replacement" product.

Can I leave a legacy to my children with a whole-life policy?

You can but it is a bad idea. We have already seen that premium cost in long-term / whole-life policies are higher. Therefore, if a person takes term life insurance only until retirement (at a lower premium) and, invests the premium so saved (by not taking long-term / whole-life policy), the corpus so created will be much higher than the claim payable under the term life policy. Moreover, such corpus created belongs to the family irrespective of whether or when the death takes place.

Section IV: Premium

When does the premium go up in long-term / whole life policy?

The premium is higher from the first year premium itself. In a term life policy the basic premium does not change during the entire tenure. Only the applicable taxes on premium (eg. GST) may change from time to time.

What is “return of premium” term life insurance?

At the end of the policy tenure, all premium paid is returned to the policy holder, without any interest.

Wow! That means I got the policy literally free! Isn’t it?

Not really! For the same insurance value and tenure, the premium cost in return of premium policy is higher compared to the policy without return of premium. Therefore, if a person had taken the policy without the return of premium (at a lower cost) and had invested diligently the money so saved (by not opting for a return of premium feature), the corpus created at the end of the policy tenure will be significantly higher than the total premium returned at the end of tenure. Moreover, such corpus created belongs to the family irrespective of whether or when the death takes place and is available at any time without waiting for the maturity date.

Is return of premium policy a combination product?

Well, not in the strict sense of the term. It is just a marketing gimmick as many policy holders does not like a life insurance policy that does not pay anything in the end.

What are the premium payment frequencies available?

Premium can be paid annually, half-yearly, quarterly or monthly.

Which frequency one should opt for?

Ideally annual.

Why annual frequency is considered the best?

The total annual premium amount in other frequencies will be higher than the annual frequency. Moreover, it is easier to ensure timely payment of premium once a year rather than monitoring timely payments twice, four times or even twelve times a year in other frequencies.

Is there a grace period within which premium can be paid?

Usually a grace period of 15 to 30 days may be available. Check your policy document.

Can the premium be paid with credit card?

Yes. However, be aware of any charges, if any, that may be levied by the insurance company for credit card payments.

What is the best payment method?

Usually the first premium is required to be paid by cheque. For renewal premiums, setting up an auto debit in your bank account is the most convenient way for paying the premium.

While setting up the auto debit, check with the bank on how they will handle the payment if the premium amount changes due to changes in taxes. The basic premium will never change.

Set up the auto debit date as few days before due date. Immediately after the scheduled payment date ensure that the payment was in fact made by the bank. In case of any clerical or error/s if the premium is not paid on time, you risk lapse of the policy for no fault of yours.

Why premium for LIC's term life insurance plans are costlier?

No clear answer to this question. One reason could be that the trust factor for LIC is more due to its "government" stature. Moreover, they are also in the business for a much longer period as compared to other private players and hence have a higher brand equity. This does not mean that one should go only for LIC. Assess your needs and see which company offers a plan that is most suitable for your needs at a competitive premium cost.

What is revival of policy?

If the premium is not paid within due date or within the grace period, the policy lapses. This means the policy is no longer in operation and no claims are payable.

The insurance company may, at its discretion, revive the policy by charging a penalty / interest along with premiums overdue and make the policy active.

There could be a possibility of another medical test before the policy is revived. These will be governed by the terms and conditions of the policy and for how long there premiums were overdue.

Why, after medical examination, the premium went up for my new policy?

The medical test would have revealed any high risk factors in your health.

What are my options if premium goes up after medical test?

The following are the options:

- accept the higher premium
- reduce the life cover or tenure or both and pay a lower premium
- decide not to take the policy and get the premium refunded (not recommended though as you will be left with n cover)

Section V: Insurance Coverage Value

What should be the value of term life insurance?

Term life insurance should be taken for the human life value.

How is human life value calculated?

There are two methods of calculating human life value. In the first method, it is calculated as the total of future income the individual will earn during his or her earning life after adjusting for inflation and the returns that would have been earned on such income. In the second method it is calculated as the monies needed to meet the financial needs and goals and from such value the existing assets and life insurances are deducted.

It is also quite normal to use a rule of thumb to arrive at the insurance value. For a person below 30 years' age, it is 20 times the annual income, and, for others, 10 times the annual income.

Can I take multiple policies?

Yes. You can take multiple term life policies, either with the same insurance company or with different insurance companies.

What are the advantages of taking multiple term life policies?

- Each policy can be earmarked as a protection for a specific financial goal. For example, <u>if one is confident of building the corpus needed for higher education of children in 15 years, with savings and investments</u>, they can take a term life policy of the required value for 15 years only. Being a shorter term policy, the premium cost will be lower.
- At a young age, the income is lower and therefore, the term life cover offered will be lower. When the income keeps increasing, further term life policies can be taken. Of course, such additional policies will come at a higher premium cost with increasing age.

What are the disadvantages of taking multiple term life policies?

- If taken from multiple insurance companies, multiple medical examinations will be involved.
- One should carefully monitor multiple premium payments every year to ensure that the policy does not get cancelled due to non-payment of premium.

Section VI: Nomination

Can a nominee be appointed in a term insurance policy?

Yes, a nominee can be appointed and should be appointed. Many insurance companies make nomination mandatory at the time of applying for the policy.

Who can be appointed as a nominee?

