

CORPORATE AGENTS-LIFE (AUTHORIZED VERIFIERS)

ACKNOWLEDGEMENT

This course is based on revised syllabus prescribed by Insurance Regulatory and Development Authority of India (IRDAI) and prepared by Insurance Institute of India, Mumbai.

AUTHORS/ REVIEWERS (in Alphabetical order)

Dr. R. K. Duggal
Dr. Shashidharan K. Kutty
Mr. Vepachedu Jayanth Kumar
CA P. Koteswara Rao
Dr. Pradip Sarkar
Dr. Ramesh Kumar Satluri
Prof. Madhuri Sharma
Dr. George E. Thomas
Prof. Archana Vaze
Mr. Krishnamohan Y



G - Block, Plot No. C-46, Bandra Kurla Complex, Bandra (E), Mumbai - 400 051.

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Year of Edition: 2025

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Published by: Secretary General, Insurance Institute of India, G- Block, Plot C-46, Bandra Kurla Complex, Bandra (E) Mumbai - 400 051 and Printed at

Any communication regarding this study material may be addressed to ctd@iii.org.in mentioning the subject title and unique publication number mentioned on the cover page

PREFACE

Insurance Institute of India, (the Institute) has developed this course material for Insurance Agents based on the syllabus prescribed by Insurance Regulatory and Development Authority of India (IRDAI). Industry experts were involved in preparing the course material.

The course provides basic knowledge of Life, General and Health insurance to enable agents in the respective line of business to understand and appreciate their professional career in the right perspective.

The course is structured as four sections. (1) Overview - a Common section that covers Insurance Principles, Legal Principles and Regulatory matters that Insurance agents need to know. Separate sections are provided for those aspiring to become (2) Life Insurance Agents, (3) General Insurance Agents and (4) Health Insurance Agents.

A set of model questions are included in the course to give students an idea of the examination format and the types of objective questions that may be asked. The model questions will also help them in revising what they have learnt.

Insurance operates in a dynamic environment. Agents need to be up to date about changes in the market. They should actively pursue knowledge through personal study and participation in the in-house training programmes arranged by the respective insurers.

The Institute thanks IRDAI for entrusting this work to the Institute. The Institute wishes all interested in studying the material a successful career in insurance marketing.

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SECTION
LIFE INSURANCE

CHAPTER L-01

WHAT LIFE INSURANCE INVOLVES

Chapter Introduction

We have seen some aspects related to Insurance in the common chapters. However, when it comes to Life insurance, we need to look at them more deeply.

- ✓ An asset
- ✓ The risk insured against
- ✓ The principle of pooling
- ✓ The contract

Let us now examine the features of life insurance. This chapter will take a brief look at the various components of life insurance mentioned above.

Learning Outcomes

- A. Life insurance business -Components, human life value, mutuality
- B. Risks and Life Insurance

A. Life insurance business - Components, human life value, mutuality

a) The Asset - Human Life Value (HLV)

We have already seen that an asset is a kind of property that yields value or a return. For most kinds of property both the value and loss of value amounts can be measured in precise monetary terms.

Example

If the estimated damage of a car meeting an accident is Rs 50000, the insurer will compensate the owner for this loss.

How do we estimate the amount of loss when a person dies?

Is he worth Rs. 50,000 or Rs. 5,00,000?

An Agent must be able to answer the above question when meeting a customer. Based on this the agent can determine how much insurance to recommend to the customer. It is in fact the first lesson a life insurance agent must learn.

Luckily we have a measure, developed almost seventy years ago by Prof. Hubener. It is known as **Human Life Value (HLV)** and is used worldwide.

The HLV concept considers human life as a kind of property or asset that earns an income. It thus measures the value of human life based on an individual's expected net future earnings. Net earnings means the income a person expects to earn each year in the future, less the amount he would spend on himself. It thus indicates the economic loss a family would suffer if the wage earner were to die prematurely. These earnings are capitalised, using an appropriate interest rate to discount them.

Although there are multiple parameters used to calculate HLV including taking into account inflation, wage rise, future earning capacity etc., a simple thumb rule to calculate HLV is to determine the amount that would generate the annual income the family would be needing by way of interest. In other words HLV is the annual contribution for the family by the breadwinner divided by the prevailing rate of interest.

Example

Mr. Rajan earns Rs. 1,20,000 a year and spends Rs. 24,000 on himself. The net earnings his family would lose, were he to die prematurely, would be Rs. 96,000 per year. Suppose the rate of interest is 8% (expressed as 0.08).

$$\text{Human-Life-Value (HLV)} = \frac{\text{Annual Contribution for Dependents}}{\text{Rate of Interest}}$$

$$\text{HLV} = 96000 / 0.08 = \text{Rs. } 12,00,000$$

HLV helps to determine how much insurance one should have for full protection. It also tells us the upper limit beyond which providing life insurance may not be reasonable.

In general, the amount of insurance should be around 10 to 15 times one's annual income. Thus one should grow suspicious if Mr. Rajan was to ask insurance of Rs. 2 crores, while earning only Rs. 1.2 lakhs a year. The actual amount of insurance purchased would depend on factors like how much insurance one can afford and would like to buy.

B. Risk and Life Insurance

As we have seen above, life insurance provides protection against those risk events that can destroy or reduce the value of human life as an asset. There are three kinds of situations where such loss can occur. They are typical concerns which ordinary people face.

Diagram 1: Typical concerns faced by ordinary people



General insurance on the other hand typically deals with risks that affect property - like fire, loss of cargo while at sea, theft and burglary and motor accidents. They also cover events leading to loss of name and goodwill. These are covered by liability insurance.

Finally there are risks that can affect the person. Termed as personal risks, these may also be covered by general insurance.

Example

Accident insurance which protects against losses suffered due to an accident.

a) How exactly does life insurance differ from general insurance?

General Insurance	Life Insurance
<ul style="list-style-type: none"> • Indemnity: General insurance policies, with the exception of Personal Accident Insurance, are usually contracts of indemnity i.e. after an event like fire, the insurer assesses the exact amount of loss that has occurred and compensates only that amount of loss - no more, no less. 	<ul style="list-style-type: none"> • Assurance: Life insurance policies are contracts of assurance. • The amount of benefit to be paid in the event of death is fixed at the beginning of the contract. • An assured sum is paid to the nominees or beneficiaries of the insured when he dies.
<ul style="list-style-type: none"> • Duration: The contract is generally short period or for one year renewable basis 	<ul style="list-style-type: none"> • The contract is generally long term though some one year renewable contracts are also prevalent
<ul style="list-style-type: none"> • Uncertainty: In general insurance contracts, the concerned risk event is 	<ul style="list-style-type: none"> • There is no such question Death is certain once a person is born. What is

uncertain. No one can be certain about whether a house would catch fire or a car meet an accident.	uncertain is the time of death. Life insurance offers protection against the risk of premature death.
<ul style="list-style-type: none"> Increase in probability: In case of General insurance perils like fire or earthquake, the probability of happening of the event does not increase with time. 	<ul style="list-style-type: none"> In life insurance the probability of death increases with age.

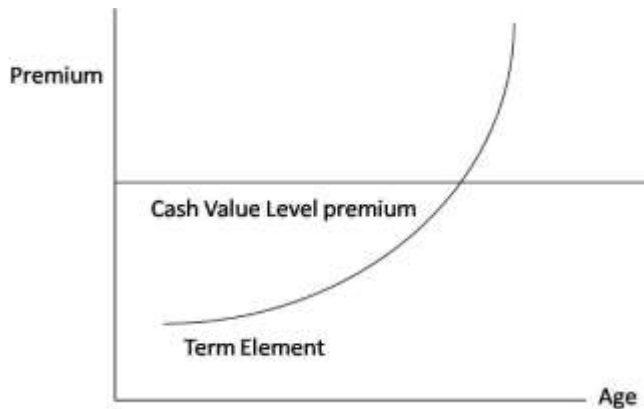
b) Nature of life insurance risk

Since probability of death increases with age, lower premiums are charged for those who are young and higher premiums for older people. One result was that old individuals who were in good health, tended to withdraw while unhealthy members remained in the scheme. Insurance companies faced serious problems as a result. Their attempts to develop life insurance policies that people could afford led to the development of level premiums.

c) Level premiums

The level premium is fixed such that it does not increase with age but remains constant throughout the contract period. This means premiums collected in early years is more than the amount needed to cover death claims of those dying when young, while premiums collected in later years are less than what is needed to meet claims of those dying at higher ages. The level premium is an average of both. The excess premiums of earlier ages compensate for the deficit of premiums in later ages. The level premium feature is illustrated below.

Diagram 2: Level Premium



Level premiums are required because life insurance contracts are long term insurance contracts that run for 10, 20 or many more years. The concept of level premiums, do not arise for general insurance policies, which are typically short term and expire annually.

Example

The level premium rate is arrived at by the insurers based on the mortality (probability of death) during the term of the policy as the age of the insured would increase every year. The rate once decided shall be constant for the entire term of the policy.

d) The Principle of Risk Pooling and Life Insurance

We have already discussed the Principle of Pooling and Mutuality earlier. The pooling principle plays two specific roles in life insurance.

- i. It **provides protection against the economic loss arising as a result of one's untimely death**. This is done by creating a fund that pools the contributions of many who have purchased a life insurance contract.

e) The Life Insurance Contract

The Policy document is the **evidence of the insurance contract** which details all the terms and conditions of the insurance.

The contract states the sum assured of the life insurance policy. Life insurance is regarded a **financial security** as the sum Insured is guaranteed by the contract. The guarantee implies that life insurance is managed efficiently and conservatively; strongly regulated and strictly supervised.

Since Life insurance contracts involve both risk cover and savings, they are often compared with financial products. They are also seen as a way of holding wealth than as protection. Indeed, many life insurance products have a large cash value or savings component which can form a significant part of an individual's savings. Some do argue that it may be better to buy only Term Insurance from an insurance company and invest the balance premiums in instruments that yield higher returns.

Let us consider the arguments for and against traditional cash value insurance contracts.

a) Advantages

- i. Insurance has historically been proven as a **safe and secure investment offering** a minimum guaranteed rate of return, which may increase with contract duration.
- ii. Regularity of premium payments requires compulsory planning of one's savings and results in savings **discipline**.
- iii. The Insurer takes care of professional investment management and **frees the individual** of this responsibility
- iv. Insurance **provides liquidity**. The insured can take a loan on or surrender the policy and convert it into cash.
- v. Both cash value type life insurance and annuities may enjoy some **income tax advantages**.
- vi. Insurance may be **safe from creditors' claims**, generally in the event of the insured's bankruptcy or death.

b) Disadvantages

- i. As insurance gives relatively fixed and stable returns, it can be seriously affected by inflation.
- ii. High marketing and other initial costs reduces the amount of cash value accumulated in earlier years of life insurance policies.
- iii. The guaranteed yield may be below that of other financial instruments

Test Yourself 1

How does diversification reduce risks in financial markets?

- I. Collecting funds from multiple sources and investing them in one place
- II. Investing funds across various asset classes
- III. Maintaining time difference between investments
- IV. Investing in safe assets

Summary

- a) Asset is a kind of property that yields value or a return.
 - b) The HLV concept considers human life as a kind of property or asset that earns an income. It thus measures the value of human life based on an individual's expected net future earnings.
 - c) The level premium is a premium fixed such that it does not increase with age but remains constant throughout the contract period.
 - d) Mutuality is one of the important ways to reduce risk in financial markets, the other being diversification.
 - e) The element of guarantee in a life insurance contract implies that life insurance is subject to stringent regulation and strict supervision.
-

Key Terms

1. Asset
 2. Human Life Value
 3. Level premium
 4. Mutuality
 5. Diversification
-

Answers to Test Yourself

Answer 1 - The correct answer is II.

CHAPTER L-02

FINANCIAL PLANNING

Chapter Introduction

In previous chapters we discussed life insurance and its role in providing financial protection. Security is only one of the concerns of individuals who seek to allocate their income and wealth to meet various needs of the present and the future. Life insurance must be understood in the wider context of “Personal Financial Planning”. The purpose of this chapter is to introduce the subject of financial planning.

Learning Outcomes

- A. Financial planning and the individual life cycle
- B. Role of financial planning
- C. Financial planning - Types

A. Financial planning and the individual life cycle

1. What is financial planning?

Most of us spend a major part of our lives working to make money. Financial planning is a smart way to make money work for us.

Definition

Financial planning is a process of identifying one's life's goals, translating these goals into financial goals and managing one's finances to achieve those goals.

Financial planning involves preparing a roadmap to meet both current and future needs, which may be unforeseen. It plays a crucial role in building a life with less worry. Careful planning can help to set one's priorities and work to achieve your various goals.

Diagram 1: Types of Goals

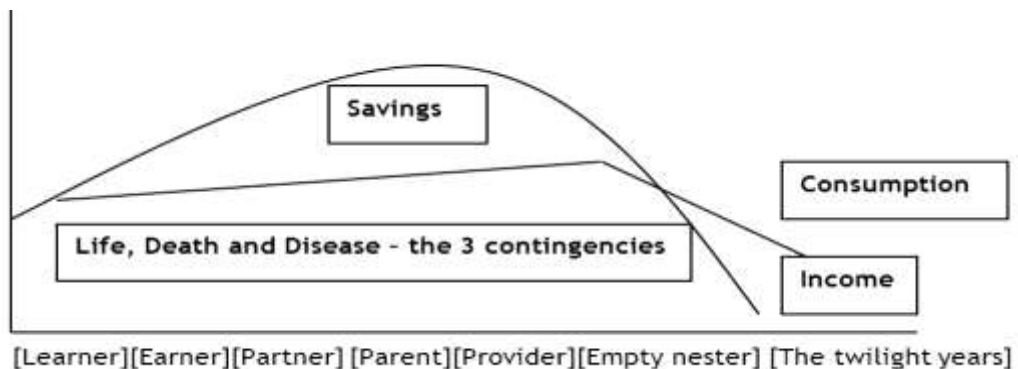


- i. Goals may be **short term**: Buying an LCD TV set or a family vacation
- ii. They could be **medium term**: Buying a house or a vacation abroad
- iii. The **long term** goals may include: Education or marriage of one's child or post retirement provision

2. Individual's life cycle

From the day a person is born till the day of his/ her death, he/ she goes through various stages in life, during which he/ she is expected to play a series of roles. These stages are illustrated in the diagram given below.

Diagram 2: The Economic Life Cycle



Life Stages and Priorities

- a) **Learner (till say age 20 -25):**The stage when one is preparing for his future by improving his or her knowledge and skills. Funds are required for financing one's education. For instance, meeting the high cost of fees for Medical or Management Education.
- b) **Earner (from 25 onwards):**When one has found employment and perhaps earns enough to meet his or her needs and has some surplus to spare. There are family responsibilities and one may also save and invest in order to have money to meet the needs that may arise in the immediate future. For instance, a young man takes a housing loan and invests in a house.
- c) **Partner (on getting marriage at say 28 - 30):** The stage when one is married and has a family of one's own. This creates new needs like having a house of one's own, perhaps a car, consumer durables, planning for children's future etc.
- d) **Parent (say 28 to 35):** The years when one becomes the parent of one or more children. One now has to worry about their health and education - getting them into good schools etc.
- e) **Provider (say age 35 to 55):** The stage when children have grown into teenagers, and includes their high school and college years. One is concerned about the high cost of education to make the child qualified to face the challenges of life. For instance, consider the amount that needs to be set up to finance a medical course that runs for five years. In many Indian homes, making provision for marriage and settlement of girl children is a critical area of concern. Indeed, marriage and education of children is a prime motive for savings for most Indian families today.
- f) **Empty Nester (age 55 to 65):**The term 'empty nester' implies that the offspring have flown away leaving the nest [the household] empty. This is the period when children have married and sometimes have migrated to other places for work, leaving the parents. Hopefully by this stage, one has liquidated one's liabilities [like housing loan and other mortgages] and has built up a fund for retirement. It is also the period when ailments like BP and Diabetes begin to manifest and plague one's life. Health care, financial independence and security of income become very important at this stage.
- g) **Retirement - the twilight years (age 60 and beyond):**The age when one has retired from active work and spends one's savings to meet the needs of life. The living needs of the husband and wife as long as both are alive is the focus. One is concerned about health issues, adequate income and loneliness. This is also the period when one would seek to enhance the quality of life and enjoy many of the things that one had dreamt of but could not achieve - like pursuing a hobby or going on a vacation or a pilgrimage. Whether one ages gracefully or in poverty would depend on how much one has provided for these years.

As we can see above, the economic life cycle has three phases: a student or Pre - job phase; the working phase that begins between ages 18 to 25 and lasts for 35 to 40 years; and the retirement years that begin after one has stopped working.

3. Why does one need to save and purchase various financial assets?

The reason is that during each stage in an individual's life, when one performs a particular role, a number of needs come up for which funds have to be provided.

Example

When a person gets married and starts a family of his own, he may need to have his own house. As children grow older, funds are needed for their higher education. As an individual goes well past middle age, the concern is for having money to meet health costs and post retirement savings so that one does not need to depend on one's children and become a burden. Living with independence and dignity becomes important.

The Savings - Investment process may be considered as being made of two decisions.

- i. **Postponement of consumption:** an allocation of resources between present and future consumption.
- ii. **Parting with liquidity** (or ready purchasing power) in exchange for less liquid assets. For instance, purchase of a life insurance policy would mean exchanging money for a contract which is less liquid.

Financial planning includes both kinds of decisions. One needs to plan in order to save for the future and also must invest wisely in appropriate assets to meet the various needs that will arise in future.

4. Individual needs

If we look at the stages of the life cycle that has been discussed above, we would see that three types of needs can arise. These give rise to three types of financial products.

a) Enabling future transactions

The first set of needs arise from funds for meeting a range of anticipated expenditures that are expected to arise at different stages of the life cycle. There are two types of such needs:

- i. **Specific transaction needs:** that are linked to specific life events which require a commitment of resources. For instance making a provision for higher education/ marriage of dependents; or purchase of a house or consumer durables
- ii. **General transaction needs:** Amounts set aside from current consumption without being earmarked for any specific purposes - these are popularly termed as 'future provisions'

b) Meeting contingencies

Contingencies are unforeseen life events that may call for large funds. These cannot met from current income and need to be pre-funded. Some of these

events, like death and disability or unemployment, lead to a loss of income. Others, like a fire, may result in a loss of wealth.

Such needs may be addressed through insurance, if the probability of their occurrence is low but cost impact is high. One may alternatively meet them by setting aside a large amount of liquid assets as a reserve.

c) Wealth accumulation

The accumulation motive refers to an individual’s desire to invest for accumulating wealth, taking advantage of favourable market opportunities. Some individuals may take a cautious approach while investing, while some may be willing to take more risks, with a view to earn a higher return. Higher return is desired because it helps to increase one’s wealth or net worth more rapidly. Wealth is linked with independence, enterprise, power and influence.

5. Financial products

Corresponding to the above sets of needs there are three types of products in the financial market:

Transactional products	Bank deposits and other savings instruments that enable one to have adequate purchasing power (liquidity) at the right time and quantum.
Contingency products like insurance	These provide protection against large losses that may be suffered in the event of sudden unforeseen events.
Wealth accumulation products	Shares and high yielding bonds or real estate are examples of such products. Here the investment is made with a view to committing money for making more money.

An individual would typically have a mix of all of the above needs and thus may need to have all three types of products. In a nutshell one may say there is:

- i. A need to save - For cash requirements
- ii. A need to insure - Against uncertainties
- iii. A need to invest - For wealth creation

6. Risk profile and investments

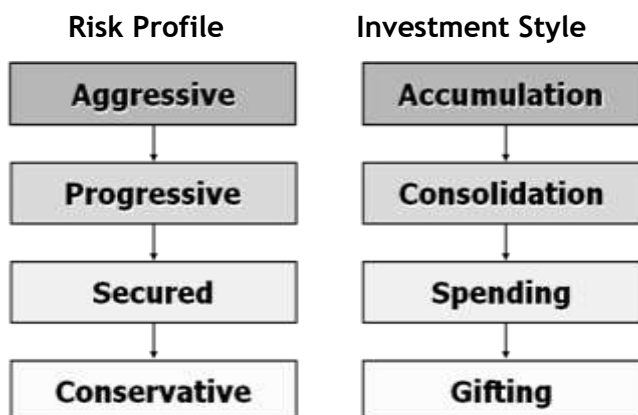
As an individual moves through various stages in the life cycle, from young earner towards middle ages and then towards the final years of one’s work life, the risk profile, or approach towards taking risks also changes.

When one is young, one may be quite aggressive and willing to take risks in order to accumulate as much wealth as possible. As the years pass however, one may become more prudent and careful about investing. One is now concerned to secure and consolidate one’s investments.

Finally, as one nears retirement one may be more conservative. The focus is now to have a corpus from which one can spend in the post retirement years. One may also think about making donations for one’s children, for gifting to charity etc.

One's investment style also changes to keep pace with the risk profile. This is indicated below:

Diagram 3: Risk Profile and Investment Style



Test Yourself 1

Which among the following gives specific protection against unforeseen events?

- I. Insurance
- II. Transactional products like bank Fixed Deposits
- III. Shares
- IV. Debentures

B. Role of financial planning

1. Financial planning

Financial planning is the process of carefully evaluating a client's current and future needs along with his or her risk profile and income, to chart out a road map for meeting various anticipated/ unforeseen needs through recommending appropriate financial products.

