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Get The Right Cover

Customers should look at these parameters before buying a policy

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Akshay Dhand - 08 February 2021

A life insurance product is by far the most comprehensive investment option for the customers offering the best of all the worlds - right from protection, investment, and liquidity to tax benefit. However, like with any other financial instrument, it is important to realise that different kinds of life insurance policies are meant to serve different purposes, and hence what may be appropriate for an individual may not be for another. Even after one has figured out which instrument is suited to their needs, it is essential to consider several parameters so that the policy which is eventually bought will serve the desired purpose.

First and foremost, it is important to identify the objective for which the instrument is being bought as the appropriateness of the parameters to consider will flow from there. For instance, if an individual is buying a pure term plan to provide financial protection to his or her family, then the choice of, say the policy term, will typically be the remaining period of their respective working lives. This is because a pure protection plan is meant to replace the income of an individual for his or her family in case of his or her unfortunate demise. Hence it is essential to ensure that the coverage period, which is effectively what the policy term is, should at least the period till the time the individual plans to actively work.

Once the objective for which the instrument is being bought has been decided, the other parameters to consider would be aspects such as policy term, premium paying term, amount of premium to be paid, frequency of premium to be paid, amount of coverage to be taken, nature of coverage to be taken, etc. Let us understand some of these in a bit more detail now.

Policy Term – As mentioned earlier, in the case of a pure protection plan, policy term should typically coincide with the expected remaining working life of the individual whereas, in the case of a more savings oriented plan, the policy term should coincide with the period at which the event for which the saving is being made is expected to occur.

Premium Payment Term – This is the period of the policy for which the customer is willing to pay the premium. Given a certain sum assured or coverage amount, the lower the premium payment term, the more will be the premium and vice versa. Hence affordability will be one of the key aspects of deciding this factor. On the other hand, especially in the case of a savings product, if one intends to pay the same premium faster i.e. through a shorter premium payment term, the customer return will be superior. Working life will also play an important deciding factor in deciding this parameter, again from the affordability perspective.

Premium or Sum Assured Amount – This parameter will critically depend upon the purpose for which the policy is being purchased. For instance, the coverage amount in case of a pure term plan should be such that the same can be used to replace the income of the breadwinner in case of loss of the same due to his or her unfortunate demise. In the case of savings products, the sum assured should be linked to an estimate of the amount that will be needed for the future event for which the savings is being made such as child's education, child marriage, house purchase, etc. Affordability will be another key aspect in deciding the amount of premium or sum assured to be chosen.

Frequency of premium to be paid – This can be monthly, quarterly, half-yearly or annual. While one would choose this basis of affordability, it is important to understand that for the same sum assured, a monthly premium will work out to be the most expensive whereas an annual premium will be the least expensive in the case of traditional products. In the case of ULIPs, while the frequency of premium will not change the premium itself but, ceteris paribus, the returns to the customers will be most superior in case of annual and least in case of monthly. This is because one is effectively investing the same amount of money earlier on in the case of the former as opposed to the latter.

Overall, it is important for customers to critically look at the above factors so that the policy that is eventually purchased is most suited to their requirements and holds the best chance of fulfilling their needs. It is also the responsibility of insurers to turn the attention of customers on these factors as part of the sale and on-boarding process so that they are better informed to make choices that are in line with their needs.

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