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TERM INSURANCE 101

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Introduction

We cannot predict the future, but we can choose to be hopeful. We cannot be there forever, but we can choose to leave a good life for the ones who will be there. Our family is all we have. They should be able to dream big, fulfil their goals, and live comfortably even in our absence. They should have something to fall back upon and be financially strong even when living costs get higher and make life difficult.

We cannot predict the future, yes, but we can invest in a better one. We can invest in Term Insurance.

Although no amount of money can replace the absence of a dear one, a Term Insurance policy aims to financially secure your family when you are not around.

CHAPTER 1

What is Term Insurance?

Term Insurance is a life insurance policy that provides coverage for a defined period in exchange for a specified premium. It is a straightforward product and one of the simplest ways to secure your family's future.

2 terms to understand before we proceed -

- A ***premium*** is the amount of money you pay to the insurer for covering your risk. This is paid on an annual, quarterly, half-quarterly, or monthly basis depending on your preference.
- A ***policy term*** is the period of time or duration for which you are covered under the term insurance policy - given that you duly pay the premiums.

WHAT HAPPENS IF YOU DON'T SURVIVE THE POLICY TERM?

In case you, unfortunately, pass away during the policy term, the insurer provides your nominee (spouse, child, etc. whomever you appoint) a guaranteed payout, as chosen by you at the time of policy purchase. This is known as the Death Benefit.

It compensates your family for the loss of your income, so they can continue living a comfortable life. Your family will receive this money as per the claim payout option you chose while purchasing the policy.

WHAT HAPPENS IF YOU SURVIVE THE POLICY TERM?

Term insurance is a pure risk insurance cover. If you survive the entire policy tenure, it won't pay any benefits to you. And this is what keeps the premiums really reasonable.

However, the situation will be different if you have a Term Return of Premium (TROP) plan. As the name suggests, TROP is a type of term insurance plan that comes with an additional benefit - you get back the premiums you paid (excluding the taxes) - if you outlive the policy term. Therefore, this plan offers a Maturity Benefit along with the stated Death Benefit.

Note: TROP option can be added only at the time of policy purchase and not at a later stage.

Let's understand how a term plan works - with the help of an example.

Leisha, 35, buys a term insurance policy with a sum assured of Rs 50 Lakhs. She buys the policy for a duration of 20 years and opts for a premium payment duration of 10 years. Hence, she is supposed to complete all her premium payments in the next 10 years. Leisha also chooses the monthly claim payout option and appoints her spouse as the nominee.

Therefore -

Sum Assured	**Rs. 50 Lakhs**
Policy Duration	**20 Years**
Premium Payment Term	**10 Years**
Claim Payout Option	**Monthly Payouts**

Let's see how Leisha's term plan will work -

Situation #1: Leisha does not survive the policy term

Let's say Leisha has completed all her premium payments under the policy. And in the 14th policy year, she passes away due to an accident.

The insurer will pay a claim amount of Rs 50 Lakhs to Leisha's nominee, i.e., her spouse. And since Leisha had opted for the monthly payout option, they will receive the claim amount in fixed monthly instalments for a certain period of time.

Situation #2: Leisha survives the policy term

If Leisha survives the entire policy term of 20 years, her policy will terminate and she won't receive any claim amount. However, if she had chosen the TROP option, she would've received all the premiums she had paid (excluding taxes) as a maturity benefit from the insurer.

CHAPTER 2

Who Should Buy Term Insurance?

When you set out to invest in a term insurance plan, you need to look into the various benefits it offers and whether it will really help you out. You shouldn't buy a plan just because your friends are doing it or your parents have advised you to. Carefully look at your needs, financial goals, and family requirements - before you make the decision.

Think About Buying Term Insurance Plan If...

01 You Have Financial Dependents

The family members who rely on your income for their financial well-being such as your spouse, parents, younger siblings, children (present or planned), etc. are considered financial dependents.

For example, say you are married and have two children, aged 5 and 8. Your spouse is a homemaker and doesn't earn. You are the only earning member in your family. Here, your spouse and children are your financial dependents.