Elements of financial planning include:

- ✓ Investing - allocating assets based on one's risk taking appetite,
- ✓ Risk management,
- ✓ Retirement planning,
- ✓ Tax and estate planning, and
- ✓ Financing one's needs

To put it in a nutshell financial planning involves 360 degrees planning.

Diagram 4: Elements of Financial Planning



2. Role of Financial planning

Financial planning is not a new discipline. It was practiced in simple form by our fore fathers. There were limited investment options then. A few decades ago many considered equity investment as akin to gambling. Savings were largely channelled in bank deposits, postal savings schemes and other fixed income instruments. The challenges facing our society and our customers are far different today. Some of them are:

i. Disintegration of the joint family

The joint family has given way to the nuclear family, consisting of father, mother and children. The typical head and earning member of this family has to bear the responsibility for taking care of oneself and one's immediate family. This may call for a lot of proper planning and advice from a professional financial planner.

ii. Multiple investment choices

A large number of investment instruments are available today for wealth creation, each offering varying degrees of risk and return. To achieve financial goals, one has to choose wisely and make the right investment decisions based on one's risk taking appetite. Financial planning can help with one's asset allocation.

iii. Changing lifestyles

Instant pleasure seems to be the order of the day. Individuals want to have the latest mobile phones, cars, large homes, memberships of prestigious clubs, etc. To satisfy these desires, people often borrow heavily and spend a good part of their income to pay off loans, leaving little scope to save. Financial planning helps to plan and one's expenditure so that one can cut down unnecessary expenses so as to maintain one's present standard of living while upgrading it over time.

iv. Inflation

Inflation is a rise in the general level of prices of goods and services in an economy over a period of time. This leads to a fall in the value of money. As a result, the purchasing power of money gets reduced. Inflation can play havoc

post retirement. Financial planning can help to ensure that one is equipped to deal with inflation, especially in later years.

v. Other contingencies and needs

Financial planning also enables individuals to meet a number of other needs and challenges like medical emergencies and tax liabilities. Individuals also need to ensure that their estate consisting of their wealth and properties, smoothly pass on to their loved ones after their death. There are other needs like the need to do charity or meet certain social and religious obligations during one's lifetime and even thereafter. Financial planning is the means to achieve all this.

3. When is the right time to start financial planning?

Financial planning is not meant only for the wealthy. Indeed, Planning should ideally start one earns one's first salary. There is no trigger point to tell when one should begin to plan.

There is however an important principle that should guide us - the longer the time period of our investments, the more they will multiply.

Hence one should start early. One's investments would then get the maximum benefit of time. Again, planning is not only for wealthy individuals. It is for everyone. To achieve one's financial goals, one must follow a disciplined approach. An unplanned, impulsive approach to financial planning is one of the prime causes of financial distress of individuals.

Test Yourself 2

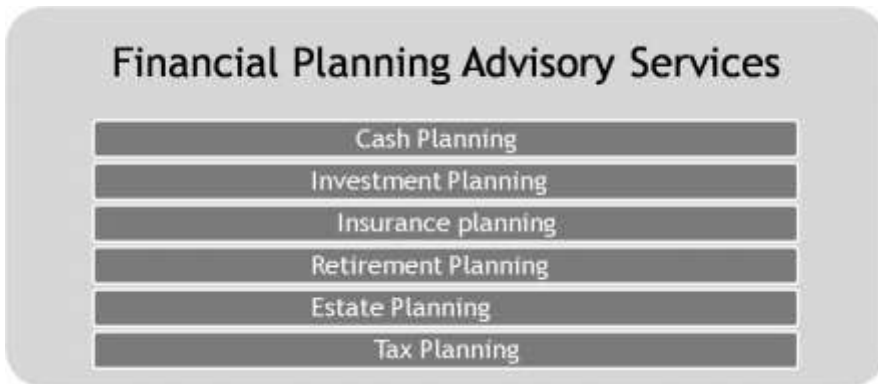
When is the best time to start financial planning?

- I. Post retirement
- II. As soon as one gets his first salary
- III. After marriage
- IV. Only after one gets rich

C. Financial planning - Types

Let us now look at the various types of financial planning exercises that an individual may need to do.

Diagram 5: Financial Planning Advisory Services



Consider the various advisory services that may be provided. There are six such areas that are taken up

- ✓ Cash planning
- ✓ Investment planning
- ✓ Insurance planning
- ✓ Retirement planning
- ✓ Estate planning
- ✓ Tax planning

1. Cash planning

Managing cash flows has two purposes.

- i. To manage income and expenditures flow including establishing and maintaining a reserve of liquid assets to meet unanticipated needs.
- ii. To systematically create and maintain a surplus of cash for capital investment.

Cash Planning involves a number of steps. One must prepare a budget and analyse one's income and expenditure flows to check on what regular and lump sum costs have been incurred. While fixed expenses cannot be controlled easily, one can reduce, postpone and manage expenses that are variable. The next step is to **predict future monthly income and expenses over the whole year** and design a plan for managing these cash flows.

Another part of the cash planning process is to design strategies for maximizing discretionary income.

Example

One can restructure one's outstanding debts.

One can meet outstanding credit card debts through consolidating them and paying them off through a bank loan with lower interest.

One may reallocate one's investments to make them earn more income.

2. Insurance planning

There are certain risks to which individuals are exposed that can keep them from attaining their personal financial goals. Insurance planning involves constructing a plan of action to provide adequate insurance against such risks.

The task here is to estimate how much insurance is needed and determining what type of policy is best suited.

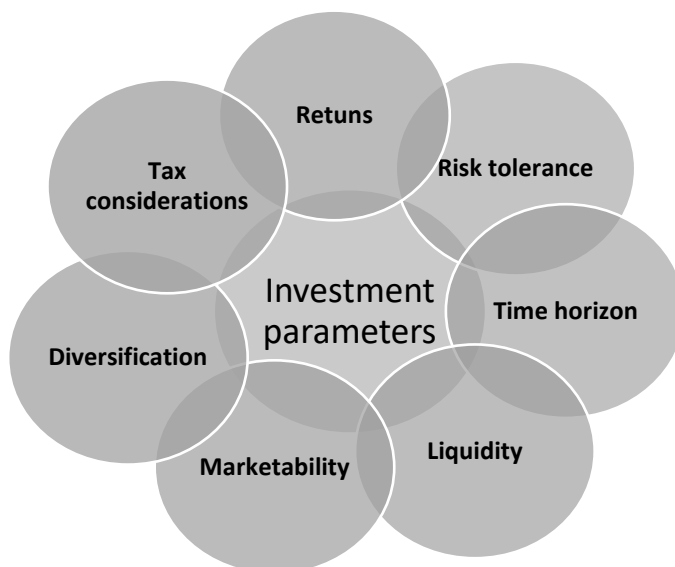
- i. **Life insurance** may be decided by estimating the income and expense requirements of the dependents in the event of premature death of the bread winner.
- ii. **Health insurance** requirements may be assessed in terms of the hospitalisation expenses that are likely to be incurred in any family medical emergency.
 - a. Finally **insurance for one's assets** may be considered in terms of the type and quantum of cover required to protect one's home/ vehicle/ factory etc. from the risk of loss.

3. Investment planning

There is no one right way to invest. What is appropriate would vary from individual to individual. Investment planning is a process of determining the most suitable investment and asset allocation strategies based on an individual's risk taking appetite, financial goals and the time horizon to meet those goals.

a) Investment parameters

Diagram 6: Investment Parameters



The first step here is to define certain investment parameters. These include:

- i. **Returns:** Returns on Investment is often the most important parameter that people look for when they invest their money. The rate of return determines how fast one's wealth from investments would grow over time. The role of returns can be appreciated when one considers the 'Power of compounding'. For instance, if an amount of Rs 1000 is invested today at 8% rate of interest, at the end of five years, it would accumulate to Rs 1469 and at the end of 10 years it would more than double to reach Rs 2159. This expectation of returns which helps to accumulate wealth is one of the prime motives of investment. At the same time, one must note that higher rates of return may be typically accompanied with higher levels of risk. One has to make a trade-off between return and risk. This depends on an individual's risk tolerance.
- ii. **Risk tolerance:** A measure of how much risk someone is willing to take in purchasing an investment.
- iii. **Time horizon:** This is the amount of time available to attain a financial objective. The longer the time horizon, the less concern is there about short term liability. One can invest in longer term, in less liquid assets that earn a higher return.
- iv. **Liquidity:** Individuals with limited investment capacity, or uncertain income and expenditure flows, or who are investing for meeting a particular personal or business expenditure, would be concerned with liquidity [This refers to the ability to convert investment into cash without loss of value.]
- v. **Marketability:** The ease with which an asset can be bought or sold.
- vi. **Diversification:** The extent to which one seeks to diversify or spread the investments to reduce the risks.
- vii. **Taxes:** Many investments confer certain income tax benefits and one may like to consider the post-tax returns of various investments.

b) Selection of appropriate investment vehicles

The next step is selection of appropriate investment vehicles based on the above parameters. The actual selection would depend on the individual's expectations about return and risk.

In India there are a variety of products that may be considered for the purpose of investments. These include:

- ✓ Fixed deposits of banks/ corporates,
- ✓ Small savings schemes of post office,
- ✓ Public issues of shares,
- ✓ Debentures or other securities,
- ✓ Mutual funds
- ✓ Unit linked policies that are issued by life insurance companies etc.

4. Retirement planning

It is the process of determining the amount of money that an individual needs to meet his needs post retirement and deciding on various retirement options for meeting these needs. Retirement planning involves three phases

- a) **Accumulation:** Accumulation of funds is done through various kinds of strategies to set aside money for investment with this purpose.
- b) **Conservation:** Conservation refers to the efforts made to ensure that one's investments are put to hard work and that the principal gets maximised during the individual's working years.
- c) **Distribution:** Distribution refers to the optimal method of converting the corpus or principal into withdrawals/ annuity payments for meeting income needs after retirement.

5. Estate planning

It is a plan for the devolution and transfer of one's estate after one's demise. There are various processes like nomination and assignment or preparation of a will. The basic idea is to ensure that one's property and assets are smoothly distributed and or utilised according to one's wishes after one is no more.

6. Tax planning

Tax planning is done to determine how to gain maximum tax benefit from existing tax laws and also for planning of income, expenses and investments taking full advantage of the tax breaks. As per the tax laws in India, life insurance premium paid by an individual on a life insurance policy on his/ her own life, on the life of his/ her spouse and children is eligible for deduction under Section 80C of the Income Tax Act for calculating the taxable income. Currently, this deduction is allowed up to Rs.1,50,000 subject to conditions. The maturity proceeds (sum assured plus bonus) of such policies are also exempted under Section 10 (10D). Similarly, Death Claim amounts are exempt from Income Tax at the hands of the recipient. One must note that the purpose here is to minimise and not evade taxes.

Life insurance agents may be often required by their clients and prospective customers to advise them not only about meeting their insurance needs but also for support in meeting their other financial needs as well. A sound knowledge of financial planning would be of great value to any insurance agent.

Test Yourself 3

Which among the following is not an objective of tax planning?

- I. Maximum tax benefit
- II. Reduced tax burden as a result of prudent investments
- III. Tax evasion
- IV. Full advantage of tax breaks

Summary

- Financial planning is a process of:
 - ✓ Identifying one's life's goals,
 - ✓ Translating these identified goals into financial goals and
 - ✓ Managing one's finances in ways that will help one to achieve those goals
 - Based on the individual life cycle three types of financial products are needed. These help in:
 - ✓ Enabling future transactions,
 - ✓ Meeting contingencies and
 - ✓ Wealth accumulation
 - The need for financial planning is further increased by the changing societal dynamics like disintegration of the joint family, multiple investment choices that are available today and changing lifestyles etc.
 - The best time to start financial planning is right after one receives the first salary.
 - Financial planning advisory services include:
 - ✓ Cash planning,
 - ✓ Investment planning,
 - ✓ Insurance planning,
 - ✓ Retirement planning,
 - ✓ Estate planning and
 - ✓ Tax planning
-

Key Terms

1. Financial planning
 2. Life stages
 3. Risk profile
 4. Cash planning
 5. Investment planning
 6. Insurance planning
 7. Retirement planning
 8. Estate planning
 9. Suitability information
 10. Tax planning
-

Answers to Test Yourself

Answer 1 - The correct option is I.

Answer 2 - The correct option is II.

Answer 3 - The correct option is III.

CHAPTER L-03

LIFE INSURANCE PRODUCTS: TRADITIONAL

Chapter Introduction

The chapter introduces you to the world of life insurance products. It begins by talking about products in general and then proceeds to discussing the need for life insurance products and the role they play in achieving various life goals. Finally we look at some traditional life insurance products.

Learning Outcomes

- A. Overview of life insurance products
- B. Traditional life insurance products

A. Overview of life insurance products

1. What is a product?

To begin with, let us understand what is meant by a 'product'. In popular terms a product is normally just considered as a commodity or good that is brought and sold in the market.

It is necessary to understand that every Product is a bundle of features or attributes that confer certain benefits.

All Companies try to differentiate their products by making them more attractive to customers and offering different kinds of features and benefits. A life insurance agent's role is to understand and pitch on these features and benefits to make the products of their companies unique and attractive compared to others.

Example

Colgate, Close up and Promise are all different brands of toothpastes. But the features of each brand is different from the other.

Products may be:

- i. **Tangible:** refers to physical objects that can be directly seen or felt by touch (for instance a car or a television set)
- ii. **Intangible:** refers to products that can only be perceived indirectly.

Life insurance is a product that is intangible.

2. Purpose of Life Insurance products.

Human beings possess an **immensely valuable asset - human capital - which is the source of our productive earning capacity**. However, there is an uncertainty about life and human well-being. Events like death and disease can destroy our Earning capabilities and life savings. Insurance provides protection for such situations.

Life insurance products offer protection against the loss of economic value of an individual's productive abilities, as a result of death or disability. The moment an individual takes a life insurance policy and pays the first premium, **an immediate estate is created** in his/ her name and its proceeds are available to his/ her dependents or loved ones.

Life insurance provides peace of mind and protection to the near and dear ones of an individual, in case of one' unfortunate death. Beyond providing such protection, life insurance fulfils other needs of the market, such as savings, wealth accumulation, safety and security of investment and certain rates of return, which are not discussed in this course.

Life insurance industry has seen enormous innovations in product offerings over the last two centuries. The journey began with death benefit products but over the period, multiple living benefits like endowment, disability benefits, dreaded disease covers and so on were added.

One of the major innovations of recent years was the creation of market linked policies where the insured was invited to participate in choosing and managing his investment assets. Another major innovation was the evolution of flexible unbundled products, in which different benefits as well as cost components could be varied by the policy holder as per changing needs, affordability and life-stages.

3. Suitability Information

In order to make insurance intermediaries including agents and brokers more accountable and reduce instances of mis-selling, IRDAI has created a concept of 'product suitability'. 'Suitability information' is the information of a prospect on age, income, family status, life stage, financial and family goals, investment objectives, insurance portfolio already held, etc. That is, before selling an insurance policy to a client, an Agents should be able to justify the suitability of the product for the client's needs.

In other words, the Agent takes into account the particular prospect's risk profile - age, income, family status, life stage, financial and family goals, investment objectives, insurance portfolio already held, insurance needs etc. and decides whether the product is suitable for that prospect. The nature of product, the amount of premium, the mode of premium payment and tenure of the policy as well as the manner of premium payment are also part of the parameters of 'Suitability'.

IRDAI mandates that the suitability information collected should be signed by the prospect and the agent; and preserved by the Insurer as part of the policy records and made available for inspection by the Authority.

4. Riders in Life Insurance Products

A rider is a provision typically added through an endorsement, which becomes part of the contract. Riders are commonly used to provide supplementary benefits like increasing the amount of death benefit provided by a policy, say, because of accidents. Life insurance companies offer a number of riders through which the value of their offerings get enhanced Riders help to customise different requirements of a person into a single plan.

Riders provide a means to provide benefits like Disability cover, accident cover and Critical Illness cover as additional benefits in a standard life insurance contract. Policy holders can avail of them by paying an extra premium.

Test Yourself 1

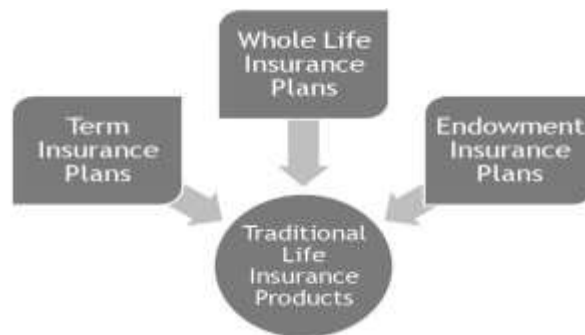
Which among the following is an intangible product?

- I. Car
- II. House
- III. Life insurance
- IV. Soap

B. Traditional life insurance products

We shall now learn about some of the traditional types of life insurance products.

Diagram 1: Traditional Life Insurance Products



1. Term insurance plans

Term insurance is a contract that is valid only during a certain time period. This may range from the short time required to complete an airplane trip to multiple years. Protection may extend up to age 65 or 70. One-year term policies are quite similar to property and casualty insurance contracts. There is no savings or cash value element in this policy.

In October 2020, IRDAI has introduced a Standard Individual Term Life Insurance Product called, “Saral Jeevan Bima” (the Insurer’s name shall be prefixed to the product name), a non-linked non-participating individual pure risk premium life insurance plan, which provides for payment of Sum Assured in lump sum to the nominee in case of the Life Assured’s unfortunate death during the policy term.

Apart from certain benefits and riders specified by the Regulator, no other riders/ benefits/ options/ variants are allowed to be offered. Also, there shall be no exclusions under the product other than the suicide exclusion. Saral Jeevan Bima is to be offered to individuals without restrictions on gender, place of residence, travel, occupation or educational qualifications.

a) Purpose

A Term Life insurance plan fulfils the main and basic idea behind life insurance, which is to provide an assured sum of money to the dependents of the insured on his/ her death.

The policy works as an income replacement plan also. Here the payment of a lump-sum amount is replaced by a series of monthly, quarterly or similar periodical payments to the dependent beneficiaries.

b) Disability

Normally a Term insurance policy covers only death. However, it is possible to buy a Disability Protection Rider on the main policy. In such a case, if the insured suffers from a specified disability during the term of the contract, a disability

benefit would be paid to the beneficiaries/ insured person. The benefits will continue till the death of the insured person.

Diagram 2: Disability



c) Term insurance as a rider

Protection under Term Life is usually provided as a stand-alone policy but it could also be provided through a rider in a policy.

Example

A rider to a pension plan provides for a death benefit to be payable if one dies before the date when pension is to start.

d) Convertibility

Convertible term insurance policies allow a policyholder to change or convert a term insurance policy into a permanent plan like “Whole Life” without providing fresh evidence of insurability. This privilege helps those who wish to have permanent cash value insurance but are unable to afford its high premiums. When the term policy is converted into permanent insurance the new premium rate would be higher.

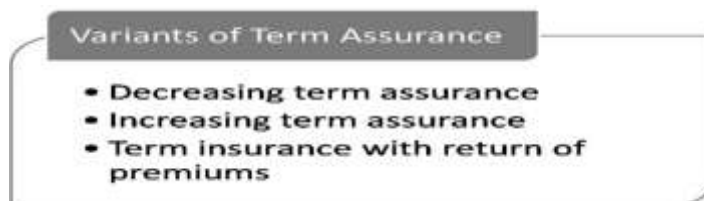
e) Unique Selling Proposition (USP)

The unique selling proposition (USP) of term assurance is its low price, enabling one to buy relatively large amounts of life insurance on a limited budget.

f) Variants

A number of variants of term assurance are possible.

Diagram 3: Variants of Term Assurance



i. Decreasing Term Assurance

These plans typically consist of decreasing term insurance which provides an amount of death benefit that is equal to the balance that is due on a loan, if the borrower dies before the loan is paid. These are often marketed as Mortgage Redemption (discussed in Chapter 15) or Credit Life Insurance. The plans are

usually sold to lending institutions as group insurance to cover the lives of their borrowers. Purchase of mortgage redemption insurance is often a condition of the mortgage loan. Such plans may also be available for automobile or other personal loans.

ii. Increasing term assurance

As the name suggests, the plan provides a death benefit, which increases along with the term of the policy. Premium generally increases as the amount of coverage increases.

iii. Term insurance with return of premiums

Another type of policy (quite popular in India) is term assurance with return of premiums. Though the premium paid would be much higher than for a similar term insurance plan without return of premiums, some customers may need such policies.

g) Relevant scenarios

Term insurance may have relevance in the following situations:

- i. Where the need for insurance protection is purely temporary, as in case of mortgage redemption
- ii. As an additional supplement to a savings plan.
- iii. As part of a “buy term and invest the rest” philosophy, where one seeks only cheap term insurance protection from the insurance company and wants to invest the difference of premiums in other attractive investments.

Important

Limitations of term plans: Term Insurance plans are available only for specific periods and one may not be able to continue the coverage beyond a certain age, say 65 or 70.

