

Diploma in INSURANCE SERVICES

Module 2:- Life Insurance



Open Vocational Educational Programme

Diploma in Insurance Services

2



NATIONAL INSTITUTE OF OPEN SCHOOLING

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A Word with You

Dear Learner,

Welcome to the course "Diploma in Insurance Services".

I am glad that you have chosen this vocational course.

Many young people are choosing Insurance as a career with well-paying jobs. In this context, our goal is to give learners a fundamental understanding of the Insurance Sector. Additionally, this course shall make you aware of the employment and business opportunities available in this sector, allowing you to focus your time and energy on activities that will produce results.

This one year programme provides individuals with specialized knowledge and skills related to the insurance industry. This course provides basic knowledge of Life, General and Health insurance that enable learners to understand and appreciate their professional career in the right perspective. Inputs that you receive in this course will assist you in comprehending how and why you could decide to pursue it as a career since Insurance Sector is one of the most demanding careers in today's market.

This course has five modules, namely Skill India and BFSI Introduction to Insurance, Life Insurance, Non-Life Insurance, Health Insurance and Regulatory Aspects in Insurance. Each module has been designed keeping in view the requirements of self-motivated learners like you. The texts are written in simple language, supplemented by pictures and figures to lend clarity to the content. You will find the lessons interesting and will be able to apply your knowledge in real-life situations. So, read all these lessons carefully and prepare well for the examinations. You ultimately have to enter the competitive world and your success at the place of work will depend on how skillfully you have performed your assigned job.

As this is a vocational course which is skill based so master your skills, practical training is must. So, we request you to kindly attend the Personal Contact Programme (PCP) at your allotted Accredited Vocational Institutes (AVIs).

I hope this study material will be very helpful to the learners who have registered for this course. Our sincere thanks go to the experts of the course writing and editing team (list given elsewhere in this booklet) who worked very hard in revising this self instructional material, particularly to Dr. Sunil Kadyan and his team, who had excellently revised the Qualification Packs (QPs) as per the BFSI Sector Skill Council.

In case you have any difficulty in your studies, do not hesitate to write to us at dirvoc@nios.ac.in

Wishing you good luck and success!

Ms. Anitha Nair

Deputy Director

National Institute of Open Schooling (NIOS)

How to use the Learning Material

Congratulations! You have accepted the challenge to be a self-learner. It means, you have to organize your study, learn regularly, keep up your motivation and achieve your goal. Here it is solely you, who is responsible for your learning. NIOS is with you at every step. It has developed the material in Diploma in Insurance Services keeping only you in mind. A format supporting independent learning has been followed. You can take the best out of this material if you follow the instructions given below.



Title: will give a clear indication of the contents within. Do read it.



Introduction: This will introduce you to the lesson linking it to the previous one.



Objectives: These are statements that explain what you are expected to learn from the lesson. The objectives will also help you to check what you have learnt after you have gone through the lesson. Do read them.



Notes: Each page carries empty space in the side margins, for you to write important points or make notes.



Intext Questions: Very short answer self check questions are asked after every section, the answers to which are given at the end of the lesson. These will help you to check your progress. Do solve them. Successful completion will allow you to decide whether to proceed further or go back and learn again.



What You Have Learnt: This is the summary of the main points of the lesson. It will help in recapitulation and revision. You are welcome to add your own points to it also.



Terminal Questions: These are long and short questions that provide an opportunity to practice for a clear understanding of the whole topic.



Answers To Intext Questions : These will help you to know how correctly you have answered the questions.



Learning Outcomes: This box provides additional information. The text in boxes is important and must be given attention. It is not meant for evaluation, but only to improve your general knowledge.

Activities: Certain activities have been suggested for better understanding of the concept.

www Web site: These websites provide extended learning. Necessary information has been included in the content and you may refer to these for more information.

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Non-Life Insurance

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Regulatory Aspects in Insurance

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**1**

INTRODUCTION TO LIFE INSURANCE

1.0 INTRODUCTION

This chapter aims to introduce the learner to the concept of life insurance and provide a basic understanding of its working. They will learn about the role of different types of premiums, factors that impact premium calculation, bonus, commission rates etc. By the end of this chapter, a student will gain a clear insight of the human life value, mortality rates, premiums and commission that form the backbone of Life insurance.