Their lifestyle and life goals are dependent on your earnings, so you need to protect them with an appropriate insurance plan that provides adequate coverage in case of your sudden demise.

Term insurance policies can provide your loved ones with financial security and ensure they won't have to compromise their standard of living - in your absence.

02 You Have Financial Responsibilities

There are certain responsibilities and obligations that every earning member of the family has towards their spouse, parents, siblings, and children. These may include your child's education, younger sibling's wedding, etc.

And, fulfilling your family's dreams and aspirations is your utmost priority. But, meeting these obligations may prove to be difficult if something unfortunate happens to you.

A term insurance policy will provide your loved ones with a fixed amount of money if you were to pass away during the policy. This way, you can help them achieve their dreams and goals without hindering their current lifestyle.

03 You Are Yet To Build Enough Wealth

Creating sufficient wealth in life will ensure that your family is financially secure, even in your absence.

But that's not always possible, right? Different people have different financial capabilities. So, if you are still in the process of building sufficient wealth that will meet your family's financial needs, term insurance is a wise choice so your family will always have a financial cushion.

04 You Have Debts Or Liabilities

If you have taken a large home loan, a business loan, etc. and you suddenly pass away before repaying the loan, your family will have to bear the responsibility for the same. In such a case, term insurance will help cover all the outstanding loans - thereby preventing your family from experiencing financial hardship.

Let's look at some examples to understand who should buy term insurance and who shouldn't -

Case 1:

Raj, a 29-year-old, has a younger brother and retired parents, who are financially dependent on him.

Case 2:

Alisha is a 35-year-old single woman with no financial dependents. She doesn't have any loans or liabilities either.

Case 3:

Amol is a 32-year-old married man, who has a 4-year-old son. He doesn't have any loans or liabilities. His spouse and son are financially dependent on him.

So, who needs term insurance?

Raj	Alisha	Amol
Raj’s brother and parents will need financial support since he is the only earning member. Therefore, Raj will need term insurance.	Alisha is not married and does not have any financial dependents. So, she doesn't need a term insurance policy at the moment.	Both his spouse and child are financially dependent on him. So, he will need to purchase term insurance.

CHAPTER 3

Why Should You Buy Term Insurance?

It is nearly impossible to predict when an unfortunate event will occur and leave your loved ones stranded. But, you can rest assured that your family will remain financially protected, even in your absence - if you have term insurance.

Here Are 5 Reasons For Investing In A Term Insurance Plan!

01 To Get High Coverage At A Low Cost

Term insurance allows you to choose sufficient coverage at a relatively low cost. You can invest in sufficient cover for your family without hurting your savings.

02 To Ensure Financial Stability

The primary reason for opting for term insurance is to secure your family's financial future. If you are the sole breadwinner of your family, your sudden demise will not only be an emotional loss, but it will also leave them in financial turmoil.

Keeping up with even household expenses and basic necessities might turn out to be extremely challenging.

03 To Fulfil Your Financial Dependents' Goals

Financial dependents depend on your earnings for their financial goals and needs. Their goals and aspirations will be hampered if you pass away before fulfilling them.

The sudden loss of income will also be detrimental to maintaining their lifestyle.

With a term insurance plan, you have an effective solution that will take care of your financial dependents' needs. Right from regular expenses like groceries, bills, school fees to long-term goals like higher education, weddings, buying a vehicle - a term insurance plan will take care of it all.

04 To Get Additional Benefits

Most term insurance plans offer add-ons known as riders, which can be added to your base plan at an additional yet reasonable cost. They enhance your coverage by offering additional benefits - other than the death cover.

You can choose from a wide range of rider options, like -

- Critical Illness Rider
- Accidental Death Benefit Rider
- Accidental Disability Rider
- Waiver of Premium Rider
- Surgical Care Rider
- Hospital Care Rider

This is an indicative list of riders. They can vary across insurers.

For instance, Raju buys a term insurance plan and adds a critical illness rider to it. If he contracts a critical illness (like cancer, heart diseases, etc.) listed in his policy document, he will receive the payout applicable under the rider. He can use these funds for additional expenses that will have to be incurred as a result of the disease, like to replace lost income if he needs to quit work, etc.