2. Whole life insurance

Whole life insurance is an example of a permanent life insurance policy. Here, the life insurer offers to pay the agreed death benefit when the insured dies, no matter when the death might occur. The premiums can be paid throughout one’s life or for a limited time as specified.

Whole life premiums are much higher than term premiums as whole life policies are designed to remain in force until the death of the insured, and pay the death benefit anytime. The Plan also provides for a cash value in the policy holder’s account. He/ she can withdraw cash in the form of a policy loan from this cash value or even redeem it by surrendering the policy for its cash value.

In case of outstanding loans, the amount of loan and interest get deducted from the pay-out to the beneficiaries upon death.

A whole life policy is a good plan for the main earner of the family who wishes to protect his/ her loved ones in the event of premature death and preserve his/ her capital against erosion from various events like terminal illness. One can also use the cash value of the whole life insurance policy for retirement needs, if

required. Whole life insurance thus plays an important role in household saving and creating wealth to be passed on to the next generation.

3. Endowment Assurance

It is a contract in which the sum assured is payable to the nominees of the insured in case of the death of the insured during the term of the policy. If the insured survives the term the sum assured is paid to the insured.

The product has both death and survival benefit components. Endowment Assurance links one's insurance and savings programmes by offering a safe and compulsory method of savings accumulation.

People buy endowment plans as a sure method of providing against old age or for meeting specific purposes like having a fund for (a) educational purposes, (b) meeting children's marriage expenses or (c) paying a mortgage (housing) loan.

Government usually offers tax benefits on the premiums paid, which make it attractive. Many endowment policies mature at ages 55 to 65, when the insured is planning for his/ her retirement. In such cases such policies can supplement retirement savings.

Variants: Endowment assurance has certain variants - discussed below.

4. Money Back Policy

The Money Back policy is a popular endowment plan in India. It has a provision for returning some part of the sum assured in instalments during the term and the balance sum assured at the end of the term.

Example

A Money Back policy for 20 years may provide for paying survival benefits of 20% of the sum assured each at the end of the 5th, 10th and 15th years and the balance 40% at the end of the full term of 20 years. If the life assured dies at the end of, say 18 years, the full sum assured and bonuses (explained in the next section) accrued are paid as death benefit, even though the insured would have been paid a benefit of 60% of the face value already, as money back.

Money Back plans have been popular because of their liquidity (cash back) element, which make them attractive for meeting short and medium term needs. Such plans provide full death protection also, if the individual dies at any point during the term of the policy.

5. Participating (Par) and Non-Participating (Non-Par) Plans

The Life Insurance products can also be classified as Participating (Par) and Non-participating (Non-Par) products. The term "Par" implies policies which are participating in the profits of the life insurer. "Non-Par", on the other hand, represents policies which do not participate in the profits. Both kinds are present in traditional life insurance. Under all traditional plans, the pooled life funds, which are derived from policyholders' premiums, are invested as per regulatory norms. Policy holders who opt for 'par products' are eligible to receive, in addition to a

guaranteed sum assured, a share in the surpluses(bonuses) that are generated by the insurer. These are known as ‘With Profit’ plans.

6. Non-participating products

The Policy holders who buy non-linked without profit [non par] plans are paid a benefit that is fixed and guaranteed at the beginning of the contract and nothing more. Non-participating products may be offered either under a ‘linked platform’ or a ‘non-linked platform’. These are known as ‘Without Profits’ plans.

Example

One may have an endowment policy of twenty years providing a guaranteed addition of 2% of sum assured for each year of term, so that the maturity benefit is sum assured plus a total addition of 40% of the sum assured.

Under the IRDAI’s guidelines on traditional non-par policies, the benefits to be paid on the happening of a specified event, have to be explicitly stated at the outset and not linked to an index or benchmark. The same applies to additional benefits that are accrued at regular intervals. This means that the return on these policies must be disclosed at the time of taking the policy.

Important

Death benefits are subject to regulations of IRDAI issued from time to time. At present, as per the new Regulation 9 of IRDAI (Non-linked) Products Regulation, 2019 pertaining to traditional products, the minimum death cover is as follows:

For all non-linked individual life insurance products, the minimum Sum Assured on death during the entire term of the policy shall not be less than 7 times the annualized premium, for limited or regular premium products, and 1.25 times the single premium for single premium products.

For participating products, in addition to the sum assured on death, the bonus and additional benefits as stated in the policy and accrued till the date of death shall become payable on death as part of the death benefit, if not paid earlier. In essence, there are **two variants**, participating and non-participating plans.

- i. For **participating policies** the bonus is linked to the investment performance of the fund and is not declared or guaranteed before. The **bonus, once it is announced, becomes a guarantee**. It is usually paid in case of death of the policyholder or maturity benefit. This bonus is also called **reversionary bonus**.
- ii. In case of **non-participating policies**, the return on the policy is disclosed in the beginning of the policy itself.

7. Pension Plans and Annuities

A pension plan is typically a fund into which money is paid during a person’s employment years and from which money is drawn to support the person after his retirement from work in the form of periodic payments.

Pension plans are designed on group (usually employer driven) or individual basis. A group pension may be a "defined benefit plan", where a fixed sum is paid regularly to a person, or a "defined contribution plan", under which a fixed sum is invested which becomes available at retirement age. Pensions are essentially guaranteed life annuities, thus insuring against the risk of longevity. A pension created by an employer for the benefit of an employee is commonly referred to as an occupational or employer pension.

On retirement, the money in the member's account is used to provide retirement benefits, typically by purchasing an annuity which then provides a regular income. An annuity is a long-term investment issued by an insurance company designed to help protect one from the risk of outliving one's income. Through annuitization, one's contributions are converted into periodic payments that can last for life.

Individuals can avail of pension benefits by purchasing pension plans from insurance companies. Pension plans can be **on accumulation or deferred basis** which allows a person to contribute in two ways, (i) in lump sum, or (ii) over a period of time; so that he/ she can get a pension from the desired age/ date (called as the 'vesting' date). One can opt to receive pensions/ annuities on monthly, quarterly, half-yearly or annual modes. Pension plans are available on an **immediate basis** also, from the very next month of purchase, on payment of a lump sum amount, called as immediate annuity.

The Indian insurance industry has several deferred and immediate annuity products marketed by Life Insurers. Each product has its own features, terms, conditions and annuity options.

Saral Pension: To provide uniformity across Insurers, to reduce confusion in the market about annuity schemes, and to make available a product that will broadly meet the needs of an average customer, in January 2021, IRDAI mandated all Life Insurers to introduce a standard, immediate annuity product, with simple features and standard terms and conditions on an individual (not group) basis. Such a standard product will make it easier for the customers to make an informed choice, enhance the trust between the Insurers and the insured, and reduce mis-selling as well as potential disputes.

The standard individual immediate annuity product is called, "Saral Pension", prefixed by the Insurer's name. The product offer two (and only two) annuity options as follows:

- a) Life annuity with 100% Return of Purchase Price; and
- b) Joint Life annuity with a provision of 100% annuity to the secondary annuitant on death of the primary annuitant and return of 100% Purchase Price on death of last survivor.

Mode of Annuity payment would be Monthly, Quarterly, Half-Yearly and Yearly. Details are available on IRDAI's website at the following link - https://www.irdai.gov.in/ADMINCMS/cms/whatsNew_Layout.aspx?page=PageNo4353&flag=1

Test Yourself 2

The premium paid for whole life insurance is _____ than the premium paid for term assurance.

- I. Higher
- II. Lower
- III. Equal
- IV. Substantially higher

Summary

- Life insurance products offer protection against the loss of economic value of an individual's productive abilities, which is available to his/ her dependents or to the self.
- A life insurance policy, at its core, provides peace of mind and protection to the near and dear ones of the individual in case something unfortunate happens to him or her.
- Term insurance provides valid cover only during a certain time period that has been specified in the contract.
- The unique selling proposition (USP) of term assurance is its low price, enabling one to buy relatively large amounts of life insurance on a limited budget.
- While term assurance policies are examples of temporary assurance, where protection is available for a temporary period of time, whole life insurance is an example of a permanent life insurance policy.

Key Terms

1. Term insurance
2. Whole life insurance
3. Endowment assurance
4. Money back policy
5. Par and non-par schemes
6. Reversionary bonus

Answers to Test Yourself

- Answer 1** -The correct option is III.
Answer 2 - The correct option is I.

CHAPTER L-04

LIFE INSURANCE PRODUCTS: NON-TRADITIONAL

Chapter Introduction

The chapter introduces you to the world of non-traditional life insurance products. We start by examining the limitations of traditional life insurance products and then have a look at the appeal of non-traditional life insurance products. Finally we look at some of the different types of non-traditional life insurance products available in the market.

Learning Outcomes

- A. Overview of non-traditional life insurance products
- B. Non-traditional life insurance products

A. Overview of non-traditional life insurance products

1. Non-traditional life insurance products - Purpose and need

In the previous chapters we have considered some of the traditional life insurance products which have insurance as well as a savings element in them.

People have been questioning the ability of traditional life insurance policies to provide a rate of return comparable to other assets in the financial market. Issues have also been raised about the way they are structured into a single package of benefits and premiums.

2. Limitations of traditional products

A critical examination would reveal the following areas of concern:

Cash value component: The savings or cash value component in traditional policies is not well defined. This makes it less transparent about mortality, interest rates, expenses and other parameters that are made.

Rate of return: It is not easy to ascertain the rate of return on traditional policies because the value of the benefits under “With Profit policies” can be known only when the contract ends. This makes it difficult to compare these policies with other financial instruments.

Surrender value: The method of arriving at the cash and surrender values (at any point of time), are set by the life insurer and not transparent.

Yield: The yield on these policies are much lower than those from other investments.

3. Features of Non-Traditional Policies: Life insurance companies started designing policies with certain innovative features, some of which are given below:

- a) **Direct linkage with investment gains:** Policies with direct linkage with the capital market were designed in an attempt to make investment gains.
- b) **Policies that can beat inflation:** Policies were designed to give returns closer to the inflation rates. The change was that insurers started thinking that life policies need to match if not beat inflation.
- c) **Policies with Flexibility:** Policies which allowed customers to decide (within certain limits) the amount of premium they wanted to pay; and the amount of death benefits and cash values they wanted, got designed.
- d) **Surrender value:** Policies that gave better surrender values available under traditional policies were also designed by insurers.

These policies became very popular and even began to replace traditional products in many countries, including India.

Test Yourself 1

Which among the following is a non-traditional life insurance product?

- I. Term assurance
 - II. Universal life insurance
 - III. Endowment insurance
 - IV. Whole life insurance
-

B. Non-traditional life insurance products

Some non-traditional products

We shall discuss some of the non-traditional products which have emerged in the Indian market and elsewhere.

1. Universal Life and Variable Life

Universal Life policy was introduced in the United States in 1979 and quickly became very popular. Its features are **flexible premiums, flexible face amount and death benefit amounts**. Unlike traditional policies, where fixed premiums have to be paid periodically to keep the contract in force, universal life policies allow the policyholder (within limits) to decide the amount of premiums he or she wants to pay for the coverage.

Variable Life was introduced in the United States in 1977. It is a type of “Whole Life” policy where the death benefit and cash value of the policy fluctuates according to the investment performance of a special investment account into which premiums are credited.

The design and sale of the above two kinds of products, both of which were called Variable Insurance Products, have been discontinued and are not allowed in India since 2019, further to the issue of IRDAI (ULIP) Regulations, 2019.

2. Unit linked insurance

Unit Linked Plans, also known as ULIPs were first introduced in UK during the 1960s. They have today emerged as one of the most popular and significant products, displacing traditional plans in many markets.

Unit linked policies help to overcome the limitations of traditional products. The premium paid by the policyholder gets divided into two major portions

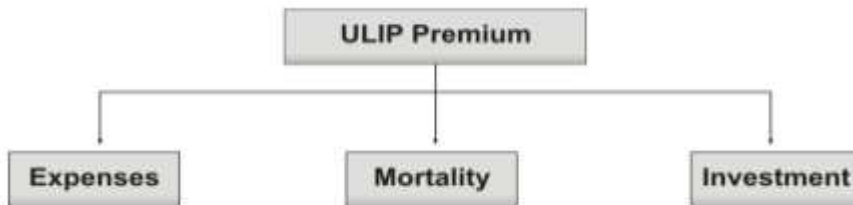
- the first portion which is utilised for providing insurance cover, and
- the second portion that gets invested into the fund opted by the insured.

The benefits under such contracts are wholly or partially determined by the value of units credited to the policyholder’s account at the date when payment is due.

In many markets these policies were positioned and sold as investment vehicles with an attached insurance component.

Unlike traditional savings policies that are bundled, Unit linked contracts are unbundled. Their structure is transparent with the charges to pay for the insurance and expenses component being clearly specified.

Diagram 1: Premium break-up



After deducting the charges from the premium, the balance of the account and income are invested in **units**.

The Value of Units

The value of units is defined by a rule or formula, which is outlined in advance. Typically the value of the units is given by the Net Asset Value (NAV), which reflects the market value of the assets in which the fund is invested. Different persons could arrive at the same benefits payable by following the formula.

The Formula is as follows:

Net Asset Value [NAV] = Market Value of Assets of the fund/ Number of units of the funds

Thus, Policyholder benefits do not depend on the assumptions of the life insurance company.

Unit linked policies allow policy holders to choose between different kinds of funds. Each fund would have a different portfolio mix. The investor gets to choose between a broad option of debt, balanced and equity funds, defined below. Even within these broad categories there may be other types of options.

Equity Fund	Debt Fund	Balanced Fund	Money Market Fund
This fund invests the major portion of the money in equity and equity related instruments.	This fund invests major portion of the money in Govt. Bonds, Corporate Bonds, Fixed Deposits etc.	This fund invests in a mix of equity and debt instruments	This fund invests money mainly in instruments such as Treasury Bills, Certificates of Deposit, Commercial Paper etc.

There is also provision to switch from one kind of fund to another if performance of one or more funds is not found to be up to the mark.

Some of the specific features of ULIP Policies are given below:

i. Unitising

Benefits under ULIP policies are determined by the value of units credited to the policyholder's account at the date when the claim payment is due to be made. A unit is created by dividing an investment fund into a number of equal parts.

ii. Transparent structure

The charges for insurance cover and expenses in ULIPs are clearly specified. Once these charges are deducted from the premium, the balance of the account and income from it are invested in units.

iii. Pricing

Under ULIPs, the insured decides the amount of premium that he/ she can contribute at regular intervals.

In all Life Insurance policies, the initial costs are very high. Under traditional policies, the premium charges for meeting these costs are spread throughout the policy term.

In the case of ULIPs, they are deducted from the initial premiums itself. This significantly reduces the amount allocated for investment. This is why the value of the benefits, vis-à-vis the premiums paid, would be very low and even less than the premiums paid in the early years of the contract.

iv. Death Benefit

Unlike in traditional policies, the amount of death benefit in ULIP policies is a multiple of the premiums paid. In case of death during the term of the policy, the beneficiary would be paid the higher of the Sum Assured [which is a multiple of the premium] or the Fund Value (unit price multiplied by the number of units) standing to his or her account.

v. The bearing of investment risk

The value of the units depends on the value of the life insurer's investments, which are not guaranteed.

The life insurer, though expected to manage the portfolio efficiently, does not give any guarantee about unit values. Hence, the investment risk is borne by the policyholder/ unit holder.

Test Yourself 2

Which of the following statements is/ are incorrect?

- I. Variable life insurance is a temporary life insurance policy
- II. Variable life insurance is a permanent life insurance policy
- III. The policy has a cash value account
- IV. The policy provides a minimum death benefit guarantee

Summary

- A critical concern with respect to life insurance policies was giving a competitive rate of return comparable to other assets in the financial marketplace.
 - Some of the trends that led to the increase in non-traditional life products include unbundling, investment linkage and transparency.
 - Universal life insurance is a form of permanent life insurance characterised by its flexible premiums, flexible face amount and death benefit amounts, and the unbundling of its pricing factors.
 - ULIPs became one of the most popular and significant products, replacing traditional plans in many markets.
 - ULIPs provide the means for directly and immediately cashing on the benefits of a Life Insurer's investment performance.
-

Key Terms

1. Universal life insurance
2. Variable life insurance
3. Unit linked insurance
4. Net asset value

Answers to Test Yourself

Answer 1 -The correct option is II.

Answer 2 - The correct option is I.

CHAPTER L-05

APPLICATIONS OF LIFE INSURANCE

Chapter Introduction

Life insurance does not merely seek to protect individuals from premature death. It has other applications as well. It can be applied to the creation of trusts with resultant insurance benefits; it can be applied for creating a policy covering key personnel of industries and also for redeeming mortgages. We shall briefly describe these various applications of life insurance.

Learning Outcomes

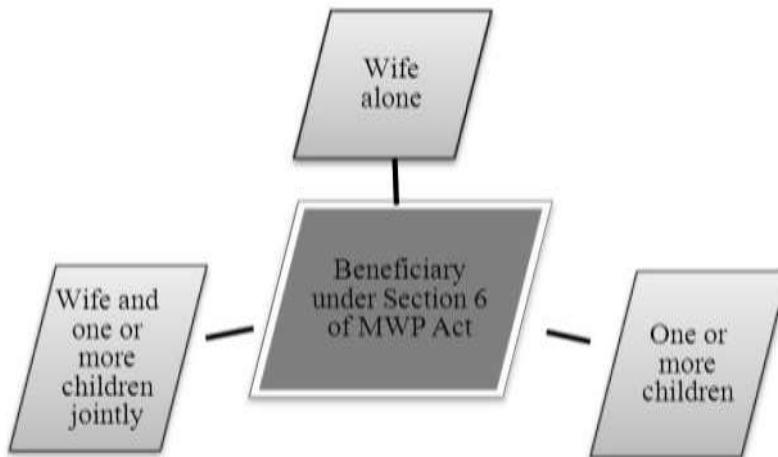
- A. Married Women's Property Act, 1874
- B. Keyman Insurance
- C. Mortgage Redemption Insurance

A. Applications of Life insurance

1. Married Women's Property Act

Section 6 of the Married Women's Property Act, 1874 tries to ensure that the benefits under a life insurance policy will pass on in a secure manner to the wife and children through creation of a trust for the purpose.

Diagram 1: Beneficiaries under MWP Act



The section provides that when a married man takes a policy on his own life and clearly expresses on the face of such policy that it is for the benefit of his wife or his wife and children, and to be held in a trust for their benefit only, the proceeds of such a policy shall not, so long as the objects of the trust remains, be subject to the control of the husband or to his creditors or form part of his estate.

Features of a policy under the MWP Act

- i. Each policy will remain a separate Trust. Either the wife or child (over 18 years of age) can be a trustee.
- ii. The policy shall be beyond the control of court attachments, creditors and even the life assured.
- iii. The claim money shall be paid to the trustees.
- iv. The policy cannot be surrendered and neither nomination nor assignment is allowed.
- v. If the policyholder does not appoint a special trustee to receive and administer the benefits under the policy, the sum secured under the policy becomes payable to the Official Trustee of the State in which the office at which the insurance was effected is situated.

Benefits

The Trust is set up under a deed that cannot be revoked or amended. It can contain one or more insurance policies. It is important to appoint a trustee who would be responsible for administering the trust property, including investing the insurance proceeds, on behalf of the beneficiaries. These benefits are secured from passing to future creditors

2. Key-man Insurance

Keyman insurance is an important form of business insurance.

Definition

Key-man Insurance can be described as an insurance policy taken out by a business to compensate that business for financial losses that would arise from the death or extended incapacity of an important member of the business.

Many businesses have key persons responsible for a major part of its profits or has knowledge and skills that are vital to the organisation and difficult to replace. Key man insurance is taken by employers on the life of such key persons to facilitate business continuity and offset the costs and losses which are likely to be suffered in the event of the loss of a key person. Keyman insurance does not indemnify the actual losses incurred but compensates with a fixed monetary sum as specified on the insurance policy.

Keyman insurance is allowed as a term insurance policy where the sum assured is linked to the profitability of the company rather than the key person's own income. The premium is paid by the company. In case the key person dies, the benefit is paid to the company. The proceeds of Keyman insurance is taxable at the hands of the company.

a) Who can be a key-man?

A key person can be anyone directly associated with the business whose loss can cause financial strain to the business. For example, the person could be a director of the company, a partner, a key sales person, key project manager, or someone with specific skills or knowledge which is especially valuable to the company.

b) Insurable losses

The following are the losses for which key person insurance can provide compensation:

- i. Losses related to the extended period when a key person is unable to work, to provide temporary personnel and, if necessary to finance the recruitment and training of a replacement

- ii. Insurance to protect profits. For example, offsetting lost income from lost sales, losses resulting from the delay or cancellation of any business project that the key person was involved in, loss of opportunity to expand, loss of specialised skills or knowledge

3. Mortgage Redemption Insurance (MRI)

A person taking a loan to buy a property, may be required to pay for mortgage redemption insurance by the bank, as part of the loan arrangement. “Mortgage Redemption Insurance” is popularly referred to “Credit Life Insurance policy”.

a) What is MRI?

It is an insurance policy that provides financial protection for home loan borrowers. It is basically a decreasing term life insurance policy taken by mortgagor to repay the balance on a mortgage loan if he/ she dies before its full repayment. It can be called a loan protector policy. This plan is suitable for people whose dependents may need assistance in clearing their debts in case of the unexpected demise of the policyholder.

b) Features

The insurance cover under this policy decreases each year unlike a term insurance policy where insurance cover is constant during the policy period.