1.1 OBJECTIVES

After reading this lesson, you will be able to:

- Describe Life Insurance
- Explain the Concept of Premium - Types and Determinants
- Explain Concepts of Bonus, Level Premiums, Rebates, Mortality Rates, Interest, Surplus
- Explain Insurance Agents Commission Rates
- Analyse Human Life Value (HLV)
- Describe Mutuality

1.2 WHAT IS LIFE INSURANCE?

Human life is invaluable but a premature death of any individual can bring huge losses and uncertainty in the lives of his/her loved ones. Life is the only precious asset that cannot be recovered once it is lost. Also, it is difficult to predict the life expectancy of

Life Insurance



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any individual as compared to predicting the life of a non-living asset. The risk of death cannot be avoided but the economic threat which it may cause can be secured. Hence, it is essential to timely prepare for the financial consequences that your family might face upon your death such as:

- ❖ Paying for rent,
- ❖ Bills,
- ❖ Children's education,
- ❖ Other household expenses
- ❖ Loans etc.

It is rational to prepare and plan for the aftermath before you are gone so that your family doesn't have to financially suffer. Life insurance is a way of looking after your loved ones even when you're gone.

"Life insurance is a contract between the insurer (Life insurance Company) and the insured (buyer) for a specified time period where in the policyholder makes regular payment of an amount (premium) to the insurer in return of which insurer agrees to provide a guaranteed payment (death sbenefit) upon the death of insured, to the beneficiaries of the contract."

1.2.1 Parties to the Life Insurance contract

- ❖ **Insurer:** The insurance company which enters into a legally binding contact with the policy holder to pay the specified amount of proceeds to beneficiary upon the death of insured.
- ❖ **Insured:** He or she is the individual whose life is insured by the insurance policy.
- ❖ **Owner or Policyholder:** The person who owns the life insurance contract and makes payment of the premiums. He/she can be the same person as insured or beneficiary but not necessarily.
- ❖ **Beneficiary:** The person/persons entitled to receive the insurance proceeds upon the death of insured.

1.2.2. Components of Life Insurance Policy

- I. **Death Benefit** - It is the sum of money which is paid to the beneficiaries of the insured at the time of his/her death before the policy matures. It is the main



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purpose of a life insurance policy. A valid proof of death has to be submitted for filing the claim.

The amount of death benefit is chosen/decided by the policyholder at the time of entering into the life insurance contract based on the estimated future needs of surviving dependents of the insured upon his/her death.

- II. Premium** - It refers to the series of periodic payments made towards the life insurance policy by the policyholder for covering the risk of insured's death for a certain period of time. In a life insurance contract, the financial risk is transferred from insured to insurer (Insurance Company). In exchange of bearing this risk, the insurance company charges premium.

Life insurance premium is determined by a number of factors such as the amount of death benefit, age of the insured, illness, term of the policy etc.

- III. Cash Value** - cash value is the surrender value of a Life Insurance policy. The policy cannot be surrendered by the insurer but it is at the option of policyholder to do it. If it is surrendered before maturity or death of the insured, the insurance company after compensating for its costs (fees, part of premiums, fixed costs etc.) will surrender the "unearned" part of premiums paid by the policyholder.

However, it is important to note that cash value isn't available in all types of life insurance policy. For example, Term Insurances have no cash value.

Interestingly, in certain types of life insurance such as Universal life Insurance 'Cash value' also earns interest.

The Oriental Life Insurance Company was the first Life Insurance Company in India that was established in Calcutta in 1818, though it failed in 1834. Insurance industry in India is regulated by Insurance Regulatory and Development Authority of India (IRDAI) which was founded in 1999 with an aim to protect the interests of the policyholders and to regulate and promote an orderly growth of the insurance industry.

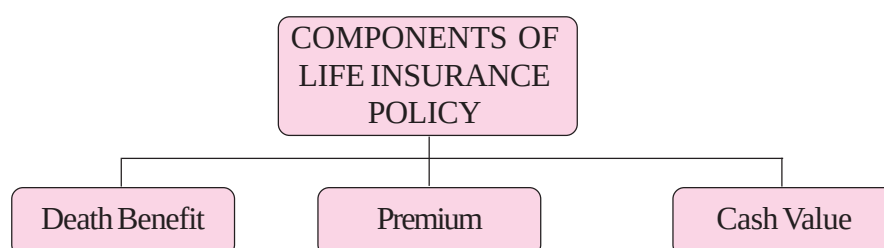


Fig. 1.1: Components of Life Insurance Policy



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1.2.3 Principles of Life Insurance

Life Insurance cannot compensate for the emotional loss that death causes. However, it is meant to provide for the financial loss faced by the surviving family in the event of untimely or unfortunate death of the 'bread-earner'. Usually, the lives of people whose death will create financial crunch for the family members are insured. The life insurance business is driven by some basic principles:

- I. **Insurable Interest** - It is an important principle of life insurance which says, that a policyholder can buy a policy in the name of another person only if he/she has a genuine interest in the life of that person. This prevents people from misusing the policy.

