In the News

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WHO NEEDS HOME LOAN INSURANCE?

Banks often encourage (and sometimes force) you to take an insurance cover along with your home loan. But, as you know by now, you cannot trust your banker to do the right thing for you. Home loan cover can be expensive, laden with fine print. Raj Pradhan analyses the details of this bundled product which, at times, does not even cover your natural death

Indians have a strong preference for real estate as an asset class. There is comfort in possessing an asset that they can touch, feel, utilise and occupy, even though there is no guarantee of value appreciation or income through rentals. Holding multiple homes has its own issues. You have to show rental income for the second or more homes, irrespective of whether or not you actually get rent from them. Real estate prices in India are too high relative to the income levels. Buying a home, for most people, involves taking a loan from a bank or a non-banking financial company (NBFC). It can place a burden of having to pay hefty equated monthly instalments (EMI), although home loans offer excellent tax-breaks.

But if you still want to possess your dream home by taking a loan, you will have to be ready to buy a couple of insurance policies. The bank or financial institution will make a pitch for it, usually while closing the deal. You will be in a hurry to get the loan and, hence, vulnerable to accept the insurance policies without knowing whether you are being taken for a ride. Be in a better position to negotiate with the lender on both the insurance policies—property and home loan cover.

Property cover is mis-sold on the market value of property; hence, it is expensive. Home loan cover is, usually, sold as a bundled product. Even if you buy an unbundled product, it comes with fine print when you refinance the loan or prematurely close the loan. Either way, it turns out to be an expensive proposition. When you do not take a loan, there is no need for home loan cover. Property insurance can be purchased on your own terms later. Read on, to know how to deal with lenders and getting the best insurance option.

Risk of Taking Home Loan

Home loan EMIs can lop off a big chunk from your salary. It is a significant part of your financial plan. But if you were to suffer death, long-term disability or chronic ailment, it can put a lot of stress on the family's finances. To mitigate this risk of your inability to pay the EMIs, home loan cover is offered by the lender. But does the home loan insurance cover all the risks of death, disability and disease (3Ds)? The answer is negative; it does not cover all the risks comprehensively. Indeed, at the extreme, there are home loan covers which will not cover any of the 3Ds fully. Buyers beware.

Banks and NBFCs will try to promote home loan covers offered by the insurance company they have a tie-up with. It will not be the best option for you and, usually, will earn them a good commission. They may push traditional policies (endowment, money-back) which are expensive, a big drain on your savings, and still leave you under-insured. If you reject the lender's offer for a traditional plan, they can try to push another unsuitable product. After all, there is no dearth of bad products offered by insurance companies!

A risk for real estate is the damage to property due to fire and allied perils. This risk is present even if you have not taken a home loan. But if you do take a home loan, the lender will push the property insurance of its choice. Moreover, as we have said, property insurance is mis-sold by lenders; these policies are priced on the market value of the property when it should really be based on re-instatement or indemnity cost. Will someone explain to the lenders that, even after total loss of the built-up property, the land will still be there and can be claimed by the rightful owners? Hence, insuring at market value of the property, which includes the cost of land, is simply dishonest. No wonder, Indians turn away from property insurance when they are quoted a high premium for something which should have been sold at an affordable cost.

Do You Really Need Home Loan Cover?