05 To Pay Off Any Loans

If you have taken a loan of any kind - be it a personal loan, home loan, automobile loan, or education loan - and in the unfortunate circumstance that you pass away before repaying it, your family will have to shoulder its burden. But, if you invest in a term insurance plan, your family can use the cover amount to repay the loan comfortably.

CHAPTER 4

When Should You Buy Term Insurance?

"I'm just in my 20s...I definitely don't need to buy term insurance right now..."
"Umm, I'm in my 50s...is it too late to buy a plan?"

Your dilemmas are entirely valid. To financially protect your loved ones in your absence, buying a Term Insurance Plan is a necessity, yes. But when is the best time to invest in it?

Before deciding when you should buy a term insurance plan, you should look at the purpose again. The main objective of a term plan is to secure the financial future of the people who depend on your income for their living expenses.

So you should ask yourself if you have financial dependents or any possibility of financial dependents in the future. Or do you have any loans?

If your answer is yes, you need to invest in a term insurance plan as soon as you can. If your answer is no, there is no urgent need to invest in a plan.

Let's take two examples and see when exactly you need a Term Plan, and when you don't.

Situation 1

Omkar is the sole breadwinner of the family, and both his spouse and child depend on his earnings for their short-term and long-term expenses. Therefore, he **must purchase a term insurance policy** as soon as possible - to keep his family financially secure.

Situation 2

Manali is a single woman, who works as an IT professional. Her parents are retired and earn a good pension. They aren't dependent on her income. So, at this moment, Manali doesn't have any financial dependents or major responsibilities. Therefore, she **doesn't need to purchase a term insurance policy** right now.

So, if you have financial dependents or any debts, you should not delay buying a term insurance plan.

How Does Buying Early Help You Save More?

The insurer will decide your premium on the basis of the age at which you buy the policy. This premium remains the same throughout the policy tenure. The thumb rule is you should buy the policy as early as possible, so you can get a lower premium rate.

And, did you know that your term insurance premium increases each time you cross your birthday? It can easily be inferred that the premium you will pay today is the lowest you'll ever get!

There are many advantages to buying term insurance when you're young since you'll most probably be at the top of your health - resulting in the best prices. As you grow older, you can contract lifestyle health conditions like diabetes, hypertension, etc. that will either increase your premiums or make you ineligible for term insurance.

So if you plan to buy it early (like in your 20s), you'll need to pay less for the same coverage as compared to someone who opts for it later in life (like in their 40s). Hence, you can stay protected at a low cost.

🚨 Keep This In Mind! 🚨

Although it is advisable to buy a term policy at an early age, the purpose of buying the policy matters much more. Before you invest in a term plan, you will need to think about every short-term and long-term financial goal of your family. This will help you understand the coverage you need and the customisation options you should pick. If you buy a policy too early, when you actually don't need it, your decision might not be very helpful to you or your financial dependents.

CHAPTER 5

How Much Term Insurance Coverage Do You Need?

The most important thing to be kept in mind when buying insurance is that - you are not buying it for today, but investing in it for tomorrow. You buy a term plan to protect your financial dependents, or to pay off loans/liabilities - in the future, when you may not be around.

India's retail inflation has spiked to 7.41% in 2022. Food and fuel prices are increasing by the day, making life an expensive affair. The term plan cover you buy today should not be dependent on the present scenario but on the future value of the goals that you have decided for your family.

A sufficient cover keeps them financially secure against all the uncertainties life has to offer.

If you are the sole breadwinner of your family, in your absence, your dependents might face financial instability. This is caused by the gap between the amount you leave behind and the amount your family actually needs.

01 How to calculate the amount you owe?

By factoring in the following aspects -

Living Expenses Fund

This fund will act as an income replacement for your family, and provide for their daily needs. For example - short-term expenses, like daily needs, groceries, monthly bills, school fees, etc.

Divide this total by the expected rate of interest (assume that it is 3%).