Mac-Gillivray defined insurable interest as:

"Where the assured is so situated that the happening of the event on which the Insurance money is to become payable would as a proximity cause, involve the assured in the loss or diminution of any right recognised by law or in any legal liability there is an insurable interest in the happening of that event to the extent of the possible loss or liability."

Example- A father buying life insurance policy for his son is genuine. But, a person buying life insurance for his neighbour cannot be allowed as the policyholder might harm the insured for his interest.

- II. **Utmost Good Faith** - It is a common law principle. It means that the buyer who enters into a contract of life insurance has a legal obligation to act with utmost good faith towards the company offering the insurance. That person must, therefore, always be honest and accurate in the information they provide to the insurance company. Similarly, the insurance company also has a responsibility to act with good faith in all its dealings with the policyholder.

That said, once the claim arises, the company is free to investigate all details to ascertain that the facts buyer have declared are correct before payouts. Any fraud or misrepresentation of facts can result into cancellation of the contract.

- III. **Indemnity** - to indemnify a loss means to fully compensate for the loss that occurred. Insurance contracts cannot be used to make profits by the policyholders instead they only make good the losses suffered. The compensation does not exceed the amount of actual damage. Thus, indemnity is very important in non-life insurance policies.



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So what about life insurance?

As far as life insurance is concerned, it is immediately that the policy proceeds in no way can compensate the life of dead (insured). That is why life insurances are called benefit policies, not indemnities.

However, every life insurance claim is a "total loss", in the sense that the full sum insured is payable.

- IV. Risk Pooling** - Life insurance is based on the principle of risk pooling which means spreading of financial risk equitably among large number of policyholders. People exposed to a risk agree to share losses on an equitable basis. They transfer the economic risk of loss to an insurance company. Insurance company collects and pools the premiums of thousands of people, spreading the risk of losses across the entire pool.

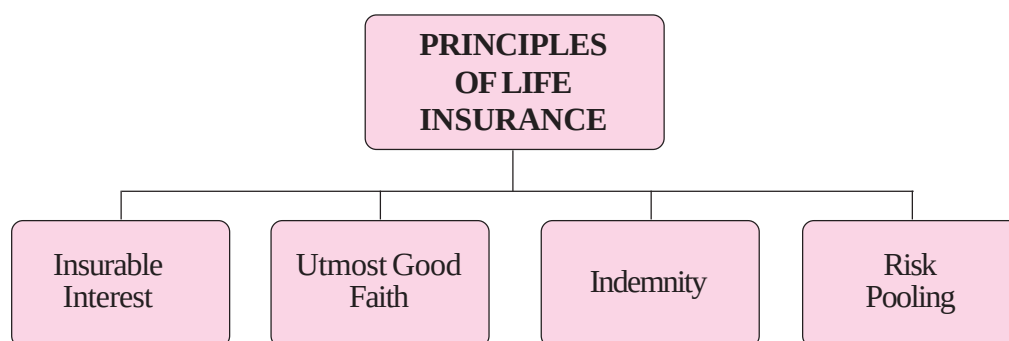


Fig 1.2: Principles of Life Insurance

1.2.4 Types of Life Insurance Contracts

Life insurance is usually a long term contract which entails periodical payment of premium by the policyholder according to the terms of contract or till the policy matures. Certainly, over the years life insurance market has exponentially grown into an organized, sophisticated and developed market providing various options to buyers. A buyer needs to choose the most appropriate policy as per his needs, affordability and goals.

- Term Life Insurance
- Permanent Life Insurance
- ULIP
- Endowment
- Universal



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A detailed explanation of these types of life insurance has been provided in later chapters.