Test Yourself 1

What is the objective behind Mortgage Redemption Insurance?

- I. Facilitate cheaper mortgage rates
- II. Provide financial protection for home loan borrowers
- III. Protect value of the mortgaged property
- IV. Evade eviction in case of default

Summary

- Section 6 of the Married Women’s Property Act, 1874 provides for security of benefits under a life insurance policy to the wife and children.
- The policy effected under MWP Act shall be beyond the control of court attachments, creditors and even the life assured.
- Keyman insurance is an important form of business insurance. It can be described as an insurance policy taken out by a business to compensate at for financial losses that would arise from the death or extended capacity of an important member of the business.

- Mortgage redemption insurance is basically a decreasing term life insurance policy taken by a mortgagor to repay the balance on a mortgage loan if he/ she dies before its full repayment.
-

Key Terms

1. Married Women's Property Act
 2. Keyman insurance
 3. Mortgage Redemption Insurance
-

Answers to Test Yourself

Answer 1 - The correct option is II.

CHAPTER L-06

PRICING AND VALUATION IN LIFE INSURANCE

Chapter Introduction

The objective of this chapter is to introduce to the learner the basic elements that are involved in the pricing and benefits of life insurance contracts. We shall first discuss the elements that constitute the premium and then discuss the concept of surplus and bonus.

Learning Outcomes

- A. Insurance pricing - basic elements
- B. Surplus and bonus

A. Insurance pricing - Basic elements

1. Premium

In ordinary language, the term premium denotes the price that is paid by an insured for purchasing an insurance policy. It is normally expressed as a rate of premium per thousand rupees of sum assured. The premium rates depend on the age of the prospect and the plan.

These premium rates are available in the form of tables of rates that are available with insurance companies.

Diagram 1: Premium



The rates printed in these tables are known as “Office Premiums”. They are in most cases the same throughout the term and are expressed as an annual rate.

Example

If the premium for a twenty year endowment policy for a given age is Rs. 4,800, it means that Rs. 4,800 has to be paid each year for twenty years.

However it is possible to have some policies in which the premiums are payable only in the first few years. Companies also have single premium contracts in which only one premium is payable at the beginning of the contract. These policies are usually investment oriented.

2. Rebates

Life insurance companies may also offer certain types of rebates on the premium that is payable. Two such rebates are:

- ✓ For sum assured
- ✓ For mode of premium

Rebate for sum assured

The **rebate for sum assured** is offered to those who buy policies with higher amounts of sum assured. It is offered as a way of passing on to the customer, the gains that the insurer may make when servicing higher value policies. The logic is that the effort and cost required to process a policy of Rs 50,000 or 5,00,000 remains the same. But higher sum assured policies yield more premium and so more profits.

Rebate for mode of premium

Similarly a rebate may be offered **for the mode of premium**. Life insurance companies may allow premiums to be paid on annual, half yearly, quarterly or monthly basis. More frequent the mode, more the administrative costs for collecting and accounting the premium. Again, in the yearly mode, the insurer can utilise this amount during the entire year and earn interest on it. Insurers would hence encourage payment via yearly and half yearly modes by allowing a rebate on these. They may also charge a little extra for monthly mode of payments, to cover additional administrative expenses involved.

3. Extra charges

The tabular premium is charged for those individuals who are not subject to any significant factors that would pose an extra risk. They are known as **standard lives** and the rates charged are known as ordinary rates.

If a person proposing for insurance suffers from certain health problems like heart ailments or diabetes that can pose a hazard to his life, he or she is considered to be sub-standard. The insurer may decide to impose an extra premium by way of a health extra. Similarly an occupational extra may be imposed on those engaged in a hazardous occupation, like a circus acrobat. These extras would result in the premium being more than the tabular premium.

Again, an insurer may offer certain extra benefits under a policy, which are available on payment of an extra premium.

Example

A life insurer may offer a Double Accident Benefit or DAB (where double the sum assured is payable as a claim if death is a result of accident). For this it may charge an extra premium of one rupee per thousand sum assured.

Similarly a benefit known as Permanent Disability Benefit (PDB) may be availed by paying an extra per thousand sum assured.

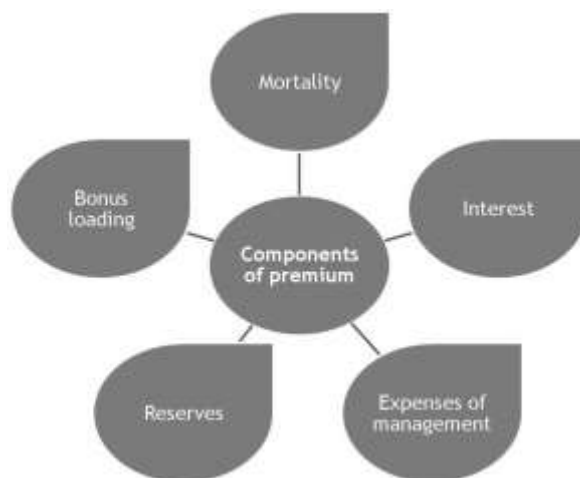
4. Determining the premium

Let us now examine how life insurers arrive at the rates that are presented in the premium tables. This task is performed by an actuary. The process of setting

the premium in case of traditional life insurance policies like term insurance, whole life and endowment considers following elements:

- ✓ Mortality
- ✓ Interest
- ✓ Expenses of management
- ✓ Reserves
- ✓ Bonus loading

Diagram 2: Components of Premium



The first two elements give us the Net premium. By adding [also called ‘loading’] the other elements to the net premium we get the gross or office premium

a) Mortality and Interest

Mortality is the first element in premiums. It is the chance or likelihood that a person of a certain age would die during a given year. To find out the expected Mortality of a person, “Mortality Tables” are used.

Example

If the mortality rate for age 35 is 0.0035 it implies that out of every 1000 people who are alive as on age 35, 3.5 (or 35 out of 10,000) are expected to die between age 35 and 36.

The table may be used to calculate mortality cost for different ages. For example the rate of 0.0035 for age 35 implies a cost of insurance of 0.0035×1000 (sum assured) = Rs. 3.50 per thousand sum assured.

The above cost may be also called the “Risk Premium”. For higher ages the risk premium would be higher.

Example

If we need to have Rs. 5 per thousand to meet the cost of insurance after five years and if we assume a rate of interest of 6%, the present value of Rs. 5 payable after five years would be $5 \times 1 / (1.06)^5 = 3.74$.

If instead of 6% we were to assume 10%, the present value would be only 3.10. In other words the higher the rate of interest assumed, the lower the present value.

From our study of mortality and interest there are two major conclusions we can derive

- ✓ Higher the mortality rate in the mortality table, higher the premiums would be
- ✓ Higher the interest rate assumed, lower the premium

Net premium

The estimates of mortality and interest give the “Net Premium”

Gross premium

Gross premium is the net premium plus an amount called loading. There are three considerations or guiding principles that needs to be borne in mind when determining the amount of loading:

b) Expenses and reserves

Life insurers have to incur various types of operating expenses including:

- ✓ Agents training and recruitment,
- ✓ Commissions of agents,
- ✓ Staff salaries,
- ✓ Office accommodation,
- ✓ Office stationery,
- ✓ Electricity charges,
- ✓ Other miscellaneous etc.

All these have to be paid from premiums that are collected by insurers. These expenses are suitably loaded to the net premium.

c) Lapses and contingencies

In addition to expenses, there are other factors that can make the calculations of life insurers go wrong.

One source of risk is that of lapses and withdrawals. A lapse means that the policyholder discontinues payment of premiums. In case of withdrawals, the policyholder surrenders the policy and receives an amount from the policy's acquired cash value.

Lapses usually happen within the first three years, especially in the first year of the contract.

d) With Profit (participating) policies and Bonus loading

The concept of 'With Profit' policies originated when Life insurers started the practice of charging a high loading in advance to create a buffer to keep them solvent even in adverse situations. If subsequent experience proved to be more favourable, the life insurer would share some of the profits it made as a result with policy holders by way of bonus.

In sum we can say that:

Gross premium = Net premium + Loading for expenses + Loading for contingencies + Bonus loading

Test Yourself 1

What does a policy lapse mean?

- I. Policyholder completes premium payment for a policy
 - II. Policyholder discontinues premium payment for a policy
 - III. Policy attains maturity
 - IV. Policy is withdrawn from the market
-

B. Surplus and bonus

1. Determination of surplus and bonus

Every life insurance company is expected to undertake a periodic valuation of its assets and liabilities. Such a valuation has two purposes:

- i. To assess the financial state of the life insurer and determine if it is solvent or insolvent
- ii. To determine the surplus available for distribution among policyholders/ share holders

Definition

Surplus is the excess of value of assets over value of liabilities. If it is negative, it is known as a strain.

Let us now see how the concept of surplus in life insurance is different from that of profit of a firm.

Firms in general look at profits in two ways. Firstly, profit is the **excess of income over outgo** for a given accounting period, as it appears in the profit and loss account. Profit also forms part of the balance sheet of a firm - it may be defined as the **excess of assets over liabilities**. In both instances, profits are determined at the end of the accounting period.

Surplus = Assets - Liabilities

Let us understand what liabilities mean in life insurance. For a given block of life insurance policies, the life insurer has to make provision for meeting future claims, expenses and other expected pay-outs that may arise. The insurer also expects to receive premiums in future for these policies.

Liabilities are thus the present value of all payments that have to be made less the present value of premiums expected to be received on these policies. The present value is arrived at by applying a suitable rate of discount [the interest rate]

Surplus arises as a result of the life insurer's actual experience being better than what it had assumed. Life insurers are obliged to share the benefits arising as a result with holders of it's with profit policies.

Example

The profits of XYZ firm as on 31st March 2013, is given as its income less expenses or its assets less liabilities as on that date.

In both instances, the profit is clearly defined and is known.

2. Bonus

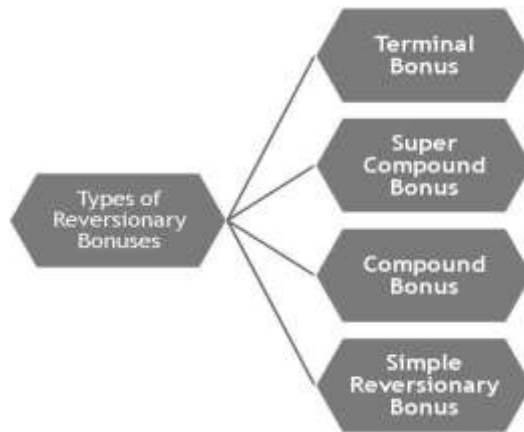
Insurers have to declare and distribute its divisible surplus among the policy holders and shareholders of the company [if any] in the form of a bonus. In India, the United Kingdom and many other countries, distribution of surplus is popular.

Bonus is paid as an addition to the basic benefit payable under a contract. Typically it may appear as an addition to basic sum assured or basic pension per annum. It is expressed, for example, as Rs. 60 per thousand sum assured

The most common form of bonus is the **reversionary bonus**. Once declared these bonus additions, made each year, get attached to the policy and cannot be taken away. They are called 'Reversionary' bonuses because they are received only at the time of a claim by death or maturity. Bonuses may also be payable on surrender provided the contract is eligible through having run for a minimum term [say 5 years]

Types of reversionary bonuses

Diagram 3: Types of Reversionary Bonuses



i. Simple Reversionary Bonus

This is a bonus expressed as a percentage of the basic cash benefit under the contract. In India for example, it is declared as amount per thousand sum assured.

ii. Compound Bonus

Here the company expresses a bonus as a percentage of basic benefit and already attached bonuses. It is thus a bonus on a bonus. A way to express it may be as @ 8% of basic sum assured plus attached bonus.

iii. Terminal Bonus

As the name suggests, this bonus attaches to the contract only at the time of its termination [by death or maturity]. It is applicable only for the claims arising in the ensuing year. Thus terminal bonus declared for 2013 would only apply to claims that have arisen during 2013-14 and not for subsequent years. Terminal bonuses depend on the time duration of the contract and increase with it. A contract that has run for 25 years would have higher terminal bonus than one which has run for 15 years.

3. The Contribution Method

Another method of distribution of surplus adopted in North America is the "Contribution" method. Here, the surplus, i.e. the difference between what was expected to happen and what actually happened over the year with respect to mortality, interest and expenses is declared and distributed as dividends.

The dividends can be paid in cash, by way of adjustments/ reductions in future premiums, by allowing purchase of non-forfeitable paid up additions to the policy or as accumulations to the credit of the policy.

4. Unit Linked Policies

The Principles of Pricing and other features of ULIP Policies have already been covered in an earlier chapter.

Summary

- In ordinary language, the term premium denotes the price that is paid by an insured for purchasing an insurance policy.
- The process of setting the premium for life insurance policies involves consideration of mortality, interests, expense management and reserves.
- Gross premium is the net premium plus an amount called loading.
- A lapse means that the policyholder discontinues payment of premiums. In case of withdrawals, the policyholder surrenders the policy and receives an amount from the policy's acquired cash value.
- Surplus arises as a result of the life insurer's actual experience being better than what it had assumed.
- Surplus allocation could be towards maintaining solvency requirements, increasing free assets etc.
- The most common form of bonus is the reversionary bonus.

Key Terms

1. Premium
2. Rebate
3. Bonus
4. Surplus
5. Reserve
6. Loading
7. Reversionary bonus

Answers to Test Yourself

Answer 1 - The correct option is II.

CHAPTER L-07

LIFE INSURANCE DOCUMENTATION

Chapter Introduction

We have seen that the insurance industry deals with a large number of forms and documents in Chapter 7. There are some documents specific to life insurance, which are discussed in this chapter. Here, we are also discussing the main provisions incorporated in a policy document. Provisions related to grace period, policy lapse and non-forfeiture and certain other privileges are also discussed.

Learning Outcomes

- A. Proposal stage documentation
- B. Policy stage documentation
- C. Policy conditions and privileges

A. Proposal stage documentation

Further to the common points discussed about the Prospectus and the Proposal Form in Chapter 7, there are some additional points that Life Insurers need to understand.

Prospectus: In insurance, 'Prospectus' means a document in physical, electronic or any other format issued by the insurer to sell or promote the insurance product. The prospectus of an insurance product shall clearly state

- (a) the Unique Identification Number (UIN) allotted by the Authority for the concerned insurance product;
- (b) the scope of benefits;
- (c) the extent of insurance cover;
- (d) the warranties, exclusions/exceptions and conditions of the insurance cover along with explanations.

The prospectus should also provide:

- (a) a description of the contingency or contingencies to be covered by insurance;
- (b) the class or classes of lives or property eligible for insurance under the terms of such prospectus.

In Life insurance, the prospectus should also mention about the Riders (also called Add-on covers in Health and General Insurance) allowable on the product and their benefits.

Proposal Form: In respect of Life insurance, the details of the proposers' family members (including parents) indicating their longevity, status of health and ailments suffered by any of them, are collected through the Proposal form. Depending on the product, the medical details of the life proposed for insurance, his/ her personal history of disease and personal characteristics may also be asked for. The Proposal Form is the document by which insurers get all the information that they need from the prospect.

Section 45 of the Insurance Act, provides that the Policy shall not be called in question on the ground of mis-statement after three years. Agents have an important role in guiding the prospect to give answers to all the questions in the Proposal Form/ Medical Forms etc. truthfully and advising them of the implications of not doing so in terms of Section 45.

Proposal Forms for Life Insurance should state the requirements of Section 45 of the Act. While answering the questions in the Proposal Form for obtaining life insurance cover, the prospect is to be guided by the provisions of Section 45 of the Act.

Similarly, Section 39 of the Act is about the provision of nomination. Wherever the facility of Nomination is available to the proposer, the Agent shall inform him/ her of the provisions of Section 39 of the Act and encourage the proposer to avail the facility.

Aspects related to the personal financial planning of the life proposed including his/ her work span, projected income and expenses, as well as needs for savings and investment, health, retirement and insurance may also be asked in the Life Insurance Proposal Form.

Age Proof: Age being an important factor for assessing the risk profile of the life to be insured, Life insurers collect documentary evidence to verify correct age. Valid age proofs may be standard or non-standard, as discussed in Chapter 7.

Life insurers look into the following documents as well.

a) Agent's Confidential Report

The agent is the primary underwriter. All material facts and particulars about the policyholder, relevant to risk assessment, need to be revealed by the agent in his/her report. This means that matters of health, habits, occupation, income and family details need to be mentioned in the report.

b) Medical Examiner's report

In many cases, the life to be insured has to be medically examined by a doctor who is empanelled by the insurance company. Details of physical features like height, weight, blood pressure, cardiac status etc. are recorded and mentioned by the doctor in his report called the medical examiner's report. The underwriter of the insurance company thereby gets an account of the current health position of the life to be insured.

Many proposals are underwritten and accepted for insurance without calling for a medical examination. They are known as non-medical cases. The medical examiner's report is required typically when the proposal cannot be considered under non-medical underwriting because the sum proposed or the age of the proposed life is high or there are certain characteristics which are revealed in the proposal, which call for examination and report by a medical examiner.

c) Moral Hazard report

Moral Hazard is the likelihood that a client's behaviour might change as a result of purchasing a life insurance policy and such a change would increase the chance of a loss. This is one factor that Life insurance underwriters take into account seriously when assessing the risk.

Life insurance companies seek to guard against the possibility of individuals seeking to make a profit from the purchase of life insurance through actions like ending one's own life or the life of another. Life insurance underwriters would thus look for any factors which might suggest such hazard. For this purpose, the company may require that a Moral Hazard Report has to be submitted by an official of the insurance company.

Example

Vikas recently purchased a life insurance policy. He then decided to go on a skiing expedition at a site which was touted to be one of the most dangerous skiing places on earth. In the past he had refused to undertake such expeditions.

B. Policy Stage Documentation

1. First Premium Receipt

An insurance contract commences when the life insurance company issues a first premium receipt (FPR).

The FPR is the evidence that the policy contract has begun. The first premium receipt contains the following information:

- i. Name and address of the life assured
- ii. Policy number
- iii. Premium amount paid
- iv. Method and frequency of premium payment
- v. Next due date of premium payment
- vi. Date of commencement of the risk
- vii. Date of final maturity of the policy
- viii. Date of payment of the last premium
- ix. Sum assured

After the issue of the FPR, the insurance company will issue subsequent premium receipts when it receives further premiums from the proposer. These receipts are known as renewal premium receipts (RPR). The RPRs act as proof of payment in the event of any disputes related to premium payment.

2. Policy Document

The policy document is the most important document associated with insurance. **It is evidence of the contract between the assured and the insurance company.** It is not the contract itself. If the policy document is lost by the policy holder, it does not affect the insurance contract. The insurance company will issue a duplicate policy without making any changes to the contract. The policy document has to be signed by a competent authority and should be stamped according to the Indian Stamp Act. Life insurers are very careful while designing the policy document because they bear onus of responsibility for any ambiguity or confusion that may arise in the interpretation of its wordings.

The standard policy document typically has three parts:

a) Policy Schedule

The policy schedule forms the first part. It is usually found on the face page of the policy. The schedules of life insurance contracts would be generally similar. They would normally contain the following information:

Diagram 1: Policy document components



- i. Name of the insurance company
- ii. Some common details of a policy are:
 - ✓ Policy owner's name and address
 - ✓ Date of birth and age last birthday
 - ✓ Plan and term of policy contract
 - ✓ Sum assured
 - ✓ Amount of premium
 - ✓ Premium paying term
 - ✓ Date of commencement, date of maturity and due date of last premium
 - ✓ Whether policy is with or without profits
 - ✓ Name of nominee
 - ✓ Mode of premium payment - yearly; half yearly; quarterly; monthly; via deduction from salary
 - ✓ The policy number - which is the unique identity number of the policy contract
- iii. The insurer's promise to pay. The events on the happening of which and the amounts that are promised to be paid. This forms the heart of the insurance contract
- iv. The signature of the authorised signatory and policy stamp
- v. The address of the local Insurance Ombudsman.

b) Standard Provisions

The second component of the policy document is made up of standard policy provisions, such as relating to proof of age, premium payment grace period etc. which are normally present in all life insurance contracts. Some of these provisions may not be applicable in the case of certain kinds of contracts, like term, single premium or non-participating (with profits) policies. These standard provisions define the rights and privileges and other conditions, which are applicable under the contract.

c) Specific Policy Provisions

The third part of the policy document consists of specific policy provisions that are specific to the individual policy contract. These may be printed on the face of the document or inserted separately in the form of an attachment.

While standard policy provisions, like days of grace or non-forfeiture in case of lapse, are often statutorily provided under the contract, specific provisions are generally linked to the particular contract between the insurer and the insured.

Example

A clause precluding death due to pregnancy for a lady who is expecting at the time of writing the contract.

Test Yourself 1

What does a first premium receipt (FPR) signify? Choose the most appropriate option.

- I. Free-look period has ended
- II. It is evidence that the policy contract has begun
- III. Policy cannot be cancelled now
- IV. Policy has acquired a certain cash value.

