

Take a long view

Life insurance disciplines your current savings and takes care of your future

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In theory, mutual funds are intended to simplify equity investments. Investors don't need to track and analyse the thousands of companies listed on the stock markets. They just need to find a good equity fund and, in exchange for a modest fee, the fund manager does all that for them. That's the theory.

In our country, life insurance was long seen primarily as a tax-saving instrument. After the opening up of the insurance industry in 2000, unit-linked life insurance policies (Ulips) came into vogue and people started looking at insurance as a good investment vehicle also.

Riding on the stock market wave, short-term Ulip caught the fancy of both agents and buyers for some time until the recent global financial meltdown sent the markets crashing and left customers reeling in deep red. The debate then got reduced to how Ulips were better than mutual funds — a good example of comparing apples with oranges.

We must understand that life insurance is a long-term investment vehicle that involves financial planning based on various stages of life.

First, we begin by answering whether life insurance can be viewed as an investment vehicle. The answer is an emphatic "Yes". Investments are made not only to generate returns, but also to serve a purpose. Life insurance in this sense helps meet the financial needs of individuals at different stages of life and even beyond.

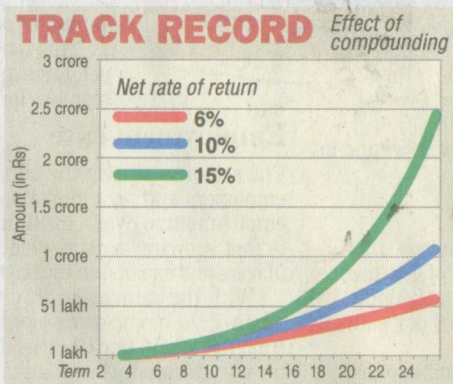
Though these needs depend on the life stage of an individual and vary over time, world over the need to save for retirement and for the children's future are important financial events. Both are long-term needs and life insurance plans address these needs. To accumulate wealth there is no sure shot formula other than,

- Saving more
- Saving regularly (disciplined savings)
- Saving for a longer time to reap the benefits of compounding effect
- Diversification, keeping in mind the risk appetite

Life insurance plans encourage all the above by the very design of the

products, the investment philosophy, distribution and service.

Let's look at the graph (indicative) to understand the power of compounding of money over longer terms. The graph assumes an investment of Rs 100,000 in the beginning of the year for 25 years. The accumulated amount at a net rate of return of 6 per cent, 10 per cent and 15 per cent at the end of the years are shown.



- The curve grows steeper as the accumulation becomes high with higher returns
- Growth becomes steep as duration increases

Conventional life insurance is appropriate for a person with lower risk appetite as the investment is made in secure asset classes. The volatility is not passed on to the customer as the returns are smoothed over the duration, the result being if Rs 35 lakh can be accumulated in 15 years at 10 per cent, then it takes only four more years to achieve the same at 6 per cent, with the long-term effect kicking in.

Life insurance plans help you to accumulate for your tomorrow, encouraging disciplined, regular savings with decent returns in line with your risk taking ability.

If a customer requires Rs 1 crore and he/she can afford to save Rs 1 lakh a year, then it takes 19 years to accumulate the targeted amount at 15 per cent return, 25 years at 10 per cent. If the customer does not have sufficient time, say 25 years, then he/she should invest in high risk-high return instruments to earn 15 per cent CAGR. If he/she doesn't have 15 years of earning life, it means it is impossible to accumulate Rs 1 crore. This also brings to the fore that one must start saving as early as possible so that he/she can enjoy the power of compounding early in life.

We can also see from the graph that the growth in volume is humongous as one stays invested for a longer time.

Life insurance policies promote thrift among policyholders, that is, regular and disciplined savings over a long period of time. Moreover, almost all products reward long-term and loyal customers.