1.2.5. Benefits of Life Insurance

Buying a life insurance cover is one of the significant financial decisions to secure your family's future. Certainly, one needs to do a cost benefit analysis before deciding the most suitable plan. Let's look at the benefits offered by life insurance policies:

- ❖ looking after your loved ones even after you're gone by providing them a stable source of income
- ❖ helps in dealing with financial liabilities after your death
- ❖ it is also an investment avenue to help achieve long-term goals
- ❖ life insurance supplements your retirement goals
- ❖ buying insurance is cheaper when you're younger as the premium amount is lower as compared to when you're older.
- ❖ tax-saving benefit under Section 80C of Indian Income Tax Act, 1961



INTEXT QUESTIONS 1.1

1. Which of the following is not the principle of insurance?
 - a) Utmost Good Faith
 - b) Risk Pooling
 - c) Maximization of Profit
 - d) Insurable Interest
2. What is the primary purpose of a life insurance product?
 - a) Tax rebates
 - b) Investment
 - c) Financial protection against the risk of death
 - d) Wealth accumulation
3. Which organisation regulates the life insurance market in India?
 - a) SEBI
 - b) IRDAI
 - c) ICAI
 - d) None of the above



4. Which among the following is not a party to a life insurance contract?
 - a) Insurer
 - b) Shareholder
 - c) Beneficiary
 - d) Insured
5. Life insurance is not
 - a) a contract of assurance
 - b) a contract of indemnity
 - c) applicable to assets other than human life
 - d) a financial asset
6. The insurance is effected to cover the _____ an asset is exposed to
 - a) Peril
 - b) Risk
 - c) Loss
 - d) Event
7. The best time to apply for life insurance is:
 - a) Today, because you don't know what might happen to you tomorrow.
 - b) Tomorrow, because you shouldn't do now what you can put off until then.
 - c) As soon as you have any dependants, whenever in the future that might be.
 - d) As soon as you develop a serious medical condition, so you can be covered for it.

1.3 CONCEPT OF PREMIUM - TYPES AND DETERMINANTS

After reading the previous section, we have got an overview of a life insurance contract and its basic concepts. The life insurance policy is essentially a product sold by the insurance company to the buyers for a premium. In this section, we will discuss about the concept of premium, its constituents and the factors that are considered for its calculation. Also, we will study about the various types of life insurance premiums.

Life Insurance



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Definition

In simple terms, insurance premium is the price of your insurance policy in exchange of which you get the policy coverage. You can choose the policy based upon coverage period and periodicity of the premium. Also, the periodicity of premium can vary from monthly to quarterly to annually or even single lump sum payment. It can be decided in the terms of the contract as per individual convenience.

1.3.1 Key Components of a Life Insurance Premium

The insurance agent may not disclose to you the composition of the premium amount you are paying to his company. All you know is that you pay an amount periodically or once for the promise that has been given by the insurance company. But it's likely that you would like to know: how the premium amount is determined by the premium company? How does it vary in case of different individuals?

Life insurance premium basically consists of four key elements:

- **Expenses** - The operational expenses incurred by the insurance company are recovered from the premium payments by policyholders. Sales and marketing expenses, agent commissions and the overhead costs incurred to run the insurance business are examples of such expenses. These costs are spread across a pool of thousands of investors so that the impact on an individual buyer is very low.
- **Mortality** - Every human being is mortal and has a limited life expectancy. All of us expect that older people die before the younger ones. Similarly, life insurance companies put a higher probability on the death of old-age individuals than the young ones. The higher the probability of death of an individual (insured), the higher would be the amount of premium. Apart from the age, medical history, illness, occupation, lifestyle etc. of an individual also helps in determining the likelihood of his/her death. All these factors combined together form the mortality aspect of life insurance premium.

To help insurance firms, actuaries determine these probabilities using scientific analysis and construct mortality tables for different ages.

- **Investment** - Call it savings or investment, there is always a component in the life insurance premium that is invested by the life insurance company in avenues like government bonds, money market, securities market, loans etc in varying proportions. This component is essential to generate income for the insurance



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companies to cover their costs, generate profits and to make distribution amongst policyholders in the form of cash value, bonus etc. However, not all policyholders are eligible for cash value and bonus; usually it is applicable in case of whole life policies.

● Contingency

What if some tragedy or natural calamity occurs impacting the lives of many individuals? What if any economic policy change or crisis drastically impacts insurance companies' investments? What if the death projections made by company fail? In the event of such unprecedented circumstances, the life insurance company keeps a percentage of the premium reserved for contingencies. Like the expense element, contingency allowance is also spread across the pool of policyholders. Hence, the larger the number of policyholders, lower will be the share of contingency allowance in an individual's premium.

