Term Plans

Introduction

You must have often heard that a life insurance policy is a mandatory requirement. Whether it is your neighborhood agent who goes out of his way to sell you a policy or those pesky calls you get from insurance representatives. In fact, insurers also send you mailers promising the benefits of their insurance plans. Too many options, aren't there?

Despite these options, how many of you actually consider a life insurance policy in your financial portfolio?

Very few! In fact, India, despite having the second largest population, has a very low insurance penetration. Sad, yet true! While many avoid insurance thinking it to be an unnecessary expense, many are ignorant of the whole concept altogether. Which category do you fall in? Do you know what a life insurance policy is?

Let's find out -

A life insurance policy covers the risk of premature death and thus provides financial security. The plan promises to pay a benefit in case of unforeseen death of the policyholder. There might also be a maturity benefit under the plan wherein a corpus is paid when the chosen term of the plan comes to an end.

This was the basic concept of a life insurance plan. But is that enough?

No, it isn't. What about variety in life insurance plans? Isn't variety the spice of life?

Life insurance plans come in different variants and each variant fulfills a specific need. While term insurance plans help in income replacement and grant financial security, endowment assurance plans or ULIPs help in investments. Child insurance plans help create a stable corpus for your child while pension plans build up a retirement corpus. Thus, whatever be your financial goal, a life insurance plan is available to cater to it.

Among different life insurance plans, a term plan is the most popular and also the most important plan offered by life insurance companies. Let us understand term insurance plans in details.

What is term insurance?

When you talk about life insurance, you cannot overlook a term insurance plan. After all, the plan is the essence of life insurance and deserves a special mention.

So, do you know what a term plan is?

A term insurance plan is life insurance in its purest form. The plan covers the risk of premature death. The policyholder chooses the plan tenure and the Sum Assured. If, during the chosen tenure, the insured dies, the term insurance plan pays the Sum Assured. Thus, the plan ensures a financial corpus for the insured's family in the event of the insured's untimely death.

Common terms associated with term plans

That was a brief about term plans. But understanding the plan requires a lot more knowledge. You should understand the technical jargon too.

Sounds cumbersome? It might but there is some good news for you. Here are some common terms simplified just for you -

- **Sum Assured –** Sum Assured is the amount of coverage opted by the policyholder. The term plan covers an individual for the chosen Sum Assured which is paid if the insured dies during the term of the plan.
- **Premium –** premium is the consideration paid for buying a term plan. The insurance company undertakes your death risk and for that you are required to pay the cost for your death risk. This cost is the premium and it depends on the age of the insured.
- **Policy term/plan term/tenure** – the term is the period for which the policyholder chooses to cover himself under a term insurance plan. The term plan offers minimum and maximum policy tenure and the policyholder can choose any term as per his requirement.
- **Maturity** – when the chosen term of the plan comes to an end, the plan is said to mature.
- **Maturity benefit** – the benefit which is paid on plan maturity (when the term expires) is called maturity benefit.
- **Death benefit –** when the insured dies during the term of the plan, the term insurance plan pays the promised benefit. This benefit which is payable on death is called death benefit.
- **Riders –** a term plan also allows additional coverage options which are called riders. Riders can be added to a basic plan by paying an additional premium and they increase the scope of coverage.

Salient features of term plans

Now, moving on to the notable features of the plan which make the plan unique:

- **Long term**

Term plans always allow longer coverage tenure so that the life insured can avail coverage for the maximum possible duration. The allowed tenure goes as high as 30 to 35 years.

- **Very high Sum Assured**

Another unique feature of a term insurance plan is that it allows the policyholder to choose high levels of Sum Assured for maximum protection. The policyholder can compute his/her coverage requirements and choose a Sum Assured of as much amount as he/she likes. There is, usually, no capping on the maximum Sum Assured on term insurance plans.

- **Very low premiums**

Against the high levels of Sum Assured allowed, the premiums charged are very low. In fact, term plans charge the lowest premium among other life insurance plans. Thus, these plans not only allow individuals to choose an optimal coverage level, they also ensure affordability of such high Sum Assured levels.

- **No maturity benefit**

Most of the term insurance plans have no maturity benefit. Term plans, usually, cover only the death risk of individuals. When the chosen term of the policy comes to an end and the insured is alive, no benefit is usually paid. However, there are return of premium term plans which return the premiums paid on maturity.

- **Need fulfillment**

Term insurance plans fulfill the income replacement need of individuals. By paying a benefit in the event of premature death, a term plan provides the bereaved family with necessary funds to replace the income lost due to the death of the bread-winner of the family.