C. Policy conditions and privileges

Grace Period

As mentioned in Chapter 4, the Grace Period provision enables a policy that would otherwise have lapsed for non-payment of premium, to continue in force during the grace period. Every life insurance contract undertakes to pay the death benefit on the condition that the premiums have been paid up to date and the policy is in force. The “Grace Period” clause grants the policyholder an additional period of time to pay the premium after it has become due.

The premium however remains due and if the policyholder dies during this period, the insurer deducts the premium from the death benefit. If premiums remain unpaid even after the grace period is over, the policy would then be considered lapsed and the company is not under obligation to pay the death benefit. The only amount payable would be whatever is applicable under the non-forfeiture provisions.

Important

Lapse and Reinstatement/ Revival

We have already seen that a policy may be said to be in lapse condition if premium has not been paid even during the days of grace. The good news is that most lapsed life insurance policies can be reinstated [revived]. As per IRDAI Product Regulations, a Non-Linked Policy can be revived within 5 years from the date of unpaid premium, whereas a Linked Policy can be revived within 3 years.

Definition

Reinstatement is the process by which a life insurance company puts back into force a policy that has either been terminated because of non-payment of premiums or has been continued under one of the non-forfeiture provisions.

A revival of the policy cannot however be an unconditional right of the insured. It can be accomplished only under certain conditions:

- i. **Revival application within specific time period:** The policy owner must complete the revival application within the time frame stated in the provision for such reinstatement, say five years from the date of lapsation.
- ii. **Satisfactory evidence of continued insurability:** The insured must present to the insurance company satisfactory evidence of continued insurability of the insured. Not only must her health be satisfactory but other factors such as financial income and morals must not have deteriorated substantially.
- iii. **Payment of overdue premiums with interest:** The policy owner is required to make payment of all overdue premiums with interest from due date of each premium.
- iv. After having evaluated the evidence of continued insurability the insurer may decide to revive the policy as per existing terms and premium or even offer revival with increase in premium or reduced risk cover or both.

Perhaps the most significant of the above conditions is that which requires evidence of insurability at revival. The type of evidence called for would depend on the circumstances of each individual policy. If the policy has been in a lapsed state for a very short period of time, the insurer may reinstate the policy without any evidence of insurability or may only require a simple statement from the insured certifying that he is in good health.

The company may however require a medical examination or other evidence of insurability under certain circumstances:

- i. If the grace period has expired since long and the policy is in a lapsed condition for say, nearly a year.
- ii. If the insurer has reason to suspect that a health or other problem may be present. Fresh medical examination may also be required if the sum assured or face amount of the policy is large.

Important

Revival of lapsed policies is an important service function that life insurers seek to actively encourage since policies in lapsed state may do little good to either insurer or policyholder.

Non-forfeiture provisions

The Insurance Act, 1938 (Section 113) protects policies (which have acquired surrender value), from lapsation, by keeping them alive to the extent of paid-up sum assured even without payment of further premiums. This is because the policyholder has a claim to the cash value accumulated under the policy.

a) Surrender values

Surrender value is the amount you stand to get when you decide to make a premature exit from the plan, i.e. when you have decided to completely withdraw or terminate the policy before its maturity.

Life insurers normally have a chart that lists the surrender values at various times and also the method that will be used for calculating the surrender values. The

formula takes into account the type and plan of insurance, age of the policy and the length of the policy premium-paying period.

The actual amount of cash one gets in hand on surrender may be different from the surrender value amount prescribed in the policy. The actual amount may differ on account of any accrued bonuses, recoveries etc.

Guaranteed Surrender Value [GSV]: The law in India as per IRDAI Guidelines (revised in 2019) provides for a Guaranteed Surrender Value [GSV] to be payable if all premiums have been paid for at least two consecutive years. This Value arrived as a percentage (say 30%) of premiums paid is called Guaranteed Surrender Value. The value depends on the duration of premium paid. The GSV is required to be mentioned in the policy document.

b) Policy loans

Life insurance policies that accumulate a cash value also have a provision to grant the policyholder the right to borrow money from the insurer by using the cash value of the policy as a security for the loan. The policy loan is usually limited to a percentage of the policy's surrender value (say 90%). Note that the policyholder borrows from his own account. He or she would have been eligible to get the amount if the policy had been surrendered. In that case the insurance would have been terminated.

Insurers charge interest on policy loans, which are payable semi-annually or annually. Although loan and interest are repayable periodically, If the loan has not been repaid, the insurer deducts the amount of outstanding (unpaid) loan and interest from the policy benefit that is payable. A loan provides relief to policyholder in case of financial emergencies while keeping the insurance alive.

Since the loan is granted on the policy being kept as security, the policy has to be assigned (explained in later para) in favour of the insurer. Where the policyholder has nominated (explained in later para) someone to receive the money in the event of death of the insured, this nomination shall not be cancelled but the nominee's right will be affected to the extent of the insurer's interest in the policy.

Example

Arjun bought a life insurance policy wherein the total death claim payable under the policy was Rs. 2.5 lakhs. Arjun's total outstanding loan and interest under the policy amounts to Rs. 1.5 lakhs. Hence in the event of Arjun's death, the nominee will be eligible to get the balance of Rs. 1 lakh.

Special policy provisions and endorsements

a) Nomination

- i. Under Section 39 of the Insurance Act 1938, the holder of a policy on his/her own life may nominate the person or persons to whom the money secured by the policy shall be paid in the event of his/her death.
- ii. The life assured can **nominate one or more than one person** as nominees.
- iii. Nominees are entitled for **valid discharge** and have to **hold the money as a trustee** on behalf of those entitled to it.
- iv. Nomination can be done either **at the time the policy is bought or later** at any time before the maturity of the Policy.

- v. Nomination may be incorporated in the text of the Policy itself or by an endorsement on the Policy. Nominations need be communicated to the insurer and registered by the insurer in the records relating to the Policy.
- vi. Nomination can be cancelled or changed at any time before Policy matures, by an endorsement or a further endorsement or a will as the case may be.

Important

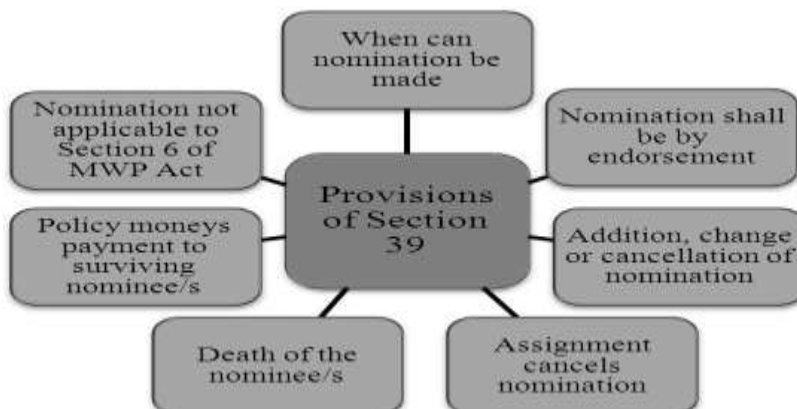
Nomination only gives the nominee the right to receive the policy monies from the insurer in the event of the death of the life assured. However, the money would be belonging to the legal heir only. **A nominee does not have any right to the whole (or part) of the claim.** However vide Section 39(7) of Insurance Act, 1938, in respect of all policies maturing for payment after 26th December, 2014, nomination in favour of parents, spouse, children or spouse and children by the owner of the policy on his/ own life makes the nominees beneficially entitled to the amount payable by the insurance company.

Where the nominee is a minor, the policy holder needs to appoint an appointee. The appointee needs to sign the policy document to show his or her consent to acting as an appointee. The appointees lose their status when the nominee reaches majority age. The policy holder can change the appointee at any time. If no appointee is given, and the nominee is a minor, then on the death of the life assured, the death claim is paid to the legal heirs of the policyholder.

Where more than one nominee is appointed, the death claim will be payable to them jointly, or to the survivor or survivors. Nominations made after the commencement of the policy have to be intimated to the insurers to be effective.

Section 39(11) of the Insurance Act says that where a policyholder dies after the maturity of the policy but the proceeds and benefit of his policy has not been made to him because of his death, his nominee shall be entitled to the proceeds and benefit of his policy.

Diagram 2: Provisions related to nomination



b) Assignment

Since life insurance policy carries a promise or a debt that the insurance company owes the insured, it is considered a security for money or property.

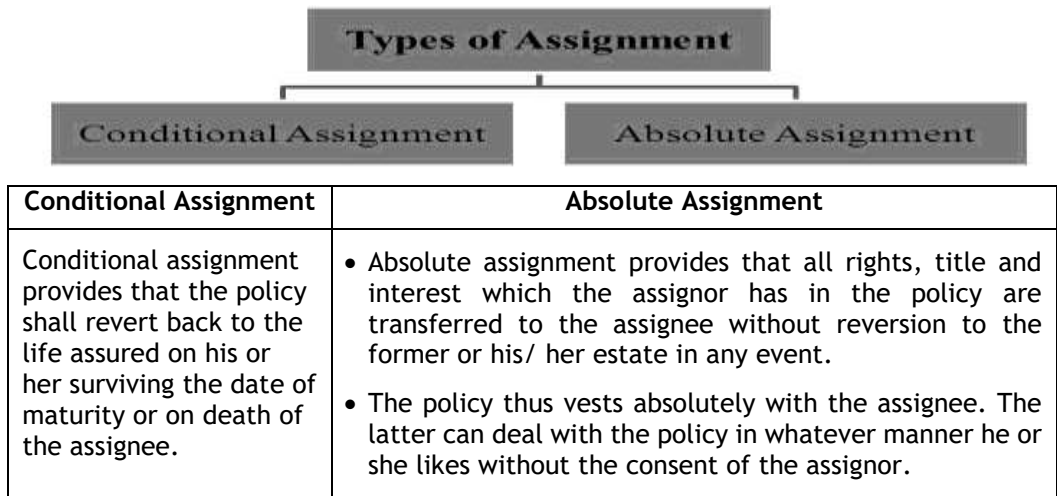
We have seen that loan is advanced against by the insurers against the surrender value of the policy. Similarly, many financial institutions including banks advance loan against the security of the insurance policy by having it assigned in their favour.

The term assignment ordinarily refers to transfer of property by writing in favour of another person.

The assignment of a life insurance policy implies the act of transferring the rights, title and interest in the policy (as property) from one person to another. The person who transfers the rights is called **assignor** and the person to whom property is transferred is called **assignee**. On assignment, the ownership of the policy changes and hence nomination is cancelled, except when assignment is made to the insurance company for a policy loan.

There are two types of assignments.

Diagram 3: Types of Assignment



Absolute assignment is more commonly seen in many commercial situations where the policy is typically mortgaged against a debt assumed by the policyholder, like a housing loan.

Conditions for valid assignment

Let us now look at the conditions that are necessary for a valid assignment.

- i. The assignor must have **absolute right and title or assignable interest** to the policy being assigned.
- ii. The assignment should **not be opposed to any law in force**.
- iii. Assignee can do another assignment, but cannot do nomination because assignee is not the life assured.

Important:

- A life insurance policy can be assigned wholly or partially
- The assignment must be signed by the transferor or assignor or duly authorized agent and attested by at least one witness.

- The transfer of title has to be specifically set forth in the form of an endorsement on the policy or a separate instrument.
- The policyholder must give notice of the assignment to the insurer, without which the assignment will not be valid.
- Section 38(2) specifies that an insurer may accept the assignment, or decline the same, if it has sufficient reason to believe that such assignment is not bona fide or is not in the interest of the policyholder or in public interest or is for the purpose of trading of insurance policy.
- However, the insurer shall, before refusing to act upon the endorsement, record in writing the reasons for such refusal and communicate the same to the policyholder not later than thirty days from the date of the policyholder giving notice of such transfer or assignment.

Diagram 4: Provisions related to assignment of insurance policies



Commonly extended privileges to policyholders

a) Duplicate Policy:

A life insurance policy document is only an evidence of a promise. Loss or destruction of the policy document does not in any way absolve the company of its liability under the contract. Life insurance companies generally have standard procedures to be followed in case of loss of the policy document.

Normally the office would examine the case to see if there is any reason to doubt the alleged loss. Satisfactory proof may need to be produced that the policy has been lost and not dealt with in any manner. Generally the claim may be settled on the claimant furnishing an indemnity bond with or without surety.

If payment is shortly due and the amount to be paid is high, the office may also insist that an advertisement be placed in a national paper with wide circulation, reporting the loss. A duplicate policy may be issued on being sure that there is no objection from anyone else.

b) Alteration

Policyholders may seek to effect alterations in policy terms and conditions. There is provision to make such changes subject to consent of both the insurer and assured. Normally alterations may not be permitted during the first year of

the policy, except for change in the mode of premium or alterations which are of a compulsory nature - like

- ✓ change in name or/ address;
- ✓ readmission of age in case it is proved higher or lower;
- ✓ request for grant of double accident benefit or permanent disability benefit etc.

Alterations may be permitted in subsequent years. Some of these alterations may be affected by placing a suitable endorsement on the policy or on a separate paper. Other alterations, which require a material change in policy conditions, may require the cancellation of existing policies and issue of new policies.

Some of the main types of alterations that are permitted are

- i. Change in certain classes of insurance or term [where risk is not increased]
- ii. Reduction in the sum assured
- iii. Change in the mode of payment of premium
- iv. Change in the date of commencement of the policy
- v. Splitting up of the policy into two or more policies
- vi. Removal of an extra premium or restrictive clause
- vii. Change from without profits to with profits plan
- viii. Correction in name
- ix. Settlement option for payment of claim and grant of double accident benefit

These alterations generally do not involve an increase in the risk. There are other alterations in policies that are not allowed. These may be alterations that have the effect of lowering the premium. Examples are extension of the premium paying term; change from with profit to without profit plans; change from one class of insurance to another, where it increases the risk: and increase in the sum assured.

Test Yourself 2

Under what circumstances would the policyholder need to appoint an appointee?

- I. Insured is minor
- II. Nominee is a minor
- III. Policyholder is not of sound mind
- IV. Policyholder is not married

Summary

- Matters of health, habits and occupation, income and family details need to be mentioned by the agent in the agent's report.
- Details pertaining to physical features like height, weight, blood pressure, cardiac status etc. are recorded and mentioned by the doctor in his/ her report called the medical examiner's report.
- Moral hazard is the likelihood that a client's behaviour might change as a result of purchasing a life insurance policy and such a change would increase the chance of a loss.
- An insurance contract commences when the life insurance company issues a first premium receipt (FPR). The FPR is the evidence that the policy contract has begun.

- The policy document is the most important document associated with insurance. It is the evidence of the contract between the assured and the insurance company.
 - The standard policy document typically has three parts which are the policy schedule, standard provisions and the policy's specific provisions.
 - The grace period clause grants the policyholder an additional period of time to pay the premium after it has become due.
 - Reinstatement is the process by which a life insurance company puts back into force a policy that has either been terminated because of non-payment of premiums or has been continued under one of the non-forfeiture provisions.
 - A policy loan is different from an ordinary commercial loan in two respects, firstly the policy owner is not legally obligated to repay the loan and the insurer need not perform a credit check on the insured.
 - Nomination is where the life assured proposes the name of the person(s) to which the sum assured should be paid by the insurance company after their death.
 - The assignment of a life insurance policy implies the act of transferring the rights right, title and interest in the policy (as property) from one person to another. The person who transfers the rights is called assignor and the person to whom property is transferred is called assignee.
 - Alteration is subject to consent of both the insurer and assured. Normally alterations may not be permitted during the first year of the policy, except for some simple ones.
-

Key Terms

1. Agents Confidential Report
2. Medical Examiner's Report
3. Moral Hazard Report
4. First Premium Receipt (FPR)
5. Policy document
6. Policy schedule
7. Standard provisions
8. Special Provisions
9. Grace period
10. Policy lapse
11. Policy revival
12. Surrender value
13. Nomination
14. Assignment

Answers to Test Yourself

Answer 1 - The correct option is II.

Answer 2 - The correct option is II.

CHAPTER L-08

LIFE INSURANCE UNDERWRITING

Chapter Introduction

A life insurance agent's work does not stop once a proposal is secured from a prospective customer. The proposal must also be accepted by the insurance company and result in a policy.

Every life insurance proposal has to pass through a gateway where the life insurer decides whether to accept the proposal and if so, on what terms. In this chapter we shall know more about the process of underwriting and the elements involved in the process.

Learning Outcomes

- A. Underwriting - Basic concepts
- B. Non-medical underwriting
- C. Medical underwriting

A. Underwriting - Basic concepts

1. Underwriting purpose

Underwriting has two purposes

- i. To assess the risk, classify the risk and decide the terms of acceptance or to decline the risk.
- ii. To prevent anti-selection against the insurer

Definition

The term **underwriting** refers to the process of evaluating each proposal for life insurance in terms of the degree of risk it represents and then deciding whether or not to grant insurance and on what terms.

Anti-selection is the tendency of people, who suspect or know that their chance of experiencing a loss is high, to seek out insurance with a view to gain in the process.

Example

If life insurers were to be not selective about whom they offered insurance, there is a chance that people with serious ailments like heart problems or cancer, who did not expect to live long, would seek to buy insurance.

In other words, if an insurer did not exercise underwriting discretion, it would be selected against and may suffer losses in the process.

2. Equity among risks

The term “Equity” means that applicants who are exposed to similar degrees of risk must be placed in the same premium class. The Mortality table, used to determine premiums, represents the mortality experience of standard lives or average risks. They include the vast majority of individuals who propose to take life insurance.

a) Risk classification

To usher equity, the underwriter engages in a process known as **risk classification** i.e. individual lives are categorised and assigned to different risk classes depending on the degree of risks they pose. There are four such risk classes.

Diagram 1: Risk classification



i. Standard lives

These consist of those whose anticipated mortality corresponds to the standard lives represented by the mortality table.

ii. Preferred risks

These are the ones whose anticipated mortality is significantly lower than standard lives and hence could be charged a lower premium.

iii. Substandard lives

These are the ones whose anticipated mortality is higher than the average or standard lives, but are still considered to be insurable. They may be accepted for insurance with higher (or extra) premiums or subjected to certain restrictions.

iv. Declined lives

These are the ones whose impairments and anticipated extra mortality are so great that they could not be provided insurance coverage at an affordable cost. Sometimes an individual's proposal may also be temporarily declined if he or she has been exposed to a recent medical event, like an operation.

3. Underwriting process

Underwriting process takes place at two levels:

- ✓ At Field level
- ✓ At Underwriting department level

a) Field or Primary level

Field level underwriting is also known as **primary underwriting**. It includes information gathering by an agent or company representative to decide whether an applicant is suitable for granting insurance coverage. The agent plays a critical role as primary underwriter. He is in the best position to know the life to be insured.

Many insurance companies may require that agents complete a statement or a confidential report, asking for specific information, opinion and recommendations to be provided by the agent with respect to the proposed life.

Fraud monitoring and role of agent as primary underwriter

Much of the decision with regard to acceptance of a risk depends on the facts that have been disclosed by the proposer in the proposal form. It may be difficult for an underwriter who is sitting in the underwriting department to know whether these facts are untrue and have been fraudulently misrepresented with deliberate intent to deceive.

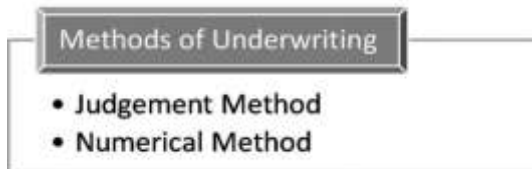
The agent plays a significant role here. He or she is in the best position to ensure that the facts that have been represented are true, due to his/ her direct and personal contact with the proposed life.

b) Underwriting at the Department level

The main level of Underwriting is at the Department or Office level. It involves specialists and persons who consider all the relevant data on the case to decide whether to accept a proposal for Life insurance and on what terms.

4. Methods of underwriting

Diagram 2: Methods of Underwriting



Underwriters may use two types of methods for the purpose:

Judgment Method	Numerical Method
Under this method subjective judgment is used, especially when deciding on a case that is complex.	Under this method underwriters assign positive rating points for all negative or adverse factors (negative points for any positive or favourable factors).
Example: Deciding whether life insurance can be given to a person staying in a disturbed country/ area.	Example: A person with history of cardiac ailments and/ or early deaths in the family may be assigned positive points. The total number of points so assigned will help an underwriter in deciding the extent of risk involved.
In such situations, the department may get the expert opinion of a medical doctor who is also called a medical referee.	The sum total of these positive/negative points, and/or is referred to as Extra Mortality Rating (EMR). Higher EMR indicates that the life is substandard. If the EMR is very high, underwriters may decline insurance.

Underwriting Decisions

Let us now consider the various kinds of decisions that underwriters may take with regard to a life proposed for underwriting.

- a) **Acceptance at ordinary rates (OR)** is the most common decision. This rating indicates that the risk is accepted at the same rate of premium as would apply to an ordinary or standard life.

Diagram 3: Underwriting decisions



b) **Acceptance with an extra:** This is the most common way of dealing with the large majority of sub-standard risks. It involves charging an extra over the tabular rate of premium.

c) **Acceptance with a lien on the sum assured:** A lien is a kind of hold which the life insurance company can exercise (in part or whole) on the amount of benefit it has to pay in the event of a claim.

