IndiaFirst
LIFE INSURANCE

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Should you invest in guaranteed income plans?

Guaranteed returns may work well for you in the short term, but in the long run it could leave you poorer

By Deepti Bhaskaran
deepti.bh@livemint.com

Would you be interested in an investment plan that bundles an insurance cover and guaranteed payouts. Investors seem to prefer guaranteed return financial products and life insurance companies are trying to make the most of this investor mindset.

"Guarantee is a very powerful word in any sales pitch. Insurers also use guarantees as a sales pitch, but it's important to see the kind of guarantees being given," says Kapil Mehta, principal officer and managing director, SecureNow Insurance Brokers Pvt. Ltd.

Some of the recent insurance plans are tailor-made to give you a guaranteed periodic income for a certain number of years, along with a basic minimum insurance cover. But before you settle for such insurance policies it's important to know the return on investment, something these insurance policies don't declare upfront. You need to understand that if it is an investment you are seeking, you need to consider what the return on this investment is, and not get caught in the web of a smart sales pitch.

We reviewed three guaranteed-income insurance plans recently and conclude that these plans are bound to entice at first glance, but fall short when the return on investment metric is calculated. To help you see through the lure of guarantees, here is a decoder on guaranteed income insurance plans. You decide if you still want to buy.

What are guaranteed income insurance plans?

These are non-participating traditional insurance plans. As traditional policies go, these plans do not disclose costs or investments. But since the investment benefits in these plans are not linked to the performance of the underlying fund, in insurance parlance this is referred to as non-participating, they are required to guarantee investment benefits upfront. A guaranteed insurance plan is attractive not only for the buyer but also for the seller. "A non-participating insurance policy is generally more capital-efficient because insurers can retain the entire profit from the portfolio. By guaranteeing small benefits upfront the insurer is able to reduce capital strain," says Mehta.

The way these policies work is like this. Depending upon your age and the sum assured or insurance cover chosen, you pay an annual premium for a certain number of years. This is also called the premium payment tenor (PPT). After PPT is over, the policy starts giving a regular guaranteed payout for a certain number of years. This can also be called the payout tenor. At the end of the term the policy would usually give the sum assured or a percentage of that sum assured and the policy would terminate.

The premium payment term and the payout term together make the policy term. The insurance cover in this policy is valid throughout the policy term.

HOW MUCH DO GUARANTEED INCOME INSURANCE PLANS RETURN?

Following is a comparison of investment returns of three such plans. The examples are for a minimum death or insurance benefit of ₹10 lakh for a 35-year-old.

	BHARTI AXA LIFE INSURANCE	FUTURE GENERALI INDIA LIFE INSURANCE	ING VYSYA LIFE INSURANCE
Name of the plan	Bharti AXA Life Secure Income Plan	Future Generali Pearls Guarantee	ING Guaranteed Income Insurance Plan
Annual premium	₹76,923	₹68,190	₹95,457
Premium payment term	10 years	12 years	15 years
Annual income (payout tenor) term	10 years	6 years	15 years
Annual income	₹38,078	₹1,00,000	₹1,30,000
Income on maturity	₹9.5 lakh (₹4.76 lakh sum assured plus ₹4.76 lakh guaranteed addition)	₹7 lakh (last annual payout is 70% of the sum assured)	₹11.3 lakh (₹10 lakh sum assured plus last payout of ₹1.3 lakh)
Internal rate of return	4%		

Source: Mint research

Paras Jain/Mint

How much do they return?

Even as the structure of the plan seems fairly straightforward, what confuses is the manner in which the payouts are mentioned. For instance let's look at Bharti AXA Life Insurance Co. Ltd's Bharti AXA Life Secure Income Plan. The first page of the brochure guarantees an annual income of 8% of the sum assured (remember this is not an 8% return, but payouts at 8% of the sum assured) broken into monthly payments during the payout phase and sum assured plus guaranteed additions on the sum assured on maturity. So even as the plan pays you a monthly income it increases the final payment, that is the sum assured, by a certain percentage.

Sample this illustration from the brochure: a 30-year-old, for a policy tenor of 20 years—10 years of PPT and 10 years of payout tenor—and a sum assured of ₹3.11 lakh will have to pay an annual premium of ₹50,000 for 10 years, the death benefit in this case is 13 times the annual premium.

During the payout phase of ten years, the policyholder will get an annual income of 8% of the sum assured which will be paid monthly. In this case, it works out to an annual income of ₹24,885 or a monthly income of ₹2,074. On maturity, the plan will pay the sum assured plus guaranteed additions accruing at a simple rate of 10% per annum of the sum assured during the payout stage. The maturity corpus will work out to a total of about ₹6.22 lakh.

Now throughout the example you see comebacks at a rate of more than 8%, this is not the net return of your investments. Despite the seemingly generous payouts, the net return is a meager 4%. "Investors are bound to mistake these rates of payout as the final return on investments. No other financial product structures returns in this form, it declares the final rate of return," says Suresh Sadagopan, a Mumbai based financial planner.

ING Vysya Life Insurance Co. Ltd's ING Guaranteed Income Insurance Plan on the other hand offers payouts at a rate of 11%, 12% and 13% of the sum assured during the payout stage along with the sum assured on maturity. Even as the first page of the brochure reads: "Choose from 3 income payout rates," you don't really get to choose as such. The income payouts depend on the PPT and premium amount that you are willing to pay; the higher the PPT or premium the higher is the rate. Again while the brochure shouts out payouts at a rate of 11% and more, the return on the policy is around 4% (*See graphic: How much do guaranteed income insurance plans return?*).

"A net return of 4% is not great in the long-term. If the plan provided a minimum return of 4% and an upside it would be a good investment product," says P. Nandagopal, chief executive officer and managing director, IndiaFirst

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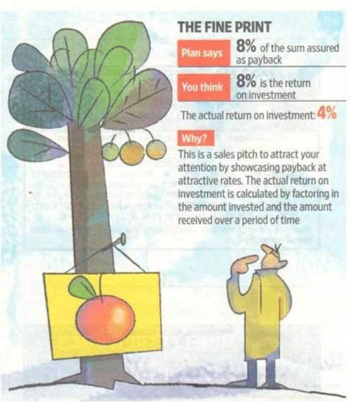
What should you do?

Given the obvious attraction of a guaranteed product you can expect more plans to line up in the market and given the lack of disclosure on net return, your job first is to calculate the net return on the policy. Take the help of online calculators or simply consult a financial planner. Keep in mind that most long term guaranteed products will offer conservative returns and entail a cost for that guarantee.

"I don't like guaranteed plans because the cost of guarantee is so huge and it is met mostly by the customer's money," says Nandagopal.

Not only do you bring home a lower return you also end up destroying the value of your investments if you factor in inflation. This is why while guaranteed products may work well in the short-term to target specific goals, in the long term you need to focus on generating value from your corpus.

Look at other products in the market. For conservative investors Public Provident Fund is a great product to have. For investors in the lower tax bracket, fixed deposit is also a



Illustrations by Shyamal Banerjee; graphic by Paras Jain/Mint

For the non-conservative mutual funds is a great option. "One of the tax efficient ways is investing in mutual funds. One can opt for a diversified portfolio to build a corpus over given time period. They can then opt for systematic withdrawal plan to generate periodic income tin B. Vyakaranam, CEO and founder, ArthaYantra.com, an online portal on personal finance. Also don't forget, insurance-cum-investment plans do not offer adequate insurance for the premium you pay. You would do well to target your need of insurance and invest-

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