Types of term insurance plans

Didn't I mention that variety is the spice of life? Well, a term insurance plan also gives you variety. The plan comes in different variants which are discussed below:

- **Level term plan**

This is the basic term insurance plan where the Sum Assured remains uniform throughout the plan term. On death, the chosen Sum Assured is paid and the plan terminates.

- **Increasing term plans**

Under increasing term insurance plans, the chosen Sum Assured increases every year by a pre-determined percentage. In case of death during the plan tenure, the increased Sum Assured applicable in the year of death is paid and the plan terminates.

For instance, if the Sum Assured increases by 5% and is Rs.10 lakhs, every year the increase would be Rs.50, 000. If the insured dies in the 3rd year, Rs.11 lakhs would be paid.

- **Decreasing term plans**

Contrary to increasing term plans, under decreasing term plans, the Sum Assured decreases every year till it becomes zero on maturity. These plans are offered as mortgage redemption plans wherein the decreased Sum Assured reflects the outstanding balance of loan at the end of each year. In case of death, the Sum Assured applicable in the year of death is paid which can be used to pay off the outstanding loan amount.

For instance, if the Sum Assured decreases by 5% and is Rs.10 lakhs, in case of death in the third year, Rs.9 lakhs would be paid.

- **Return of premium plans**

Where most term plans do not pay any maturity benefit, return of premium plans are different. Under these plans, the premiums paid are returned back on maturity if the insured is alive on that date.

- **Monthly income plans**

Monthly income term plans are simple term plans where the death benefit is paid in instalments rather than in lump sum. These instalments are usually paid monthly while in some cases, annual instalments are also available. Under monthly income plans, the monthly incomes can be uniform or increase at a specified rate.

- **Convertible term plans**

Convertible term plans are normal term insurance plans which have an option of conversion. Under the conversion option, the term plan can be converted to endowment plans during the plan tenure.

Importance / benefit of term plans

Why give importance to a plan if it doesn't provide any benefits? Well, a term insurance plan is plush with benefits, benefits which make the plan a must buy. So, let's find out what is in store -

- **Affordable coverage**

Term plans are the only life insurance plans which allow a coverage which is affordable. Premiums are low and the available Sum Assured levels are high. Thus, individuals don't feel the pocket pinch in buying a term plan.

- **Low premiums allow correct coverage**

Since premiums are low, individuals can choose the ideal coverage level for their needs. There are various term insurance calculators available online which can be used to calculate the ideal coverage amount. Choosing this amount is also easy because the premiums are low and affordable.

- **Financial security for family**

A term plan promises a benefit in case of premature death of the insured. Thus, when an individual buys the plan he also buys financial security for his family after his death. The individual is assured of the family receiving a financial benefit from a term plan in case of his death which would help the family to meet their financial obligations easily.

- **Creates a contingency fund**

The benefits paid by a term plan are like a contingency fund. The family can use the fund for any financial requirements. Any outstanding liability can be cleared, the family's day-to-day living expenses can be met, children's future can be secured, etc. Whatever be the need, the contingency fund can be used to meet it.

- **Takes care of other life goals**

Since term plans allow a high Sum Assured level, the benefit paid is also substantial. The bereaved family can use the substantial benefit to meet their life goals. For instance, the future of the children can be secured if the benefit is invested wisely, the family can buy a home or a car with the funds, the spouse's retirement can be planned with the benefit received, etc. Thus, a term plan helps in taking care of other life goals too.

Tax benefits

Wouldn't it be great if, besides giving the above-discussed benefits, a term plan also helped in saving your money?

Actually, it does. A term insurance plan also helps individuals in saving taxes. Tax exemptions can be claimed under two Sections which are described below:

- **Section 80C**

Premiums paid for a term life insurance plan are exempt from taxation under Section 80C of the Income Tax Act. There is a limit to the exempted amount which is Rs.1.5 lakhs. Moreover, the premium should not be more than 10% of the Sum Assured to claim tax benefit. If premium exceeds 10% of the Sum Assured, premiums up to 10% would only be tax-free and the remaining would be taxable. However, if your policy has been issued before 1st April 2012, premiums up to 20% of the Sum Assured are tax-free.

- **Section 10 (10D)**

Not only the premiums paid but any maturity benefit or death benefit received under a term insurance plan is also free from tax under Section 10 (10D) of the Income Tax Act. There is no maximum limit on the amount of benefit which can be claimed for tax exemption. However, the Sum Assured should at least be 10 times of the premium for claiming tax benefit. For policies issued before 1st April 2012, the Sum Assured should be at least 5 times the annual premium.