Example: Consider the case of an insured who has suffered and recovered from a certain disease like TB. Imposition of Lien would imply that if this person were to die from a relapse of the TB, within a given period, only a decreased amount of death benefit may be payable.

d) **Acceptance with a restrictive clause:** For certain kinds of hazards a restrictive clause may be applied which limits death benefit in the event of death under certain circumstances.

Example is a pregnancy clause imposed on pregnant ladies that limits insurance payable in the event of pregnancy related deaths occurring within say three months of delivery.

e) **Decline or postpone:** Finally, a life insurance underwriter may decide to decline or reject a proposal for insurance. This would happen when there are certain health/ other features which are so adverse that they considerably increase the risk.

Example: An individual who suffers from cancer and has little chance of remission, would be a candidate for rejection,

Similarly in some cases it may be prudent to postpone acceptance of the risk until such time as the situation has improved and become more favourable.

Example

A lady who has just had a hysterectomy operation may be asked to wait for a few months before insurance on her life is allowed, to allow any post operation complications that may have arisen to disappear.

Test Yourself 1

Which of the following cases is likely to be declined or postponed by a life insurer?

- I. A healthy 18 year old
- II. A sports person
- III. A person suffering from AIDS
- IV. A housewife with no income of her own

B. Non-medical underwriting

1. Non-medical underwriting

A large number of life insurance proposals may typically get selected for insurance without conducting a medical examination to check the insurability of a life to be insured. Such cases are termed as **non-medical proposals**.

In view of multiple reasons including the costs involved, in some types of policies, Life insurers grant insurance without insisting on a medical examination

2. Conditions for non-medical underwriting

However non-medical underwriting calls for conditions like applicability to certain class of lives, certain plans of insurance, certain upper limits of sum insured, entry age limits, maximum term of insurance etc. to be followed.

3. Rating factors in underwriting

Rating factors refer to various aspects related to financial situation, life style, habits, family history, personal history of health and other personal circumstances in the prospective insured's life that may pose a hazard and increase the risk. Underwriting involves identifying these hazards and their likely impact and classifying the risk accordingly.

Rating factors may be broadly divided into two - those which contribute to moral hazard and those which contribute to physical [medical] hazards. Life insurance companies often divide their underwriting into categories accordingly. Factors like income, occupation, lifestyle and habits, which contribute to moral hazard, are assessed as part of **financial underwriting**, while medical aspects of health fall under **medical underwriting**.

a) Female insurance

Women generally have greater longevity than men. However they may face some problems with respect to moral hazard. This is because many women in Indian society are victims of male domination and social exploitation. Evils like dowry deaths exist even today. Longevity of women can also be affected from problems connected with pregnancy.

Insurability of women is governed by need for insurance and capacity to pay premiums. Insurance companies may thus decide to grant full insurance only to those who have earned income of their own and may impose limits on other categories of women. Similarly some conditions may be levied on pregnant women.

b) Minors

Minors have no contracting power of their own. Hence a proposal on the life of a minor has to be submitted by another person who is related to the minor in the capacity of a parent or legal guardian. It would also be necessary to ascertain the need for insurance, since minors usually have no earned income of their own. Three conditions would generally be sought when considering insurance for minors:

i. Whether they have a properly developed physique

Poor physique can be a result of malnutrition or other health problems posing grave risks.

ii. Proper family history and personal history

If there are adverse indicators here, it may pose risks.

iii. Whether the family is adequately insured

It is necessary to check if the family has a culture of insurance. One must be on guard if no other member of the minor's family has been insured. Amount of insurance is generally linked to that of parents.

c) Large sums assured

An underwriter needs to be wary when the amount of insurance is very large relative to annual income of the proposed insured. Generally sum assured may be assumed to be around ten to twelve times one's annual income. If the ratio is much higher than this, it raises the possibility of selection against the insurer.

Example

If an individual has an annual income of Rs. 5 lakhs and proposes for a life insurance cover of Rs. 3 crores, it raises a cause for concern.

Typically concerns can arise in such instances because of the possibility that such a large amount of insurance is being proposed in anticipation of suicide or as a result of expected deterioration in health. A third reason for such large sums could be excessive misselling by the sales person.

Large sums assured would also mean premiums increasing in proportion and raise the question of whether the payment of such premiums would be continued. In general, the premium payable should be within one third of an individual's annual income

d) Age

Mortality risk is closely related to age. The underwriter needs to be careful when considering insurance for people of advanced ages.

Example

If the insurance is being proposed for the first time after age 50, there is a need to suspect moral hazard and enquire about why such insurance was not taken earlier.

We must also note that chances of occurrence of degenerative diseases like diseases of the heart and kidney failure increase with age and become higher at older ages. Life insurers may also seek for some special reports when proposals are submitted for high sums assured/ advanced ages or a combination of both.

Example

Examples of such reports are ECG; EEG; X-Ray of the chest and Blood Sugar test. These tests may reveal deeper insights about the health of the proposed life than the answers given in the proposal or an ordinary medical examination can provide.

Examples

When a proposal is submitted at a branch located far away from the place of residence of the proposed insured

A medical examination is done elsewhere even when a qualified medical examiner is available near one's place of residence.

A third case is when a proposal is made on the life of another without having clear insurable interest, or when the nominee is not the near dependent of the life proposed.

In each such case an enquiry may be made. Finally, when the agent is related to the life assured a moral hazard report may be called from a branch official like the agency manager/ development officer.

e) Occupation

Occupational hazards can arise from three sources:

- ✓ Accident
- ✓ Health hazard
- ✓ Moral hazard

Diagram 4: Sources of Occupational Hazards



i. **Accidental hazards** arise because certain kinds of jobs expose one to the risk of accident. There is any number of jobs in this category - like circus artistes, scaffolding workers, demolition experts and film stunt artistes.

ii. **Health hazards** arise when the nature of the job is such as to give rise to possibility of medical impairment. There are various kinds of health hazards.

- ✓ Some jobs like that of **rickshaw pullers** involve a lot of physical strain and impact the respiratory system.
- ✓ Situations where one may be exposed to **toxic substances** like mining dust or carcinogenic substances (that cause cancer) like chemicals and nuclear radiation.
- ✓ Working in **high pressure environments** like underground tunnels or deep sea, can cause acute decompression sickness.
- ✓ Finally, **overexposure** to certain job situations (like sitting cramped before a computer or working in a high noise setting) can impair functioning of certain body parts in the longer run.

iii. Moral hazard can arise when a job involves proximity or can cause predisposition towards criminal elements or to drugs and alcohol. An example is that of a dancer in a nightclub or an enforcer in a liquor bar or the ‘bodyguard’ of a businessman with suspected criminal links. Again the job profiles of certain individuals like superstar entertainers may lead them to intoxicating lifestyles, which sometimes come to tragic ends.

When an occupation falls under any such hazardous category, the applicant for insurance may need to complete an occupational questionnaire that asks for specific details of the job, duties involved and risks exposed to. A rating may also be imposed for occupation in the form of a flat extra (for example Rupees two per thousand sums assured.) Such extra may be reduced or removed when the insured’s occupation changes.

f) Lifestyle and habits

Lifestyle and habits are terms, covering a wide range of individual lifestyle characteristics, which may be brought out in the agent’s confidential reports and moral hazard reports, suggesting an exposure to risk. In particular three features are important:

Smoking and tobacco use: Use of tobacco is not only a risk in itself but also contributes to increasing other medical risks. Companies charge differential rates today for smokers and non-smokers and users of other forms of tobacco usage like *gutkha* and *paan masala*.

Alcohol: Drinking alcohol occasionally or in modest quantities is not considered a hazard. However, long term heavy drinking can impair liver functioning, affect the digestive system and lead to mental disorders. Alcoholism is also linked with accidents, violence, family abuse, depression and suicides.

Substance abuse: Substance abuse refers to the use of various kinds of substances like drugs or narcotics, sedatives and other similar stimulants. Some of these are even illegal and their use indicates criminal disposition and moral hazard.

Test Yourself 2

Which of the following is an example of moral hazard?

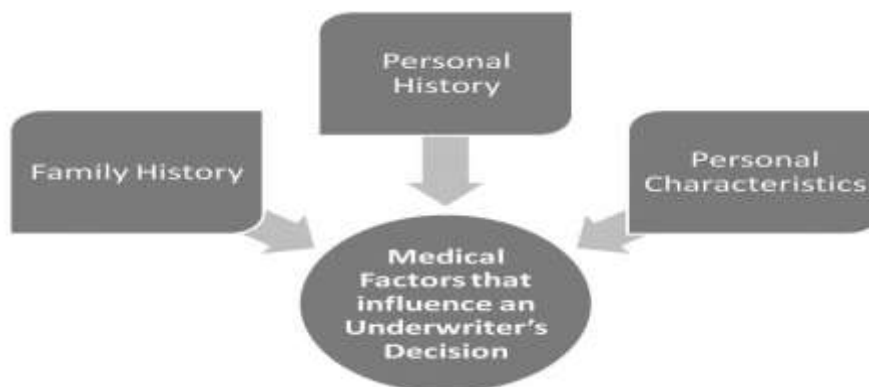
- I. Stunt artist dies while performing a stunt
- II. A person drinking copious amounts of alcohol because he is insured
- III. Insured defaulting on premium payments
- IV. Proposer misplacing policy document

C. Medical underwriting

1. Medical underwriting

Let us now consider some of the medical factors that would influence an underwriter's decision. These are generally assessed through medical underwriting. They may often call for a medical examiner's report. Let us look at some of the factors that are checked.

Diagram 5: Medical Factors that influence an Underwriter's Decision



a) Family history

The impact of family history on mortality risk has been studied from three angles.

- i. **Heredity:** Certain diseases can be transmitted from one generation to another, say from parents to children.
- ii. **Average longevity of the family:** When the parents have died early on account of certain diseases like heart trouble or cancer, it may be a pointer that the offspring may also not live long.
- iii. **Family environment:** Thirdly, the environment in which the family lives can cause exposure to infection and other risks.

Life insurers have thus to be careful when entertaining cases of individuals with adverse family history. They may call for other reports and may impose an extra mortality rating in such cases.

b) Personal history

Personal history refers to past impairments of various systems of the human body which the life to be insured has suffered from. The proposal form for life insurance typically contains a set of questions which enquire whether the life to be insured has been under treatment for any of these.

The major kinds of ailments that are considered by the underwriters include Cardiovascular diseases, diseases of the respiratory system, malignant tumours/cancer, ailments of the renal system, impairments of the endocrine system, diseases of the digestive system like gastric ulcers and cirrhosis of the liver and diseases of the nervous system.

c) Personal characteristics

These can also be significant indicators of the tendency to disease.

i. Build

A person's build consists of his height, weight, chest and girth of the abdomen. For given age and height, there is a standard weight that has been defined and if the weight is too high or low in relation to this standard weight, we can say that the person is overweight or underweight.

Similarly, it is expected that the chest should be expanded at least by four centimetres in a normal person and that the abdominal girth should not be more than one's expanded chest.

ii. Blood pressure

Another indicator is a person's blood pressure. There are two measures of this

- ✓ Systolic
- ✓ Diastolic

When the actual readings are much higher than the normal values, we say that the person has high blood pressure or hypertension. When it is too low, it is termed as hypotension. The former can have serious consequences.

iii. Urine - Specific gravity

Finally, a reading of the specific gravity of one's urine can indicate the balance among various salts in the urinary system. It can indicate any malfunctioning of the system.

d) Backdating:

Backdating means changing the start date of the policy to an earlier one. For example, you bought a Life insurance policy on 1st June, 2013 but later you think that the policy would have generated better returns if you had bought it in April 2013. You and your insurance company agree to change the policy to officially start it from April, 2013. In this case, you have backdated the policy. Usually, no interest is charged if the policy is backdated by less than a month.

Backdating is done for the following purposes:

- (i) **Getting a lower premium based on age:** While issuing the policy, insurers consider the nearest age of the policyholder. It means if you are 32 years and 7 months old, the insurer will consider your age as 33 years. This nearest age may put you in a higher premium slab. However, if you backdate the policy by 2 months, the insurer will consider your age as 32 years and 5 months only. Now you will be paying lower premiums based on a plan for a 32-year old.
- (ii) **Set the timing of payment:** There are specific professions where the income flow is not steady. In such a scenario if an individual accidentally buys a life insurance policy in its off-season then the policy can be backdated to the period of maximum earnings. For instance, a farmer may have a seasonal income. He would prefer to make insurance payments only after he has received his crop proceedings. In this case, a farmer could backdate the policy to start it in the harvest season.
- (iii) **To coincide with special dates:** You can backdate the policy to coincide with your important dates, such as birthday and anniversary. It keeps easy for you to remember your premium due date.
- (iv) **Early maturity claims:** Backdating reduces the tenure of a policy and facilitates early maturity. For instance, if a 30-year life insurance cover bought on March 2000 is backdated to April 1999, the policy would mature on April, 2029 instead of March 2030. In case of endowment policies, this could be beneficial as maturity benefits accrue earlier.

Test Yourself 3

Why is heredity history of importance in medical underwriting?

- I. Rich parents have healthy kids
- II. Certain diseases can be passed on from parents to children
- III. Poor parents have malnourished kids
- IV. Family environment is a critical factor

Summary

- To bring equity, the underwriter engages in risk classification where individual lives are categorised and assigned to different risk classes depending on the degree of risks they pose.
- Underwriting process may be said to take place at two levels:
 - ✓ At field level and
 - ✓ At underwriting department level
- Underwriting decisions made by underwriters include acceptance of standard risk at standard rates or charging extra for sub-standard risks. Sometimes there is acceptance with lien on sum assured or acceptance is based on restrictive clauses. Where the risk is large the proposal is declined or postponed.

- A large number of life insurance proposals may typically get selected for insurance without conducting a medical examination. Such cases are termed as non-medical proposals.
 - Some of the rating factors for non-medical underwriting include
 - ✓ Age
 - ✓ Large sum assured
 - ✓ Moral hazard etc.
 - Some of the factors considered in medical underwriting include
 - ✓ Family history,
 - ✓ Heredity and personal history etc.
-

Key Terms

1. Underwriting
2. Standard life
3. Non-medical underwriting
4. Rating factor
5. Medical underwriting
6. Anti-selection

Answers to Test Yourself

- Answer 1** - The correct option is III.
- Answer 2** - The correct option is II.
- Answer 3** - The correct option is II.
-

CHAPTER L-09

LIFE INSURANCE CLAIMS

Chapter Introduction

This chapter explains the concept of claim and how claims are ascertained. The chapter then explains the types of claims. In the end you will learn about the forms to be submitted for a death claim and the safeguards in place to protect a beneficiary from claim rejection by the insurer, provided no material information has been suppressed by the insured.

Learning Outcomes

- A. Types of claims and claims procedure
- B. Ascertaining whether a claim situation has occurred
- C. Claims Procedure for Life Insurance Policies

A. Types of claims and claims procedure

Concept of claims

The real test of an insurance company and an insurance policy comes when a policy results into a claim. The true value of life insurance is judged by the way a claim is settled and benefits are paid.

IRDAI's Protection of Policyholders' Interests Regulations, 2017 prescribes that life insurers, shall process death claims without delay and call for all requirements together, within 15 days of the receipt of the death intimation.

A death claim shall be paid, rejected or repudiated giving all the relevant reasons, within 30 days from the date of receipt of all relevant papers/ clarifications.

If, in the opinion of the insurer, the claim warrants investigation, it shall complete the same expeditiously, within 90 days from the date of intimation and settle the claim within 30 days thereafter.

IRDAI specifies that in respect of Maturity claims, Survival Benefit claims and Annuities, the Life Insurer shall initiate the claim process by sending advance intimation, by sending post-dated cheque or by giving direct credit to the bank account of the claimant through any electronic mode approved by RBI, so as to pay the claim on or before the due date.

Definition

A claim is a demand that the insurer should make good the promise specified in the contract.

A claim under a life insurance contract is triggered by the happening of one or more of the events covered under the insurance contract. While in some claims, the contract continues, in others, the contract is terminated.

Claims can be of two types:

- i. survival claims payable when the life assured is alive and
- ii. death claim

Diagram 1: Types of claims



While a **death claim** arises only upon the death of the life assured, **survival claims** are payable on happening of events specified in the policy.

Important

In all claims situations, the insurer has to ensure that the identity of the claimant is proven and well documented as per KYC norms.

Example

Such specified events where the claims are paid to the insured.

- i. The insured reaching the maturity period of the policy;
 - ii. The insured reaching the pre-decided duration(s) under a money-back policy, when instalment(s) become payable; or under annuity plans.
 - iii. Occurrences of Critical illnesses covered under the policy (as a rider benefit or otherwise);
 - iv. Surrender of the policy either by the policyholder or assignee;
-

B. Ascertaining whether a claim situation has occurred

- i. **Survival claim** is payable to the insured on reaching the period of maturity or fulfilling conditions stipulated in the policy.
- ii. **Maturity claims and money-back instalment claims** are easily established as they are based on dates which are determined at the beginning of the contract itself. For instance, the date of maturity and the dates when the instalments of survival benefits may be paid under a money back policy are clearly laid out at the time of preparing the contract.
- iii. **Surrender value payments** are different from other claim payments. Here, unlike other claims, the event is triggered by the decision of the policy holder or assignee to cancel the contract and withdraw what is due to him or her under the contract. There is typically a penalty for premature withdrawal. The amount paid would be less than what would be due under a full claim and hence would be less than what would have been due if the full claim were to be paid.
- iv. **Critical illness** claims are ascertained based on the medical and other records provided by the policyholder in support of his claim.
- v. **Annuities:** In case of annuity payments (pension plans), insured need to provide life certificates periodically.

The purpose of a critical illness benefit is to enable a policy holder to defray his/her expenses in the event of a critical illness. If this policy were to be assigned, all the benefits would be payable to the assignee and it would not meet the intended purpose of the critical illness benefit. To avoid this situation, policy holders need to be educated about the extent of benefits they may assign by way of a conditional assignment.

A **maturity or death claim** or a surrender leads to termination of the insurance cover under the contract and no further insurance cover is available.

Types of claims: The following payments may occur during the policy term:

a) Survival Benefit Payments

Periodical payments are made by the insurer to the insured at specified times during the term of the policy.

I. Surrender of Policy

Surrender value reflects the value of investments and depends on various factors such as sum assured, bonuses, policy term and premiums paid. Premature closing of a life insurance policy is a voluntary termination of the policy contract. A policy can be surrendered only if it has acquired paid-up value. The amount payable to the insured is the **surrender value** which is usually a percentage of the premiums paid. The actual surrender value paid to the insured is more than the Guaranteed Surrender Value (GSV).

II. Rider Benefit

A payment under a rider is made by an insurance company on the occurrence of a specified event according to the terms and conditions.

Under a **critical illness rider**, in the event of diagnosis of a critical illness, a specified amount is paid as per terms. The illness should have been covered in the list of critical illnesses specified by the insurance company.

Under **hospital care rider**, the insurer pays the treatment costs in the event of hospitalisation of the insured, subject to terms and conditions.

The policy contract continues even after the rider payments are made.

The following claim payments are made at the end of the policy term specified in the insurance contract.

III. Maturity Claim

In such claims, the insurer promises to pay the insured a specified amount at the end of the term, if the insured survives the plan's entire term. This is known as a **maturity claim**.

- i. Participating Plan:** The maturity claim amount payable under a participating plan is the sum assured plus accumulated bonuses less dues such as outstanding premium and policy loans and interests thereon.
- ii. Return of Premium (ROP) Plan:** In some cases premiums paid over the term period are returned when the policy matures.
- iii. Unit Linked Insurance Plan (ULIP):** In case of ULIPs, the insurer pays the fund value as the maturity claim.
- iv. Money-back Plan:** In case of money-back policy, the insurer pays the maturity claim minus the survival benefits already paid during the term of the policy.

The insurance contract terminates after the claim is paid.

b) Death Claim

If the insured expires during the term of his/ her policy, accidentally or otherwise, the insurer pays the sum assured plus accumulated bonuses, if participating, less dues to be recovered by the insurer [like outstanding policy loan and interest or premiums plus interest]. This is the **death claim**, which is

paid to the nominee or assignee or legal heir whatever the situation may be. A death claim generally marks the end of the contract as a result of death.

A death claim may be:

- ✓ Early (less than three years policy duration) or
- ✓ Non-early (more than three years)

The nominee or assignee or legal heir has to intimate the insurer of the cause, date and place of death.

i. Forms to be submitted for death claim

Usually, the following forms are to be submitted by the beneficiary to the insurer to facilitate processing of the claim:

- ✓ Claim form by nominee
- ✓ Certificate of burial or cremation
- ✓ Treating physician's certificate
- ✓ Hospital's certificate
- ✓ Employer's certificate
- ✓ Death certificate issued by municipal authorities etc., as proof of death
- ✓ Certified court copies of police reports like First Information Report (FIR), Inquest Report, Post-Mortem Report, and Final Report - these reports are required in case of death by accident.

Diagram 2: Forms to be submitted for Death Claim



ii. Repudiation of death claim

The death claim may be paid or repudiated. If, while processing the claim, the insurer detects that the proposer had made any incorrect statements or had suppressed material facts relevant to the policy, the contract would be declared as void. All benefits under the policy are forfeited.

iii. Section 45: Indisputability Clause

However this penalty is subject to **Section 45** of the Insurance Act, 1938.