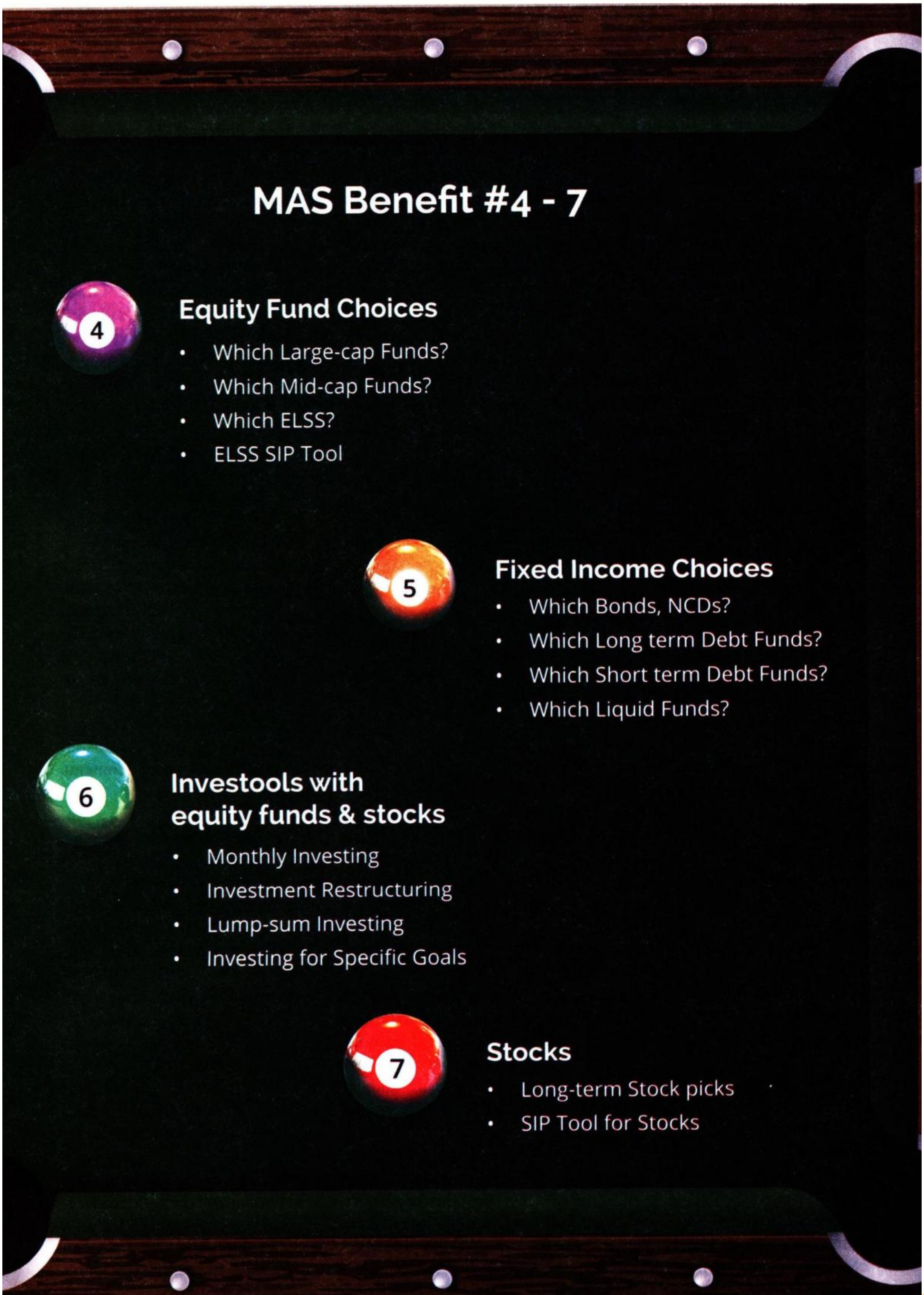
Well, this is the first question to ask and, if you don't have the answer and the logic behind the answer, you may fall for the lender's sales pitch disguised as sagacious advice. A home loan is one of the longest-term debts in your life which requires a long-term commitment. You owe money to the lender; this increases your risk profile. A home loan insurance plan mitigates your risk. But the lenders are not facing any risk as the home loan is a secured loan—against the home as asset.

What happens to the lender, if you were to die without a proper life cover and your family cannot pay the EMIs? The lender possesses your house forcing the family to vacate. The lender can then sell the property and recover the loan amount. Home loan is a secured loan and the bank doesn't really need the home loan cover. So, the lender will not be suffer any loss, unless property prices have crashed in the meantime. Home loan cover is not important for the lender at all. Home loan or term plan will be in your interest for safeguarding your family. If so, should home loan cover be mandatory? Why does the lender try to sell home loan protection plan (HLPP) instead of a term plan?

> From the financial planning perspective for the family and providing them complete security, an individual will be better off buying a term plan
>
> - Ashish Vohra, ED and CEO, Reliance Nippon Life Insurance

Home loan cover is just a cushion for them. It helps them avoid putting the property for sale to recover the loan amount. HLPP and property insurance is a third-party product which gives the lender a fat commission from sales. Why will they not take the opportunity to hard-sell a couple of expensive insurance policies to the customer? Will they protect their own interest or try to guide you to buy the best product for your needs? HLPP helps the lender as the insurance company directly settles the claim with the lender to help close the loan amount. Any excess insurance cover after settling the outstanding loan is paid to the nominee or legal heir of the borrower.