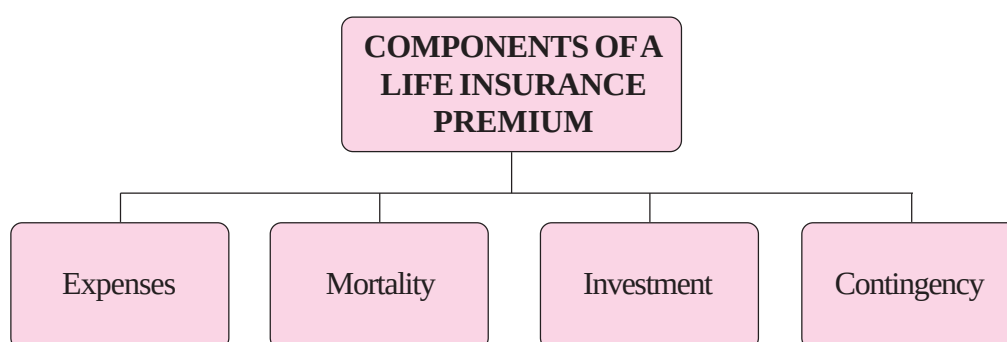


Fig. 1.3: Components of Life Insurance Premium

1.3.2 Factors Affecting Life Insurance Premium

Life insurance is a great way to financially secure your loved ones. But it's also a major investment as it involves regular payments of premium. With the tremendous growth in insurance business, different companies offer different rates of premium and even a slight difference can yield major savings.

So question arises, what are the factors that insurers consider for pricing their policies and how does the price vary?

Let's analyze each factor one by one:

1. **Age** - It is the most important factor for consideration by the insurer. As you get older, the number of premium payments to insurer will decline. Thus, with the higher age of insured the amount of premium also rises. On the other hand, if the

Life Insurance



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insured is young the chances of living longer are high. Consequently, the chances of insurer paying the death benefit to the beneficiaries will be low, hence the lower amount of premium. It is usually advised to take a policy at a younger age.

2. **Gender** - It is a statistically observed fact that women on an average, live five years longer than men. The premium paying capacity in case of woman insured is higher as compared to man. Thus, gender brings about a difference in premium calculations.
3. **Smoking** - If a person is a smoker, it puts him/her at higher risk of diseases or even death as compared to non-smokers. Hence, amount of premium will be higher in case of smokers because of the high risk involved.
4. **Health** - Usually, the application process of any life insurance policy includes a basic medical check-up (height, weight, blood pressure, diabetes, cholesterol, ECG etc) of the insured to examine any pre-existing health condition that might have been overlooked or hidden by the buyer. It is obvious that the premium would be higher in case of any illness or serious health condition.

Some companies do offer "no exam" policies, but you can expect to pay more.

5. **Lifestyle** - Is your favourite hobby racing cars or climbing treacherous mountains? If yes, you'll probably have to pay substantially more for insurance premium. If you regularly engage in high-risk activities, there's an increased likelihood that you'll meet an early end - a big factor for insurance companies to determine your policy premium. Some companies also charge more if you have a relatively dangerous profession, such as mining, fishing or transportation.
6. **Family medical history** - Certain health conditions are hereditary. Although, not much can be done about the genetic history insurance companies are interested to know if your parents or siblings suffered any hereditary serious health condition such as diabetes, stroke, cancer etc. The existence of any such condition is likely to increase the risk in your case thus, impacting your life insurance premium.
7. **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.

8. **Others** - Other factors taken into consideration by insurance companies to determine your policy premium include profession, drinking habits, driving record, type of policy etc.

The combination of the factors discussed above concludes your life insurance premium. It is important to note that the weightage and combinations of these factors vary across different insurance companies, which leads to variation in the premium amount.

1.3.3 Types of Life Insurance Premiums

A policyholder can decide to pay the premium on the basis of its flexibility and periodicity. Let's have a brief of each of these premium types:

1. **Level Premium Insurance** - In this type, the amount of premium remains the same throughout the life insurance policy term. The payments are locked-in (fixed) and don't change with increase in age. Since, the premium remains fixed throughout the policy term, it is relatively expensive in the initial years of policy to compensate the inflation in later years. At the time of maturity, if the holder wants to renew the policy the premium amount usually gets revised because the older premium was decided a long time ago (such as 10, 20, 30 years). This is the most common type of premium.
2. **Flexible Premium Insurance** - flexibility of premium allows the policyholder to make changes in the policy such as death benefit, scheduling of payments etc. The premiums are recalculated based on such changes.

It is a common feature in Universal Life policies. Policyholders are allowed to make additional payments or even skip payments. The higher the amount of premium payments, higher would be the death benefit.