Important

Section 45 states:

“No policy of life insurance shall be called in question on any ground whatsoever after the expiry of three years from the date of the policy, i.e. from the date of issuance of the policy or the date of commencement of risk or the date of revival of the policy or the date of the rider to the policy, whichever is later”.

C. Claim Procedure for Life Insurance Policy

Although there is no laid down standard claims procedure for all insurers, the IRDAI has laid down guidelines for insurers in the matter of claim settlement.

Regulation 8: Claims procedure in respect of a life insurance policy

- i. A life insurance policy shall state the **primary documents** which are normally required to be submitted by a claimant in support of a claim.
- ii. A life insurance company, upon receiving a claim, shall process the claim without delay. Any queries or requirement of additional documents, to the extent possible, shall be raised all at once and not in a piece-meal manner, within a period of 15 days of the receipt of the claim.
- iii. As per the IRDAI (Protection of Policyholders’ Interests) Regulations, 2017, a death claim under a life insurance policy shall be paid, rejected or repudiated giving all the relevant reasons, within 30 days from the date of receipt of all relevant papers and required clarifications. However, if the insurer needs the claim to be investigated, it shall initiate and complete the investigation at the earliest, in any case not later than 90 days from the date of receipt of claim intimation. The claim should be settled within 30 days of completing the investigation.
- iv. Where a claim is ready for payment but the payment cannot be made due to any reasons of proper identification of the payee, the life insurer shall hold the amount for the benefit of the payee and it shall earn interest at the rate applicable to a savings bank account with a scheduled bank (effective from 30 days following the submission of all papers and information).
- v. Where there is a delay on the part of the insurer in processing a claim for a reason other than the one covered by sub-regulation (iv), the life insurance company shall pay **interest on the claim amount at a rate which is 2% above the bank rate** prevalent at the beginning of the financial year in which the claim is reviewed by it.

Role of an agent

An agent shall render all possible service to the nominee/ legal heir or the beneficiary in filling up of claim forms accurately and assisting in submission of these at the insurer’s office.

Apart from discharging obligations, goodwill is generated from such a situation whereby there exists ample opportunity for the agent to procure business or referrals in future from the family of the deceased.

Test Yourself 1

Which of the below statement best describes the concept of claim? Choose the most appropriate option.

- I. A claim is a request that the insurer should make good the promise specified in the contract
- II. A claim is a demand that the insurer should make good the promise specified in the contract
- III. A claim is a demand that the insured should make good the commitment specified in the agreement
- IV. A claim is a request that the insured should make good the promise specified in the agreement

Summary

- A claim is a demand that the insurer should make good the promise specified in the contract.
- A claim can be survival claim or death claim. While a death claim arises only upon the death of the life assured, survival claims can be caused by one or more events
- For payment of a survival claim, the insurer has to ascertain that the event has occurred as per the conditions stipulated in the policy.
- The following payments may occur during the policy term:
 - ✓ Survival Benefit Payments
 - ✓ Surrender of Policy
 - ✓ Rider Benefit
 - ✓ Maturity Claim
 - ✓ Death Claim
- Section 45 (Indisputability Clause) of the Insurance Act offers protection against rejection of claim by the insurer on flimsy grounds provided and sets a time limit of 3 years for the Insurer for calling a policy into question.
- Under the IRDAI (Protection of Policyholders Interests) Regulations, 2017, the IRDAI has laid down regulations to safeguard/ protect the insured or beneficiary in case of claims.

Answers to Test Yourself

Answer 1 The correct option is II.

CHAPTER L-10

PREMIUMS AND BONUSES

Most Insurance Companies operate with the Aim of Earning the Profits, and Rewarding their Policy-Holders and Share-Holders. The Biggest Worry for Insurance Companies, is, to maintain the Solvency, that is, Income, Earned by the Company, should be enough to recover the Cost of Expenses and Liabilities. If the Income-Earned is more than the Amount required to meet Expenses and Liabilities, then, the Company is said to have earned Profits.

The Premiums-Charged, are the Prime Source of Income, for the Insurance Company. An In-Adequate Amount of Premium-Collected, can affect the Entire Operations of the Business, making it Un-Viable. In this Chapter, we will try to understand, the Concept of Premium; and analyse the Ways, in which, Companies recover the Cost, by arriving at Appropriate Premiums. We will also explore the Concept of Bonus; and learn the Difference between Simple Revisionary Bonus and Compound Revisionary Bonus.

Learning topics

1. Understand, the Concept of Premium.
2. Analyze, Different Types of Premium.
3. Determine the Factors that are considered, in Calculation of Premium.
4. Understand, the Concept of Bonus.
5. Scenario

Mr. Nishant has been in a Dilemma, since the Time, He met One of His Old Friends. While discussing Various Aspects, they had a Conversation, regarding the Various Insurance Policies that are available in the Market. During the Discussion, Mr. Nishant found out that, His Friend also, had the Same Term Insurance Plan, from ABC Company, that He had bought, 2 Years Ago. He is now 35 Years 'Old. His Friend had purchased the Policy, about 10 Years Ago, when He had joined His First Job. He was 25 Years 'Old, then. Mr. Nishant was surprised to find out that, His Friend was paying Only Rupees 3,000/- per Month as the Premium, while, for the Same Policy, He was paying Rupees 7,000/-.

Mr. Nishant couldn't understand why there was a Difference in the Premium-Amount of the Same Plan, by the Same Company. He had always looked at Premiums, as the Cost of Insurance Plans. Has Inflation resulted in Change in Premium of the Plan, in 8 Years? Also, Can Companies charge, Two Different Persons, Two Different Premiums? On What Basis, does the Company calculate the Premium? These were Some Questions in Mr. Nishant's Mind.

This Chapter aims to clear, All Doubts about Premium, its Types and the Factors, that go into its Calculation.

1. Understand, the Concept of Premium.

What is Premium?

Before addressing Mr. Nishant's Dilemma about Premium, let us first understand, a Few Things about an Insurance Plan. When an Individual purchases an Insurance Plan, following things happen:

- A Contract is signed, between the Proposer and the Insurance Company.
- In this Contract, the Insurance Company generally agrees to make a Payment of Sum-Assured, along with Bonuses, (if Applicable), to the Nominees, in Case, Something happens to the Life-Assured, or to pay the Same to the Policy-Holder, if He or She survives the Specified Term, if the Client pays the Appropriate Premium, within the Stipulated Time. The Benefits-Payable differ from One Product to Another.
- For the same, the Life-Assured (or Proposer) agrees to pay a Consideration (that is, Pre mium(s)) to the Insurance Company, as specified in the Contract.

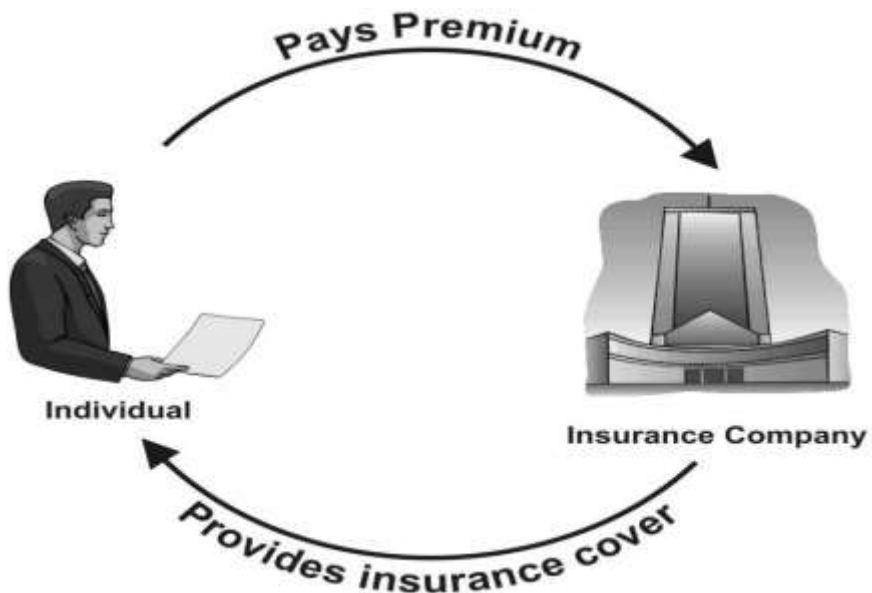


Diagram-1: Insurance Contract, in which, Insurer provides Risk-Cover, for a Consideration (Premium):

From the above, we can conclude that, Premium refers to the Amount (Consideration), that the Life-Assured has to pay, to the Insurance Company, Periodically, for the Insurance-Cover purchased. Premium can also be paid in a Lump-Sum Amount, as a Single Premium.

Insurance Company has mainly 2 Sources of Income. (a) The First is Premium Amount, collected from Policy-Holders; and (b) Through the Returns on Investments, made by the Company. The Funds for Investment come from the

Premium-Collected. Hence, the Main Source of Income for the Insurance Company is the Premium.

In this Respect, Insurance Company has to calculate the Premium-Amount, Very Carefully. The Premium should be Sufficient Enough to meet All the Expenses of the Company. The Expenses include the Payment that needs to be made in Case of Claims, made by the Life-Assured (Sum-Assured), Administrative Expenses and Other Infrastructure Costs.

Basically, the Premium depends upon the Sum-Assured, Age and the Type of Insurance Plan taken. Premiums can also be referred to as the Cost of the Insurance Plan that is purchased by the Individual.

Before moving further, let us first understand, some of the Important Terms, related to Premiums that will be used in this Chapter.

Important Terms, Defined:

- **Sum-Assured:** The Insurance Company signs a Contract, with the Life-Assured, where, it promises to pay, a Certain Amount to the Beneficiaries of the Policy- Holders, in Case the Policy-Holder (Life-Assured) dies during the Term of the Policy; or to the Policy-Holder, Him-Self or Her-Self, if He or She survives the Term of the Policy. The Amount, Paid to the Beneficiaries, is also known as, Death- Benefit. This Sum-Assured is the Amount, Pre-Determined by the Individual, based on His or Her Future Liabilities and Current Income.
- **Lapsed Policy:** A Default in the Payment of Premium can result in the Cancellation of the Policy. This is known as a Lapsed Policy. A Certain Grace-Period is provided by Insurance Companies, to make the Premium-Payment, if the Policy-Holder fails to make the Payment, during this Grace-Period, the Policy is considered to be lapsed.
- **Age of the Policy-Holder:** The Correct Age of the Policy-Holder needs to be determined, for calculating the Premium. The General Rule is “Higher the Age, Higher will be the Premium”. Age of the Policy-Holder on the Date of the Commencement of the Policy, needs to be calculated, by Insurance Companies. For calculating the Age, by and large, the Insurance Companies consider Only the Number of Years-Completed, and ignores Months and Days. There are 3 Methods, using which, the Age of the Policy-Holder can be determined:
 1. **Age, Next Birth-Day:** Life Insurance Companies calculate the Premiums, based on the Age that an Individual will achieve, on His or Her Next Birth-Day. In Other Words, the Age, as on the Birth-Day, coming After the Commencement of Policy.

Scenario-1

	Date of Birth
	4 th July, 1982

Date of Commencement of the Insurance Policy	4 th December, 2010
Age will be...	29 Years

Scenario-2:

Date of Birth	10 th October, 1976
Date of Commencement of the Insurance Policy	11 th August, 2010
Age will be...	34 Years

2. **Age, Last Birth-Day:** This Method is also known as Actual Age Method. In this Method, Insurance Companies calculate the Age, based on the Last Birth-Day. In Other Words, the Age is taken as on the Birth-Day, coming Before the Commencement of Policy.

Scenario-1:

Date of Birth	4 th July, 1982
Date of Commencement of the Insurance Policy	4 th December, 2010
Age will be...	28 Years

Scenario-2:

Date of Birth	10 th October, 1976
Date of Commencement of the Insurance Policy	11 th August, 2010
Age will be...	33 Years

3. **Age, Nearest (or, Nearer) Birth-Day:** In this Method, Insurance Companies calculate the Age, based on the Nearest Birth-Day, which could be, either the Last Birth-Day or the Next Birth-Day. In Other Words, the Age is taken as on the Birth- Day within 6 Months, before or after, the Date of Commencement of Policy.

Scenario-1:

Date of Birth	4 th July, 1982
Date of Commencement of the Insurance Policy	4 th December, 2010
Age will be...	28 Years

Scenario-2:

Date of Birth	10 th October, 1976
Date of Commencement of the Insurance Policy	11 th August, 2010

- **Mortality Table:** Mortality Tables are also known as, Life Tables or Actuarial Tables. Mortality tables are used by Insurance Companies for calculating the Premiums for Insurance Products. The Mortality Table contains the Mortality-Rate for Each Age. The Mortality Experience for Each Plan is Different. Mortality Table is prepared by Actuaries, on the Basis of Past Experience.
- A Mortality Rate is the Probability, that, a Person will Die, within the Next One Year. Based on this, Insurance Companies can calculate the Probability, that, a Person would survive a Certain Age. These Mortality-Rates are based on the Past Data.

Mortality Studies, reflecting the Experience of Indians, are made by the Mortality and Morbidity Investigation Bureau (M.M.I.B.), set-up jointly, by the Life Insurance Council and the Institute of Actuaries of India, to help the Insurers.

- **Actuaries:** An actuary is a business professional who deals with the management and measurement of risk and uncertainty all insurance companies must have actuaries. They are the People, Qualified from the Institute of Actuaries of London or Institute of Actuaries of India. They analyse the Occurrence of Risks and probability of events, such as death, disability, illness, loss of property etc. their Impact, by using Various Mathematical, Statistical and Financial Models. Actuaries study Probability, and analyse the Whole Operations of Insurance Business.
- **Duties of Actuaries:**

Listed Below, are, the Duties of an Actuary:

1. They have the Duty to Protect the Benefits, Promised by Insurance Companies.
2. They Provide, Actuarial Advice to the Insurance Companies.
3. They Analyse, the Trends in Mortality-Rate of the Policy-Holders.
4. They Analyse, the Past Trend of the Company's Expenses-Incurred and the Revenues-Generated.
5. They Provide, Technical Expertise in Designing the Insurance Products.
6. They Help in Financial Analysis, while Deciding on the Pricing of Products.
7. They Prepare the Mortality Tables, which are used as the Basis for Product-Development and Valuation-Studies.
8. They Help in the Construction of the Premiums.
9. They Define and Evaluate, the Standards, to Assess the Risk.
10. They Evaluate, the Solvency of the Insurance Company.
11. They Provide, Advice to the Insurance Company, in the Investment-Related Decisions.
12. They Help in Ascertaining the Profits that need to be distributed to the Policy-Holders.

13. They are Responsible for Valuation of Insurance Companies.

14. They Ensure, Compliance with Law.

- **Actuarial Valuation:** This Valuation refers to the Evaluation of the Entire Gamut of Financial Operations of Insurance Company. It is done, to check the Validity of Assumptions-Made, to ensure that, the Business is on the Sound Lines. It involves Analysis of Income-Generated (or, expected to be Generated), from Premiums and Investments. The Income is compared with the Expected Liabilities or Expenses of the Company. This is done, to evaluate the Over-All Solvency of the Business.

In a Valuation, the Actuary estimates the Liability of the Insurer, in respect of the Business in the Books. He or She, then, estimates the Amount of Premiums, that are due to be received in Future, as, these will add to the Funds, to meet the Liability. The Difference between the Two is, the Fund that the Insurer must have, to remain Solvent. This is compared with the Actual Existing Life Fund. If the Present Life Fund is more, the Insurer is Solvent. The Excess in the Life Fund is called 'Surplus'. This is also called 'Valuation-Surplus' or 'Actuarial Surplus'.

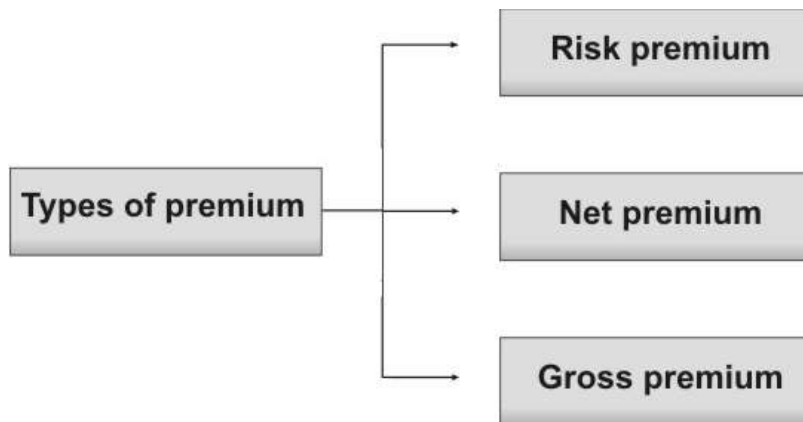
If the Fund is less, the Insurer is Not Solvent. The Difference is called a 'Deficit'. The Method of estimating the Liability of the Business and of the Future Premiums is Very Technical and Complex, involving Actuarial Principles. It has to be done by an Actuary with Professional Qualifications.

2. Analyse, the Different Types of Premium.

Types of Premium: Risk Premium:

The Business of Insurance is based on the Probabilities of Risk. Risk Premium is calculated on the Basis of a Probability that, a Person of a Certain Age is Likely to Die, Before His or Her Next Birth-Day. This Expectation is calculated by Actuaries, based on the Past Experience, which is, presented in a Mortality Table. Let us have a Look at the Case of an Insurance Company XYZ.

Diagram-2: Premiums can be classified into Following Types:



Risk Premium:

The Business of Insurance is based on the Probabilities of Risk. Risk Premium is calculated on the Basis of a Probability that, a Person of a Certain Age is Likely to Die, Before His or Her Next Birth-Day. This Expectation is calculated by Actuaries, based on the Past Experience, which is, presented in a Mortality Table. Let us have a Look at the Case of an Insurance Company XYZ.

Details for Company XYZ		Comment
The Insurance Company has 1,000 Policy-Holders, whose Age is 50 Years; and Each Policy is issued for a Sum-Assured of Rupees 50,000/-.		All of them are Healthy, at the Commencement of Policy.
Probability, that, a 50-Years' Old Person would die, before His or Her Next Birth-Day, is, 1%.		10 Persons out of 1,000 ($1,000 \times 0.01$)
Total Claims, made to the Company, in Case of Death of 10 Policy-Holders, (Probability of 1%).	Rupees $50,000/- \times 10$ = Rupees 5,00,000/-.	Total Claim would be of Rupees 5,00,000/-.
Premium, collected from 1,000 Policy-Holders will be...	Rupees 500/- , Each.	This is the Risk Premium that will be paid by the Policy-Holder.
Total Funds, received by the Company, will be...	$1,000 \times$ Rupees 500/- = Rupees 5,00,000/-	Total Collected Premium will be Rupees 5,00,000/- . This Amount will be Sufficient to Settle the Claims.

A) Net Premium or Pure Premium:

The Premiums, collected by Insurance Companies, Every Year, are Not All used-up for Payment of Claims, for Various Reasons. The Real Experience may be Different from the Probabilities, indicated by the Mortality Tables. Also, the Portion of the Premium is meant to meet Survival-Benefits, and must be kept aside. The Balance Premium, kept aside, after Outgoes of Various Kinds, will be invested, and will earn some Interest. To the Extent of these Interest-Earnings, the Premium-Charged can be reduced. The Premium, worked-out, after taking into account, the Interest, likely to be earned, is called “**Net Premium**” or “**Pure Premium**”.

Investment Earnings: The Premium, received by the Insurance Company, from the Policy-Holders, is invested in Various Funds and Securities. The Insurance Company calculates the Expected Return on Investments of Premium-Amount, based on Past Trends, and also Regulatory Mandates (if any). If the Interest-Earnings are expected to be high, then the Premium-Amount can be reduced.

Based on the Expected Returns on Investment, the Net Premium is calculated.

Loading is the Part of a Premium that includes Various Expenses, incurred by the Insurance Company. Loadings are the Extra Charges that are added to the Premium, by the Insurance Companies.

B) Level Premium:

In Level Premium, the Premium-Amount is fixed for the Entire Period of the Policy- Term. If the Total Policy Term is for 20 Years, then, the Same Premium Amount is fixed for the Entire Term of the Policy.

Level Premiums are charged by Insurance Companies, for 2 Main Reasons:

- In the Later Years of His or Her Life, the Risk-Profile of an Investor, increases substantially, and so does, the Risk Premium. As the Cost of Risk to Life will be

High, in the Later Years; this could make Premium-Payment, Very Challenging, and could trigger the Defaults in Payment of Premium, as, He or She would not be able to afford such a High Premium. Also, the Insurance Company would find it Difficult to administer the Annual Changes in the Premium, once the Contract is signed. Hence, the Insurance Company spreads the Risk-Premium, towards the Whole Time Period of the Policy, (also called as, **Premium-Paying Period**), and charges “Level” Premium.

The Insurance Company sets aside, a Certain Sum of Money, received from the Premium in the Initial Years, to a Separate Account, to help them meet the Higher Risk-Expenses, for the Later Parts of the Term of the Policy, when

the Available Premium will be less than what would be needed, to cover the Expenses, at that Point of Time.