According to Ashish Vohra, ED and CEO, Reliance Nippon Life Insurance, "A home loan protection plan/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credit life product is a must when taking a loan/ credit as it provides security for the loan amount outstanding in case of any adverse happenings and reduces the burden of the family to that extent. However, from the financial planning perspective for the family and providing them complete security, an individual will be better off buying an individual term plan which will provide financial security to the family for a bigger amount and for a longer duration. It is suggested to buy term plan in conjunction with a credit protection plan to serve the objectives of providing financial security for the family and protection against loan liability."

You do need to have a proper life insurance or HLPP to ensure that the home loan is paid off even if you were to die tomorrow. It will ensure that your family keeps the property without having to give it up to the lender. It is necessary to cover the risk of your death. A term plan (an alternative to HLPP sold by the lender) would pay your nominee, or legal heir, who would then have to settle the loan with the lender. You also need additional cover to mitigate risks of disability or disease. You need to have a good personal accident (PA) policy covering accidental death, permanent total disability (PTD), permanent partial disability (PPD) and temporary total disability (TTD). If you can afford it, buy critical illness (CI) cover after having adequate mediclaim. You need to ensure home loan EMIs are not missed due to death, disease and disability.

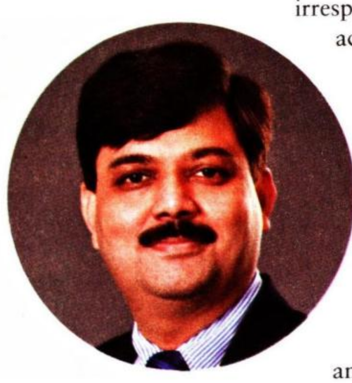
What Does Home Loan Insurance Cover?

HLPP can include one or more of the following:

- Life cover;
- Accidental death;
- Critical illness;
- Accidental disability;
- Property cover;
- Property contents cover;
- Job loss EMI cover.

With a home loan protection a borrower is covered from accidents and critical illnesses along with certain number of pre-decided equated monthly instalments

- Rakesh Jain, ED and CEO, Reliance General Insurance



According to Rakesh Jain, ED and CEO, Reliance General Insurance, "The basic coverage of home loan protection states that the borrower is covered from accidents and critical illnesses along with certain number of pre-decided equated monthly instalments payable in case the borrower loses his/her job for reasons cited in the coverage and child care allowance in case the borrower loses his/her life in an accident."

Life and general insurance companies can offer HLPP. Be wary of buying home loan cover from the general insurers as they do not cover natural (non-accidental) death. They can cover accidental death, but non-accidental death can only be covered by life insurance companies. The life cover, offered by life insurance companies, covers death by non-accident or accident, irrespective of whether or not accidental death rider is specifically purchased.

So, it makes sense to buy HLPP from life insurance companies. The alternative is a term plan from life insurers. HLPP, which includes critical illness (CI) and accidental disability, may not have comprehensive cover. It can include a few CIs and accidental disability may not cover TTD. Property cover is mis-sold on market value of property, while property contents cover is not really a must-have cover.

There can be an additional rider against losing a job. The insurer will pay the EMIs for up to three months. Avoid getting lured by it as there are several clauses in fine print. It will pay only if you are laid-off and not if you resign. So, if you have been forced to resign, your claim may be denied. If the company folds up, the onus will be on you to prove it. Insurers know how to make you run around so that they can deny the claim. They will not pay your three EMIs easily. Moreover, this rider can be availed only once.

General insurer, HDFC ERGO's, Home Suraksha Plus covers property insurance for structure (fire and allied perils) and contents, critical illness cover, personal accident covering accidental death and disability, and loss of job. The product does not cover natural death, only accidental death. Life insurer, SBI Life, offers Rinn Raksha covering death benefit and accidental total and permanent disability. The following are the major aspects of home loan covers:

- HLPPs mostly offer reducing cover option. The life cover goes down in tandem with your loan's outstanding principal. While it helps to keep premium lower than the level cover option, such reduction means that there may not be excess cover beyond the cover for the loan. Level cover option has a fixed cover for the term of the plan. It is the same concept as that of term plan. Another option can be fixed cover for a specific period followed by reducing cover for the remaining years.