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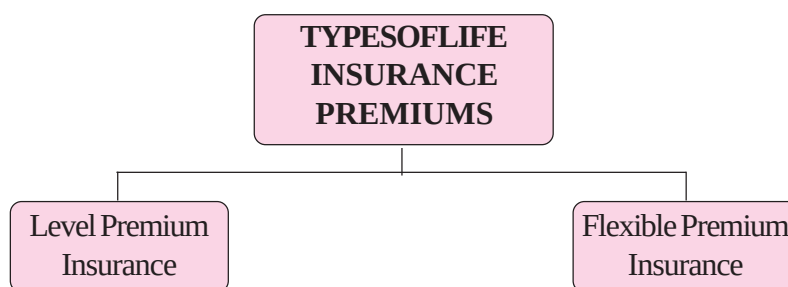


Fig. 1.4: Types of Life Insurance Premiums

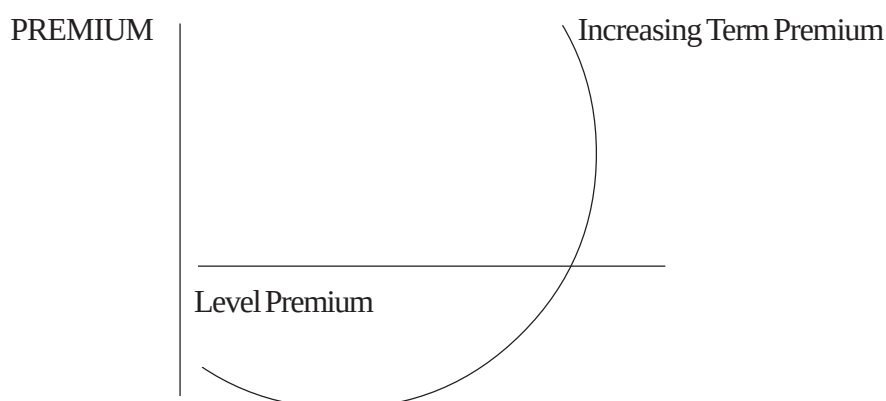
1.4 LEVEL PREMIUMS

1.4.1 Concept

The level premium is the premium amount that remains stable throughout the policy term. The death benefit or the sum assured also remains the same.

It is a common feature in life insurance policies. The term of a life insurance contract is generally long such as 10, 20 or more years. The calculation of level premiums is based on the concept of averages. Thus, the periodic payments of level premiums may appear expensive in the initial years of the contract since the risk of death is lower. As the age of the insured increases, the risk of death rises which means higher premiums are required to compensate higher risk. But the amount of level premium does not change. Hence, the premium in later years appears to be cheaper than the average. Overall, the excess premium in younger ages compensates for the deficit premium in older age.

Level premium can be further explained with the help of the diagram below:



The level premiums collected in initial years of the policy term are held by the insurance company in trust. The amount so accumulated is called a "Reserve". The company keeps this reserve to meet the future obligations of the insurer. The excess amount can

also be used to create a "Life Fund". Life insurance companies invest this fund to earn an interest.

1.4.2 Components

Level premiums usually comprise of the following two components:

1. **Protection Component** - it consists of that portion of premium which is needed to pay the cost of the risk.
2. **Cash Value** - it is made up of the accumulated excess payments of the policyholder. It constitutes the savings component.



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1.5 BONUS

1.5.1 Meaning

Bonus, in common parlance, refers to an add-on payment received over and above the assured income. In life insurance as well, the concept of bonus is somewhat similar. A policyholder is entitled to the amount of sum assured at maturity or demise and there may be an extra income in terms of bonus payments.

Like any other business life insurance companies also make profits. They invest a proportion of their premium receipts in diverse investment options such as equities, government bonds, loans, etc. to earn interest income. Bonus is that surplus income which gets accumulated yearly, after covering all other company expenditure. The company can decide to distribute the bonus to the policyholders every year or once at the time of maturity.

Not all the life insurance policies have a 'bonus' feature available. Only the 'participatory' or 'with-profits' type of policies attract bonus. Moreover, the rate of bonus is not pre-decided; it depends upon the insurer's profit and strategy. It may vary from year to year.

Lastly, the bonus payment is contingent upon the successful completion of premium payments by the policyholders.

1.5.2 Types of Bonus

The most common type of bonus paid is termed as 'reversionary bonus'. It is regularly declared and paid at the time of maturity of the contract. The amount of bonus declared every year gets accumulated and treated as a liability for the insurance company. But the policyholder will receive them only at the time of maturity or death claim.