- **Adverse Selection:** If a High Premium Amount is charged in Later Years, then, it could result in Most of the Healthy People, quitting the Plan, at that Point of Time, as, they would feel that, they do not require the Insurance Plan. People, who suffer from Various Diseases, would be ready to continue the Plan, to receive the Benefit, available with the Plan. They will be ready to pay the High Premium. This would lead to **Adverse Selection** that is, Proportion of Un-Healthy People in the Portfolio, would be more, as compared to Healthy People. This would adversely affect the Calculations of the Insurance Company, based on Mortality Tables.

C) Office Premium:

The Major Expenses, Insurance Company incurs, is, Commission, Salaries to Employees, in Addition to Other Expenses, like, Rent, Electricity, and Other Administration Expenses. These are known as **Office Expenses**.

The Level Premium Figure, arrived at, after loading the Net Premium or Pure Premium, is called the Office Premium. They are Now, Ready-for-Use. The Premium Figures, printed in the Promotional Literature and Brochures, are Office Premiums. They are also referred to as the “Tabular Premiums”.

The Risk (of Death) is more in a Policy with a Longer Term, than in a Policy with a Shorter Term. But, because of the Practice of Level Premium, the Tabular Premium- Charged (Per Annum), would be less for a Longer Term Policy, than for a Shorter Term Policy. On the Aggregate, the Total Premium over the Entire Term, would be higher in the Longer- Term Insurance Plan, than in the Shorter-Term Insurance Plan.

If the Mode of Premium-Payment is yearly, the Probability of Default in the Subsequent Renewal Premium, to complete the Year, does not arise. The Insurer can utilize this Amount for the Entire Year, and earn More Interest, than if, the Premiums were paid in Instalments. Therefore, the Premium-Rates would have to be slightly increased or decreased, depending on the Chosen Mode of Payment.

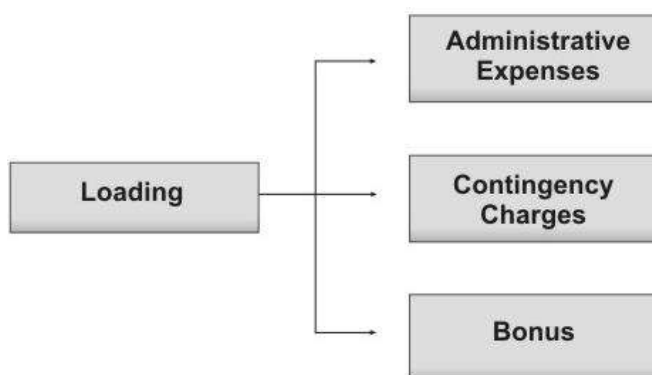
Some Insurers provide Increases or Additional Amounts in Premium, for Quarterly Modes or Monthly Modes, but No Adjustments for Yearly Modes. This depends on, How the Insurer-Concerned, has worked-out the Office Premiums.

Similarly, there may be Adjustments to be made, depending on the Sum-Assured (S.A.). If the Policy is for a Small Sum-Assured (S.A.), the Administrative Costs would, as a Proportion of Premium, be More than, if the Policy is of a Large Sum-Assured (S.A.), because, Many Expenses, like, Clerical Costs, Printing of Policies, Accounting Over- Heads, etc., are Constant, and do not vary, according to the Sum-Assured (S.A.) of the Policy. Depending on the Manner of the Loadings-Made, Insurers will provide the Rebates for Higher Sum-Assured (S.A.) or Extra for Small Sum-Assured (S.A.).

D) Extra Premium:

Extra Premiums may be charged on a Particular Policy. This may happen because of the Grant of Some Benefit, in Addition to the Basic Benefits under the Plan, like, Accident Benefit or Premium-Waiver Benefit. Extra Premium may become Chargeable, because of the Decisions, relating to the Extent of Extra Risk in Any Particular Case, if the Risk of the Person to be Insured is assessed as More than Normal, because of Health or because of Occupation, Residence or Personal Habits, Insurers may charge Extra Premiums.

Premium Loading:



Some of the Reasons, for which, Insurers load the Net Premium or Pure Premium, are:

- a. **Administrative Expenses:** These include the Administrative, Investment- Management, Infrastructural Expenses, etc.
- b. **Contingency charges:** The Expenses, that are expected to arise, in Case of Un- Expected Contingencies that can result in Sudden Increase in the Mortality-Rate. The Premium-Payments are calculated, on the Basis of the Mortality-Rates in the Mortality Table, which are determined for Normal Circumstances. In Case, Some Natural Disasters, like, Tsunami, Earth-Quakes, etc., occur, where, Large Number of Deaths take place, the Number of Deaths can be more than the Expected(Assumed) Number of Deaths, while pricing. In this Case, the Insurance Companies would have to pay Much Larger Amount of Money as Insurance Claims, than the Amount, that was originally estimated or assumed. In such Events, the Solvency of the Company could get impacted, adversely. To avoid this Situation, Companies load the Charges, for meeting these Contingencies, through Additional Amounts being factored in the Premium Amount.
- c. **Bonus** will be paid to the **With-Profits** Policy-Holders. The Policy-Holders that are entitled to the Bonus have to pay, Some Additional

Premium-Amount.

Some of the Factors, that need to be considered, for Gross Premium, are, as follows:

a. The Policy- Term: The Gross Premium for Long- Term Insurance Plans, would be High, as compared to the Short- Term Insurance Plans. In Case, the Term of the Policy is for a Long Period of 20 Years, then, in this Case, the Risk on Life would be high, as compared to a Policy for a Short- Term of 5 Years. In Other Words, the Probability, that a Person would die, in the Next 5 Years, would be Low, as compared to the Probability, that the Person would die, in the Next 20 Years.

b. Periodicity of the Premium-Payment:

(1) Insurance Companies offer Different Modes or Frequencies, at which, Premiums can be paid (Yearly or Half-Yearly or Quarterly or Monthly).

(2) Insurance Companies prefer the Yearly Mode of Premium-Payment, as, the Administrative Charges and Risk of Default of Payment by the Policy-Holder in this Mode is Low, as compared to that of Monthly Mode Premium-Payment. The Benefit of Yearly Mode is that, the Company gets a Lump-Sum Amount for the Investment, as compared to the Monthly Mode of Premium-Payment, where, the Amount, Available for Investment, would be less and received over 12 Small Monthly Instalments. The Risk of Default in Payment of Premium under Monthly Mode is high.

Some Companies prefer the Yearly Premium-Payment. Accordingly, the Companies provide a Rebate on the Yearly Mode of Premium-Payment, as, it is received in One Lump-Sum, during the Beginning of the Policy Year.

Reasons, Why Yearly Mode of Premium-Payment is preferred:		
	Annual Premium-Payment Mode	Monthly Premium-Payment Mode
Administrative Expenses	Administrative Expenses are Less, as, the Premium-Payment is done, Only Once in a Year, that is, Yearly.	Administrative Expenses are High, as, the Premium-Payment Intimation or Reminder Notice for Premium-Payment and Issue of Receipts has to be done on a Monthly Basis.

Risk of default in PremiumPayment	Once the Company receives the Yearly Payment, the Company is secured against Any Default for at least a Year, until the Next Annual Premium-Payment falls Due.	Risk of Default is High in a Monthly Premium-Payment, as, Every Month, the Company has to track the Receipt of Payment, thereby, increasing the Expenses-Incurred.
Return son Investment	The Company can earn Good Returns on the Lump-Sum Investments.	The Earning in this Case, would be Less, as, the Premium, Available for Investment, is Less.

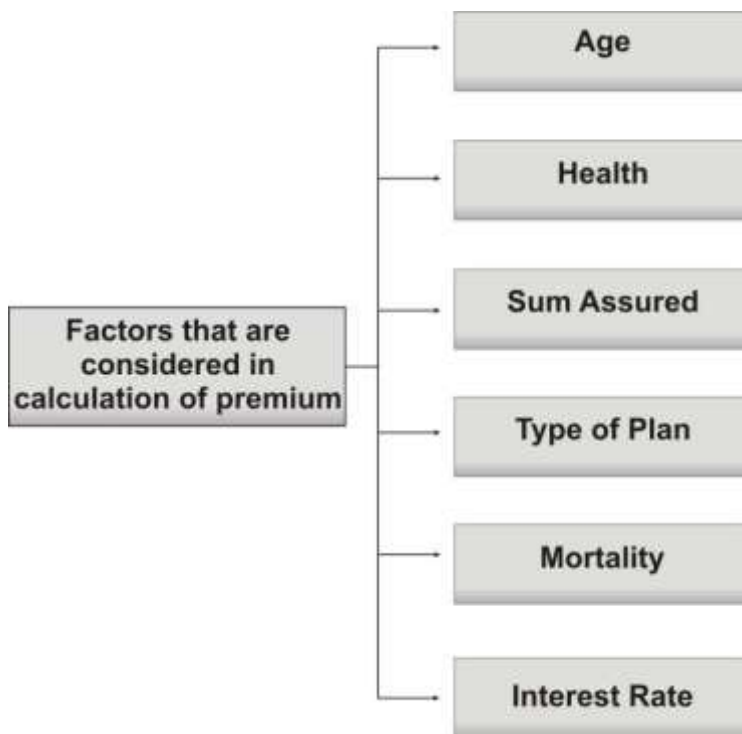
3. Determine the Factors that are considered in the Calculation of Premium.

Premium-Calculation:

Insurance Premium for Each Individual, differs, and is based on Several Factors. Someof these Factors, are, as follows:

- a. **The Age of the Person-to-be-Insured:** If the Age of the Person is High, then, Premium will also be High, to cover the Cost of Risk on His or Her Life.
- b. **Medical Condition:** An Individual, suffering from Some Disease, may be charged a Higher Premium, as compared to, a Healthy Individual, depending on, the Nature ofMedical Impairment, etc.
- c. **Sum-Assured:** Premiums also depend on the Sum-Assured of the Insurance Policy. Higher the Sum-Assured, Higher will be the Premium.
- d. **Type of Insurance Plan:** Premium also depends upon the Type of Insurance Plan. The Insurance Company will charge Higher Premium on “With Profits (Bonus)” Insurance Plans, as compared to “Without Profits (Bonus)” Insurance Plans.
- e. **Mortality Table:** Mortality Tables determine the Risk-Associated, based on Several Factors, based on which, the Premiums are determined, by the Actuaries.
- f. **The Interest Amount:** The Rate of Interest, at which, the Company will offer the Guaranteed Benefits, will increase or decrease the Premium.

Diagram-4: Factors that are considered in Calculation of Premium:



Example:

If you remember the Scenario that we discussed in the Very Beginning of the Chapter Mr. Nishant was concerned about the Difference in the Premiums, Paid by Him and His Friend.

From the Above Discussion, it is Clear that, One of the Primary Reasons, for the Difference in Premium, is, the Age, at which, the Policy is purchased. Mr. Nishant’s Friend had taken the Policy, when He was 23 Years of Age). Hence, the Premium for Him is lesser, for the Same Sum-Assured, as compared to Mr. Nishant, who is of the Same Age. Mr. Nishant purchased the Policy, when He was 32 Years ‘Old; hence, He paid a Higher Premium.

Apart from Age, the Other Factor, that could impact the Premium, could be, His Medical Conditions, His Occupation, etc., at the Time of Commencement of Risk.

Steps in Premium-Calculation:

Steps:	Example:
1. Find Out, the Office Premium, for a Given Age, based on the Required Insurance Plan and Term of the Plan. The Given Age could be either of the Following:	Tabular Premium of ABC Insurance Company, for the Given Age (Age, Next Birth-Day) of the Policy-Holder, for aTerm Insurance Plan, is, Rupees 32.50 per Thousand Sum-Assured.

<ul style="list-style-type: none"> ➤ Age, Next Birth-Day; ➤ Age, Last Birth-Day; ➤ Age, Nearer Birth-Day. <p>The Premium-Mentioned, is, per Thousand Sum-Assured</p>	
<p>2. If the Insurer provides Rebate on the Sum-Assured, then deduct these, from the Tabular Premium. This is known as Adjustments on Rebate.</p>	<p>The Following Rebates per Thousand Sum-Assured (S.A.), are offered by ABC Insurance Company, on the Sum-Assured:</p>
	<p>Rupees 20,000/- to Rupee 1/-</p>
	<p>Rupees 49,999/-:</p>
	<p>Rupees 50,000/- to Rupees 1.50</p>
	<p>Rupees 99,999 /-:</p>
	<p>Rupees 1 Lakh, and Rupees 2/-</p>
	<p>Above:</p>
	<p>If the Sum-Assured for the Policy-Holder</p>
	<p>is Rupees 60,000/-, then the Premium</p>
	<p>will be Rupees 31/-, (that is, Rupees</p>
	<p>32.50 - 1.50).</p>
<p>3. If the Insurance Company offers Rebate on the Mode of Payment of Premium, then Further Deductions for the same, are made.</p>	<p>The Company offers Rebate of 1.5% on the Annual Mode of Payment. The Policy-Holder has selected Annual Mode of Premium-Payment. The Deducted Premium will be Rupees 30.54, that is, Rupees 31 - $(31 \times (1.5 \div 100))$.</p>
<p>4. Add the Extra Premiums.</p>	<p>The Extra Charges, Levied by the Company, are, as follows:</p> <p style="margin-left: 40px;">Benefits Rupees 2/-, Payable per Thousand.</p> <p style="margin-left: 40px;">Administrative Rupee 1/- Expenses per Thousand.</p> <p>The Total Addition has to be made for Rupees 3/-, hence, the Total Premium will be Rupees 33.54.</p>
<p>5. Multiply the Amount with the Sum-Assured.</p>	<p>The Sum-Assured is Rupees 60,000 and the Premium per 1000 Sum-Assured (S.A.) is Rupees 33.54.</p>

	Premium will be $33.54 \times 60 =$ Rupees 2012.4.								
6. If the Premium-Amount, arrived at, is having Paisa in the Final Figure, then they:	The Insurance Company can either follow, Any of the Following Rules:								
<ul style="list-style-type: none"> ➤ Could be Ignored; ➤ Could be Rounded-Off, to the Next Higher Integer; ➤ Could be Rounded-Off to the Nearest 50 Paisa. <p>Any One of the Above Rules is followed by Insurance Companies.</p>	<table border="1"> <thead> <tr> <th>Rules</th> <th>Premium will be</th> </tr> </thead> <tbody> <tr> <td>Could be Ignored:</td> <td>Rupees 2,012/-</td> </tr> <tr> <td>Could be Rounded-Off to the Next Higher Integer:</td> <td>Rupees 2,013/-</td> </tr> <tr> <td>Could be Rounded-Off to the Nearest 50 Paisa:</td> <td>Rupees 2012.50</td> </tr> </tbody> </table>	Rules	Premium will be	Could be Ignored:	Rupees 2,012/-	Could be Rounded-Off to the Next Higher Integer:	Rupees 2,013/-	Could be Rounded-Off to the Nearest 50 Paisa:	Rupees 2012.50
Rules	Premium will be								
Could be Ignored:	Rupees 2,012/-								
Could be Rounded-Off to the Next Higher Integer:	Rupees 2,013/-								
Could be Rounded-Off to the Nearest 50 Paisa:	Rupees 2012.50								

Additional Information:

It is to be remembered that, Insurance Companies have Choice, over the Steps-to-be- followed, for calculating the Premium-Amount. In the Above Calculation, the Deductions for the Rebate on Mode of Payment, are done, After the Deductions for the Rebate on Sum-Assured. Insurance Companies have the Choice, to First Deduct the Rebate on Mode of Payment, and then Further Deduct, the Rebate on Sum-Assured.

In the Above Example:

Office Premium	Rupees 32.50
Rebate on Mode of Payment	1.5 % on Annual Payment of Premium
Premium, After Deductions on Sum-Assured	$32.50 - (32.50 \times (1.5 \div 100)) = 32.0125$
Rebate on Sum-Assured	Rupees 1.50
Premium, After Deductions on Sum-Assured	$32.0125 - 1.50 = 30.5125$
Premium Amount	Rupees 1,831/-

The Above Calculation has been done, for the Annual Mode of Premium-Payment. If the Premium-Payment Option, Selected, is Half-Yearly, Quarterly, or Monthly; then, the Premium-Amount will be Different, as, the Rebate-Offered for Annual Payment, is Higher; and Rebate reduces in Case of Half-Yearly, Quarterly, or Monthly Modes; resulting in an Increase in the Premium.

Test Yourself 3

The Premium, charged by Insurance Company, depends on --.

- A. Age of the Person
- B. Type of Insurance Plan
- C. Participation in Bonus
- D. All of the Above.

4. Understand the Concept of Bonus.

Bonus:

The Distribution of Valuation-Surplus to the Participating or With-Profits Policy-Holders is done through the Declaration of Bonus.

Bonus is the Benefit, in Addition to the Sum-Assured, that is distributed to “With-Profits” or “Participating” Policy-Holders. Only the Policy-Holders, holding “With-Profits” Policy, are entitled to a Share in the Bonus.

Types of Bonus:

Simple Reversionary Bonus: In this Method, the Bonus is generally indicated as a Percentage of the Basic Sum-Assured under the Policy, and added to the Sum-Assured. Such Addition of Bonus to the Sum-Assured is called **Vesting**. The Simple Reversionary Bonus is calculated as follows:

Sum-Assured	Rupees 60,000/-
Bonus-Declared	Rupees 3,000/-, (@ Rupees 50/- per Thousand; or 5% of Sum-Assured)
Total Amount that will be Paid to Policy-Holder will be... (Sum-Assured + Bonus)	Rupees 63,000/-

Simple Reversionary Bonus is declared, generally annually; and remains Attached to the Policy, but is Payable on Maturity of the Policy or Prior Death of the Life- Assured. Once declared, it cannot be withdrawn, and is Payable on Maturity or on the Death of the Life-Assured. If the Bonus-Declared in the Subsequent Year is 6% (Rupees 60/- per Thousand), then, the Bonus for that Year will be Rupees 3,600/-, in the Above Example. This will get added to the Sum-Assured, and the Total Sum- Assured at the End of the Year, will become Rupees 66,600/-, (Original Sum-Assured: Rupees 60,000/- + First Year Bonus: Rupees 3,000/- + Second Year Bonus: Rupees 3,600/-).

- **Compound Reversionary Bonus:** In this Method, the Bonus is calculated on Compound Interest Basis. Compound Reversionary Bonus is added to the Existing Sum-Assured (S.A.) including the Vested Bonuses. (In the Above Example, if a 5% Compound Reversionary Bonus is declared in the Subsequent Year, the Next Sum- Assured (S.A.) will be Rupees 66,150/-; (Rupees 63000 + (Rupees 63000 ×(5 ÷ 100))).
- **Terminal Bonus:** This is a One-Time Bonus, provided for Long- Term Policies, on attaining Maturity or Death of the Life-Assured, so long as, the Policy has continued for a Specified Period. The Bonus-Paid, depends on the Profits-Made by the Insurance Company. Terminal Bonus is the Sum, Added to the Policy, at the Time of its Maturity. Terminal Bonus is assigned to the Policy, only when, the Policy reaches its Eligibility Period, and which may differ from One Insurance Company to Another. This works like an Incentive, encouraging the Policy-Holder(s) to continue keeping their Policies, In-Force.

Interim Bonus:

Interim Bonus is Payable on policies where in a final payments becomes payable between Two Valuation-Dates. Bonus is declared after Valuation, as on 31st March, Every Year. Only the Policies, which were In-Force on 31st March, would be included for providing the Bonus. The Policies that commenced after 31st March would not be entitled to the Benefits, till the Next Valuation-Date. Hence, Interim Bonus is declared for these Policy-Holders, to make Payment to the Policies that get concluded between Two Valuations

Test Yourself 4

What is the Type of Bonus, which is, Payable on policies which become Claim between Two Valuation-Dates?

- A. Terminal Bonus
 - B. Interim Bonus**
 - C. Simple Reversionary Bonus
 - D. Compound Reversionary Bonus
-

Summary

- Premium refers to the Specific Amount that the Insured has to pay, to the Insurance Company, Periodically, as per the Policy- Terms.
 - A Default in Premium-Payment can result in the lapsation of policy.
 - The Mortality Table contains Mortality Rate, for Each Age and Gender, which is used, for calculating the Premium.
 - A Mortality Rate is the Probability that a Person Will Die, Before His or Her Next Birth-Day.
 - Actuaries are Professionals, who also deal with the measurement and management of risk and uncertainty. They analyse the Occurrence of Risk and their Impact by using Various Mathematical, Statistical, and Financial Models; along with Many Other Functions.
 - Loading is a Part of the Premium that includes Various Expenses, incurred by the Insurance Company, to manage the Operations of the Business.
 - In Level Premium, the Premium remains Fixed, for the Entire Term of the Policy.
 - The Premium, charged by Insurance Companies, is Different for Each Individual, and Premium-Calculations are based on Many Factors: Age of the Individual, His or Her Medical Condition, Sum-Assured, Morality Rate, Type of Insurance Plan, and Several Other Factors, which differ from Person-to-Person, like, His or Her Family History, Social Habits, Occupation, etc.
 - Bonus is the Benefit, in Addition to Sum-Assured, that is distributed to 'With Profits' or 'Participating' Policy-Holders.
 - Interim Bonus is Payable under the Policies, where, a Final Payment is Payable between 2 Valuation Dates
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