- HLPP is generally offered as a single-premium policy. Insurance companies insist on a one-time payment of premium. There can also be variants available for regular premium and limited premium payment terms.
- Insurer may follow relaxed underwriting norms for HLPP. There may not be medical tests based on parameters of cover amount, age, medical history, loan amount and loan term. Ashish Vohra says, "Pros of HLPP include relaxed underwriting since primary financial underwriting is done by lending institute. The cons of HLPP are that benefit payment is linked to initial re-payment schedule. Change in outstanding loan amount due to fluctuations in interest rates and any change in loan tenure due to it, has to be settled by the customer."
- Home loan insurance eligibility criteria differ from one company to another. The minimum entry age is 18 years. The maximum age of the borrower, while availing the HLPP, is usually 50 years for most banks; some banks extend this up to 60 years. Some banks also stipulate the maximum age of the borrower on the expiry of the policy.
- The premium amount can be bundled with the loan and included in the EMI amount. For example, if the home loan is for Rs30 lakh and the insurance premium is for Rs2 lakh, the lender pays the full premium to the insurer upfront. The loan amount for borrower will be Rs32 lakh which will be spread out as EMIs over the tenure. You will end up paying interest on the Rs2 lakh premium amount.

Home Loan Insurance Flaws

There is no best option, as HLPP cannot be as good as online term plan combined with stand-alone products for PA, CI, mediclaim and property insurance. HLPP is neither a comprehensive product covering all the risks nor is it a cost-effective option. But the lender feels he holds the trump card as your loan approval is at stake; there is little competitive pressure for HLPP. *Moneylife* tried to contact seven insurance companies (life and general) to get feedback regarding HLPP benefits compared to term plan. General insurers were asked about the main flaw—that their product does not cover natural death. Unfortunately, there were only two responses which shows that insurers cannot defend the concept of HLPP. Large commission is a key incentive for lenders to push you into buying HLPP. Here are the major flaws of HLPP.

> The bank/NBFC will have only one or two tie-ups with insurers and, hence, hardly offer any choice. Banks tie up with their own group insurance company; hence, you are a captive customer for the insurer

Photo courtesy: Kari Shea

- The biggest flaw of HLPP is that it may not cover death by natural causes. This holds true for HLPP offered by general insurance companies. They cover accidental death, but not death due to natural reasons. HLPP offered by life insurance companies will offer death benefit which covers both accidental and non-accidental death. Be aware of the HLPP cover details when you are buying. Rakesh Jain, says, "In India, we believe the prevalent trend is that on an average, a person applies for a home loan in the age bracket of 30-40 years. Home loan protection plans are generally bundled with home loans. It is unlikely that in this age group, people will face a natural death. However, there could be a high probability of being inflicted with prolonged illness, lifestyle diseases or accidents. The HLPP product acts as a financial contingency plan so that policyholders can glide through such difficult times without facing any financial crunch." *Moneylife* is of belief that a person having dependents does need a life insurance policy which covers natural and accidental death. It is expected that, by the time you retire, your life insurance needs should come down to zero.
- The bank/NBFC will have only one or two tie-ups with insurers and, hence, hardly offer any choice. Banks tie up with their own group insurance

How Property Cover Is Mis-sold

Property insurance is inexpensive and necessary, since a home is your most-prized asset. Avoid falling prey to mis-selling of property insurance (that covers the risks of fire and allied perils to the property structure) when you take a home loan. The bank, often, arm-twists you into buying from the insurance company of their choice. Be wary of mis-selling that will inflate your premium outgo.

Read our Cover Story - http://tinyurl.com/zr7nv3o It makes no sense that someone buying a flat of market value of over Rs1 crore is made to buy property insurance for sum insured at market value or loan disbursement amount of Rs1 crore. The reconstruction of such a flat may cost only Rs20 lakh to Rs25 lakh, the insurance premium for which should be less than Rs900 annually. It means the bank is mis-selling insurance policy by fleecing the customer into paying three times more than is required. Asking for a premium for the term of loan on market value instead of re-instatement or indemnity value will make the purchase a necessary evil, an expense to be incurred just to get the loan passed. The borrower is at the mercy of the bank to complete the loan documentation: he agrees to the bank's demands more in exasperation and not as a satisfied customer. Banks are mis-selling property insurance at inflated sum insured, to earn higher commissions from the insurance company which, most often, is part of the same group. You have the power to resist it. Ask questions and show your knowledge on property insurance.

company; hence, you are a captive customer for the insurer.