Any person can be appointed as a nominee including a friend or a stranger. However, many insurance companies mandate that the nominee should be related to the insured. This is to avoid controversies in the event of a claim. So a nominee could be the spouse, children, parents etc. In case a distant relative is nominated, the insurance company may ask for evidence of whether that nominee has an insurable interest in the life of the insured. The insurance company may also reject such nomination. Such rejection will take place at the time of nomination itself and the insured will have to nominate another person who is a close relative.

Can a minor be appointed as a nominee?

Yes. However, an appointee should also be named in case the nominee is a minor.

Once appointed, can the nominee be changed?

The nominee can be changed at any time.

What mistakes are usually made on the subject of nomination?

The usual mistakes are:

- not keeping the nominee informed
- not giving the correct contact details of the nominee
- not naming an appointed person in case the nominee is a minor

What right a nominee has?

A nominee has the right to receive the claim but has no ownership over the money. However, if the legal heir is not the nominee, then the nominee acts as a trustee. The monies ultimately will belong to the legal heirs. Of course, if the nominee is also the legal heir, there will be no complications.

What is the role of insurance company if there is a dispute?

As long as the insurance company has paid the claim to the nominee and if all documentary requirement were met in full, the insurance company has no liability in case of ay dispute between the nominee and the legal heir.

Can multiple nominees be appointed?

Yes, by mentioning a specific percentage to be paid to each nominee with the total being 100%.

Who is a beneficial nominee?

The parents, spouse and children of the policy holder are called beneficial nominees.

What is the advantage of being a beneficial nominee?

A beneficial nominee has the ownership of claim amount and any other legal heir will have no right over the same.

What is successive / alternative nomination?

Multiple names can be declared as nominees in a specific order. So if A is the first nominee and if A is not alive at the time of claim, the claim will be paid to B, and if B is not alive, then to C etc. All the names should be declared upfront.

Where can I see the nomination details?

Nomination details are mentioned in the policy document. A nomination is not valid if is not mentioned in the policy document. If, by mistake, if the nomination details are not mentioned in the policy, get the policy document corrected immediately.

Section VII: Residency Status / NRIs

Can NRIs take term insurance plans in India?

Yes, they can. They may have to complete certain additional documentation as per the requirement of the insurance company.

Is a NRI required to be in India while buying the policy?

It is not necessary. However, if a pre-medical examination is involved, then the NRI may have to be present in India. However, some insurance companies may even provide the facility of getting the medical examination done in the country of residence of the NRI.

Are the claims received on an NRI policy repatriable?

It is repatriable if the premium payments were made in foreign currency.

What if there is change in status from resident to NRI?

If there is a change in status after taking the policy, immediately inform the insurance company of the change in status and get the necessary documentation like KYC done afresh.

Section VIII: Claims

When an insurer cannot reject a death claim?

As per Section 45 of the Insurance Act, 1938 if the death takes place two years after the policy is issued or two years after the policy is revived, the claim cannot be rejected on grounds of mis-statements or wrong disclosures unless the insurance company is able to prove that the claim was fraudulent.

If the policy document is lost, can the claim be rejected?

No. The loss of the policy document, by itself, cannot be a ground for claim rejection. Having said that, keep the policy document carefully and ensure that the nominee / family members know where the policy document is. If the policy document is lost, the insured should get a duplicate issued as soon as possible, as a matter of abundant caution.

Section IX: Insurance Companies

Are private insurers as safe as LIC?

All insurance companies are governed by Insurance Regulatory and Development Authority of India (IRDA), which is established under an act of parliament. Therefore, there are no additional risks involved in taking a policy from a private insurer. Having said that restrict your choices to the top few companies and do not go for smaller companies just because the premium is a little cheaper.

Section X: Riders

What are riders?

Riders are additional benefits given under a policy on payment of additional premium.

What are the typical riders?

The most common riders are:

- Accidental death rider
- Disability rider
- Critical illness rider
- Waiver of premium rider

What is accidental death rider?

On additional premium payment, an additional amount is payable in case the death occurs due to accident.

Should one opt for accidental death rider?

It depends. It is a nice to have. By paying a smaller additional premium, the death benefit could even be doubled. But accidental death insurance should not be considered as part of the family's financial protection. The corpus needed for family for meeting various financial goals should be covered under the basic term life insurance itself. Otherwise, if death occurs but not due to accident, the family will fall short on the corpus.

What is disability rider?

If, due to accident, there is a temporary or permanent disability, a monthly income is paid by the insurance company for a specific number of years. In some plans a lump sum payment may also be offered. The death benefit will continue and no further premiums are required to be paid under the policy.

Should one opt for disability rider?

Yes. Highly recommended.

What is critical illness rider?

If the policyholder is diagnosed with any of the specific critical illnesses (as included in the policy document), then a lump sum is payable. This can be used for treatment as well as for replacing the lost income. This is not a health insurance. This claim is payable irrespective of the cost of treatment. Therefore, this is not a reimbursement of expenses but a lump sum payment to tide over difficult times. The future premiums under the policy is waived.

Should one opt for critical illness rider?

Yes. Highly recommended, especially when there is a family history of critical illnesses.

What is waiver of premium rider?

Under specific circumstances like disability or critical illness all the premiums payable under the policy in future is waived under this rider.

Contact Information

Subramanian Venkataraman

advisor@finzen.com

+91 96 2020 7659

www.finzen.xyz