Following are the variants of Reversionary bonuses:

1. **Simple Reversionary Bonus** - The calculation of such bonus is done on the basis of simple interest. At the end of each year, an amount is declared which gets accumulated till the time of maturity. The amount of bonus accrued each year does not earn any interest thereupon.

For example, XYZ Insurance Ltd. declared a Simple reversionary bonus of Rs 25 per 1000 of sum assured. Thus, a policy of Rs. 5 lakhs will accrue a bonus of Rs. 12500 which will be paid at the time of maturity.

2. **Compound Reversionary Bonus** - In this type, the bonus is declared every year as a percentage of the sum assured plus the preceding accrued bonuses. It entails the effect of compounding. Thus, it's a bonus on bonus which accumulates throughout the life of contract and paid at the maturity.

For example, XYZ Insurance Ltd. announced bonus @ 5% of the sum assured plus attached bonus.

3. **Terminal Bonus** - It gets accrued only once i.e. at the time of death or maturity. Thus, every year the bonus is declared only for the death claims or maturity claims. **For example,** the terminal bonus declared in the year 2018 will only apply to claims arising during the financial year 2018.

Usually, the longer the time duration of the policy, higher is the amount of terminal bonus. It is also called as 'persistency' bonus.

Other than the reversionary bonuses, there is another type called as '*Cash Bonus*'. **Cash Bonus** is the bonus accrued in a year and gets paid at the end of the same year. Thus, a company may decide to pay cash bonus every year instead of accumulating them till maturity.

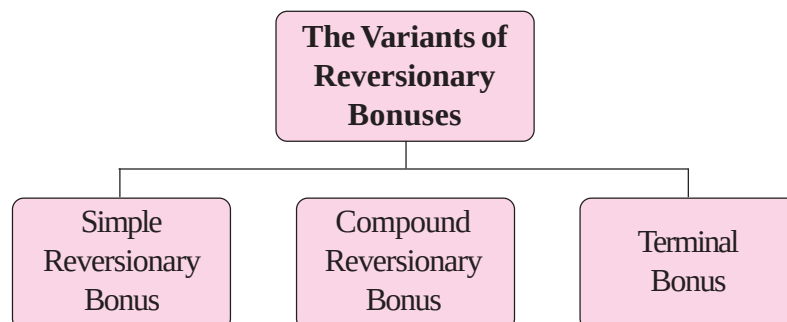


Fig. 1.5 Variants of Reversionary bonuses



1.6 REBATES

Often, life insurance companies offer discounts on premium rate to the policyholders based on sum assured or the mode of payment. Such discounts in insurance jargon are called as rebates.

Primarily, there are two types of rebates:

- Based on sum assured
 - Based on Mode of premium
1. **On Sum Assured** - This type is offered on policies with larger sum assured. Usually, the fixed costs or the service costs incurred by the insurer are uniform across all policies irrespective of the sum assured. These costs include the cost of preparation of policy, postal expenses, office expenses etc. The fixed costs are divided to calculate cost per thousand of the policy amount. Thus, higher the sum assured, lower will be the fixed cost per thousand of sum assured. This results in savings which the insurer shares with the policyholder in the form of rebates in premium per thousand of the sum assured.

For example, an insurance company offered reduction in premium for large sum assured at Rs. 2 per thousand of the policy amount.
 2. **Rebate for Mode of Premium** - Similarly a rebate may be offered for the mode of premium. Premiums payments could be done in annual, half yearly, quarterly or monthly basis. However, higher the frequency of premium payments in a year, more will be the cost of service. Yearly and half yearly modes involve collection and accounting of premiums only once or twice a year while in quarterly and monthly modes, it becomes more frequent. Half-yearly or yearly premiums thus enable a saving in administrative costs as compared to quarterly or monthly modes. Moreover, in the yearly mode, the insurer can utilise the saved cost 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.



Notes



INTEXT QUESTIONS 1.2

1. What is the meaning of "premium" in reference to a life insurance policy?
 - a) Profit earned by the insurer
 - b) Price paid by the policyholder for purchasing the policy
 - c) Compensation paid at the time of claim
 - d) Expenses incurred by an insurer on a policy
2. Which of the following is not a component of Life Insurance Premium?
 - a) Mortality
 - b) Expenses
 - c) Contingency
 - d) Death Benefit
3. Which of the factors do not affect the life insurance premium calculation of an individual?
 - a) Environmental conditions
 - b) Lifestyle of the individual
 - c) Underlying illness
 - d) Age of the individual
4. What is the characteristic of level premiums?
 - a) Stable throughout the policy term
 - b) Stepped
 - c) Fluctuating
 - d) None of the above
5. In which type of the following types, a company expresses the bonus as a percentage of basic death benefit and already attached bonuses?
 - a) Simple Reversionary Bonus
 - b) Compound Bonus
 - c) Terminal Bonus
 - d) Cash Bonus