- Term life insurance is easy to compare for premium and features. HLPPs are offered by lenders at the time of loan. It can be difficult to get product details and even more difficult to compare with other HLPPs in the market. The product itself is a combination of different benefits; so, you cannot know if the premium is really worth it or not. You will need to break-up the benefits and see if the premium you will pay is cost-effective. The average saver will find this exercise tedious and difficult.
- HLPP is, generally, a bundled product which brings in inefficiencies of pricing and varying features as well as lack of transparency makes it difficult to compare. It is an opaque product with a lot of fine print. It is not as easy as buying a term plan. It is a marketed at the time of loan closure and, hence, easy to sell due to time constraint.
- If you get the loan refinanced by another lender, you may not be able to port HLPP. If you are lucky, you may get a partial refund. You are buying a policy for which the bank has purchased group cover from the insurance company. It is a rigid product, unlike a term plan which can be discontinued anytime without any loss.
- HLPP can be twice as expensive compared to an online term plan even when HLPP has the disadvantage of reducing cover product while the term plan offers level cover which remains same for the full policy term. Better to go with level cover as it offers additional buffer for the family to get benefit after repayment of loan amount.

'No medical test needed' is not good news for customers. You don't want the insurer to raise an issue at the time of claim

Photo courtesy: Naomi Hebert

- HLPP can lack robust underwriting. This relaxation in underwriting norms increases the premium. 'No medical test needed' is not good news for customers. You don't want the insurer to raise an issue at the time of claim. Claim rejection can mean the home loan will not be paid by HLPP; so the legal heir will have to repay the home loan. The lender does not have much to lose; it is in your interest to have proper underwriting for the policy for which you are paying premium.
- If there are wrong declarations in the proposal and/or medical tests find health issues, premium for HLPP will go up. It can add to the cost of an already

expensive product. But submit the proposal with utmost good faith and don't shy away from medical tests.

- Even though term plans offer single-premium option, it is better to avoid it. In case of death, your family will not get a partial refund. If you are alive, you will have difficulty surrendering term plan prematurely. Regular premium payment is best option. But HLPP is usually single-premium paid as lump-sum when you take a loan and, hence, you are offered the worst option. It is designed to help the insurer and lender, not you. Surrendering HLPP will be at a huge partial or total loss.
- Some HLPP can provide cover for up to a specific number of years (say 5 years), even though the home loan is for a longer term. It means the you will need to buy another cover at the end of five years. Term plan is for a longer term and is usually up to the time you retire.
- Tax deduction can be an issue. The lender may not offer you an option to pay separately for your home loan insurance and include the sum paid towards premium in loan amount which, in effect, will increase your EMI. You will not be able to claim Section 80C tax benefit. If your HLPP premium is added to the home loan EMI, effectively, you are also paying interest on the HLPP premium which will increase your net premium.
- HLPP can include benefit for accidental disability. But it will not be as comprehensive as disability cover from PA policy. For example, PA covering TTD for two years is a good benefit when you are temporarily disabled and unable to work. Stand-alone PA cover is best option. Do not go with life insurance rider or other bundled cover like HLPP for it. As such, there is lack of long-term disability cover in India; hence, it is better to choose the best available PA cover.
- HLPP can have cover for CI, but is it required? CI cover is not a requirement if you have proper mediclaim. A CI product will cover only specified illnesses. Mediclaim is more comprehensive. Mediclaim policy covers hospitalisation and specific day-care procedures like chemotherapy, dialysis, etc. CI will supplement mediclaim for your health insurance needs. First, buy mediclaim and, then, think about buying a CI product. You can also go for super top-up policy, if you are willing to bear the deductible cost or has corporate mediclaim.
- HLPP covering CI have fewer CIs in the list. If the borrower has a CI which is not in the list of covered CIs, it does not really help. It will leave the borrower in difficulty if he/she is unable to repay the loan due to the uncovered CI and, possibly, loss of work due to it.

HLPP can include benefit for accidental disability. But it will not be as comprehensive as disability cover from PA policy

Photo courtesy: Irene van der Poel

Is Term Plan the Ultimate HLPP?