Major Expenses Fund

Large one-time expenses your family will incur in the long run. For example - children's higher education, their wedding, etc.

Major Liabilities Fund

Any loans or liabilities you've taken that your family will have to pay off in case you pass away. For example - home, business, education loans.

02 How to calculate the amount you own?

Factor in the existing funds you hold. This will include - the money you have, cash at the bank, and financial products you've invested in, like mutual funds, fixed deposits, etc.

However, these funds will not be readily available to be used, so you will have to multiply them by their respective risk factors - such as interest rates, etc. that keep fluctuating and changing the price of the financial instrument - and factor in their utility as well.

Here's how this work -

- **Existing life insurance plans** @ 100%
- **Savings, cash, fixed deposits** @ 100%
- **Equity investments** @ 50% (Because of market fluctuations)
- **Gold and residential property** @ 0% (If you look at the utility of these assets, you wouldn't want these assets to be liquidated for grocery purchases or paying off loans/liabilities - so take them at zero value)
- **Stock options** @ 0% (These are high-risk investments - so take them at zero value.)

Also, it's very important to factor in **inflation** and multiply the cover amount by 2.5 to 3X while calculating. This will ensure that the cover you buy today is sufficient for tomorrow.

Therefore, the cover you need to buy =

Amount you owe - Amount you own

=

(Living Expenses Fund + Major Expenses Fund + Major Liabilities Fund) - (Existing funds)

This is the most meticulous and scientific way to calculate the exact coverage your family needs. Random thumb rules, like - '20x your yearly income' - that are generally recommended for calculating cover do not factor in your specificities.

Let's understand this better - with the help of an example.

Viraj, 35-years-old, earns Rs. 9 lakhs yearly. This is how his finances look at this point.

1. Living Expenses	Rs. 50,000 per month (excluding EMIs on loan)
2. Major Expenses - child's higher education	Rs. 35 lakhs
3. Major Liabilities	No liabilities
4. Existing Funds	Savings: Rs. 8 Lakhs Fixed Deposit: 15 Lakhs Mutual Fund: 10 Lakhs

Let's break them down to -

Money Viraj owes -

1. Living Expenses	Rs. (50,000 **x** 12) / 3% *(3% is the current rate of interest)* = Rs 2 crores
2. Major Expenses	Rs. 35 lakhs
3. Major Liabilities	No liabilities
Total Liabilities	**Rs. 2.35 crores**

Money Viraj owns -

1. Savings @100%	Rs. 8 Lakhs **x** 100% = Rs. 8 Lakhs
2. Fixed Deposit @100%	Rs. 15 Lakhs **x** 100% = Rs. 15 Lakhs
3. Mutual Funds @50%	Rs. 10 Lakhs **x** 50% = Rs. 5 Lakhs
Total Existing Fund	**Rs. 28 Lakhs**

So the Term Plan cover Viraj would need will be the difference between his total liabilities and total existing fund.

Total Liabilities - Total Existing Fund
= Rs. (2.35 crores - 28 lakhs)
= Rs. 2.07 crores

If Viraj went by the thumb-rule of buying a cover 20X his annual salary, he'd only take a cover of (20 **x** 9) lakhs = 1.8 crores. This would leave his family with inadequate coverage.

Note: *To simplify the example, the rate of* ***inflation*** *wasn't considered. In real life, if you want to factor in inflation for the entire term, you should multiply your cover amount by 2.5 to 3X. This will give you the inflation-proof cover you'd need.*

Otherwise, it's strongly recommended to opt for the ***increasing cover option*** *available with all leading term insurance plans. This helps your cover increase systematically over a period of time - beating inflation.*

Summing Up!

We cannot put a value on our life. After all, it is priceless. But we can make sure our loved ones lead a good life when we aren't there to take care of them anymore.

As life gets faster and uncertainties increase by the day, your family might need a term insurance plan to help them cope financially with the loss of a loved one. Term plans provide great coverage at affordable premiums, and they can be personalised to your convenience.

We hope you assess your needs, do your research, and choose a policy that lets you be there for your family, even when you are not.