There a simple solution to the issues that HLPP promises to solve. Buy a term plan and PA instead of HLPP. The customer's life is insured. The family will not be burdened with loan repayment, in case of an unfortunate event. The benefit can be used to pay off the bank debt and the balance can go to the borrower's family. If there is no death, the borrower can freely change the lender if he/she wishes to. The pre-payment of the loan to foreclose it will also have no impact on continuation of the term plan. *You can keep paying the premium for term plan, or discontinue it, if you do not want the cover after the loan is fully repaid.*

Term plan is a simple cost-effective life insurance product for all your liabilities including a home loan. You need to have a life cover which is 10-12 times your annual salary + any liability (home loan, car loan, etc) minus assets (excluding the home where you reside). You need to have term plan in force until your retirement. You may break the term cover into multiple policies, each linked to a different objective. One policy could be for a term up to retirement while the other can be to cover the loan amount for the duration of the loan. This way, the term plan meant for covering the home loan will get over when the loan ends. Declare existing policies when you apply for a new insurance policy.

The Insurance Regulatory and Development Authority of India (IRDAI) needs to issue a directive to ensure that HLPPs sold by financial institutions are easily transferred from one lender to another as the customer is paying for it. If the borrower repays the loan prematurely, HLPPs should allow continuation of the life cover, or terminate it, with pro-rated refund. If borrowers are ready to buy a term plan and PA policy, then they need not be pushed into buying HLPP. The main intention of home loan cover is to mitigate the risk of death or disability of the borrower. But expecting IRDAI to work in consumer interest is perhaps expecting too much.

How To Deal with Lender for Home Loan Cover

Unfortunately, what used to be your trusted neighbourhood banker is now a pushy salesman of questionable insurance products, working for fat commissions. How should one deal with him when he insists that you buy an HPPL of his choice? Purchase of HLPP with home loan is not mandatory. The lender cannot force a home loan buyer to take HPPL. If the bank's own policy requires the purchase of insurance, it must be specified in the loan agreement. Ask the banker to show the relevant clause in the loan agreement which makes it mandatory. Even if it is mandated in the agreement, the bank cannot compel you to buy from the insurance company that it has a tie-up with. If the bank insists on selling HLPP, ask for it in writing. There can be a clause for mandatory purchase of property insurance, but it is different from HLPP.

There have been instances of borrowers complaining to the Reserve Bank of India (RBI) when a banker wanted to push HLPP. RBI clarified that banks cannot force an HLPP on a borrower. Mention this and it might stop the lender from further attempts to sell insurance policy when giving a loan. If you resist the bank's selling pitch, then it will let you buy a term plan. You can buy online term to save on premium. You can buy term plan from the bank if it helps to close the deal. Do not skip either term plan or HLPP for home loan. If you have made a mistake of buying life insurance policy (endowment, money-back, whole-life, etc), then return the policy within free-look period of 15 days. There can be deduction for pro-rata life coverage provided, expenses on medical examination and stamp duty charges.

> RBI clarified that banks cannot force an HLPP on a borrower. Mention this and it might stop the lender from further attempts to sell insurance policy when giving a loan

Photo courtesy: Sylwia Pietruszka

The term plan sold by the lender is an option, but will be expensive compared to an online term plan. Negotiate with the lender that you will buy an online term plan to cover the home loan. While HLPP would pay the lender to close the loan and pay the balance (if any) to the nominee or legal heir of the deceased borrower, a term plan will pay the nominee who, in turn, will have to pay the lender to close the loan and distribute the rest among the legal heirs. You should prefer to have a legal heir as the nominee to avoid any issues with death benefit being misused. To give assurance to the lender, you can make a conditional assignment of the life insurance policy in the bank's name.

Under conditional assignment, the transfer of rights will happen from the assignor to the assignee subject to certain conditions. If the conditions are fulfilled, the policy will get transferred from the assignor to the assignee. You may have a term plan of Rs1 crore and wish to apply for a home loan of Rs1 crore. The lender can ask you to assign the term policy in its name to get the loan. If so, you can do conditionally assignment of the policy. If the borrower dies, the lender can receive the death benefit money from the insurer. It can be used to close the loan, while the remaining money will be given to the nominee or legal heir. The policy would be reassigned to you on repayment of the loan during your lifetime.

Home loan is a major liability; hence, life insurance and personal accident cover is important. You work all your life to pay for your home. It is a matter of pride to have a home without any loan outstanding. It is an achievement in itself for a hardworking individual. Home without loan is an asset for you and your family to cherish. Ensure that in your absence your family does not face any hardship and doesn't have to worry losing the home. Home is an emotional attachment. Let your family inherit your home and not your home loan. Buying adequate life insurance cover and PA cover will help ensure that family can repay the home loan in your absence or in case of your disability. ■