6. Which of the following statement is false in context of bonus:
 - a) It is one of the ways of allocating surplus by life insurance companies
 - b) It is paid to policyholders every year
 - c) It is paid on to the policyholders who agree to participate in company's profits
 - d) The rate of bonus is not pre-decided
7. Life insurance companies may offer rebate to the buyer on the premium that is payable on the basis of _____.
 - a) Sum assured chosen by the buyer
 - b) Type of policy chosen by the buyer
 - c) Term of the plan chosen by the buyer
 - d) Mode of payment (cash, cheque, card) chosen by the buyer

1.7 MORTALITY RATES/CHARGES

1.7.1 Concept

Mortality is the inevitable truth of life. A human being usually has an average life expectancy of 65-75 years but the risk of death always remains. The risk is higher in older people as compared to younger ones. Thus, mortality is closely related to age. Also, the risk of death is higher in case of a person suffering from a pre existing medical condition. A life insurance policy provides you a cover against this risk of untimely death. The premiums are higher in case of high risk of mortality.

When one buys a life insurance policy, the insurer levies a charge every year to provide risk coverage. It is called the cost of life insurance or 'Mortality charge'. Mortality is an important element while determining the life insurance premiums.

For example, Mrs. Bindu pays a premium of Rs. 12000 every year for a life insurance cover of Rs. 600000. Out of the premium that she pays every year, Rs. 2000 is the mortality charge.

Mortality charge is usually a small percentage of premium. After deducting Mortality charge and other costs from the premium, the remaining amount is invested by the company. The amount deducted as mortality charge is kept aside as 'Life Fund' reserve which is utilized to provide risk coverage in future. Thus, higher the sum assured, higher would be the mortality charge.

Life Insurance



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Life insurance companies in India use the Indian Assured Life Mortality Table 2012-14 prescribed by the Insurance Regulatory and Development Authority (IRDA) for calculating the mortality rates. It provides an estimate of the mortality rate for different ages.

Say, for the age of 45, the mortality rate is 0.0045. This implies that out of every 1000 people alive at the age of 45, 4.5 (1000 multiplied by 0.0045) are expected to die before they turn 46. Further, the mortality rate of 0.0045 for the age of 45 would mean a cost of insurance or 'risk premium' of $0.0045 \times 1000 = \text{Rs. } 4.5$ per thousand sum assured.

1.8 INTEREST

Life insurers collect the risk premiums at the beginning of each term. These premiums earn interest thereon. To estimate the amount of money required by the insurance companies in future, to settle the claims, it is important to consider the rate of interest into account.

This rate of interest is simply, the discount factor assumed by companies to calculate the present value of the future claims to be made.

For example, if Rs. 5 per thousand is needed to meet the cost of insurance after 5 years, and the interest rate is assumed at 6% p.a. Then the present value of Rs. 5 payable after 5 years would be $5 \times \frac{1}{(1.06)^5} = \text{Rs. } 3.74$. However, had the interest rate been assumed at 10%, the present value would only be Rs 3.10.

Hence, the following conclusions can be derived:

- Higher the mortality rate, higher would be the premiums.
- Higher the rate of interest assumed, lower would be premium.

This estimate of present value of the future claim costs is also called the '*Net Premium*' which is computed using the estimates of mortality and interest rate.

'*Gross Premium*' is then calculated by adding an amount of 'loading' to the net premium.

1.9 GUIDING PRINCIPLES FOR DETERMINING AMOUNT OF LOADING

To determine the amount of loading, the following considerations or guiding principles are kept in mind:

1. **Adequacy** - The total loading from all policies must be sufficient to cover the company's total operating expenses. It should also provide a margin of safety and finally it should contribute to the profits or surplus of the company.
2. **Equity** - Expenses and safety margins should be equitably apportioned among various kinds of policies depending upon type of plan, age and term etc. Basically, each class of policy should pay for its own costs, such that one class of policy does not subsidise another.
3. **Competitiveness** - The gross premiums computed as such should enable the insurance company to improve its competitive position. If the loading is too high making the policies costly, people would be reluctant to buy the policy.

1.10 EXPENSES AND RESERVES

Like every company, life insurance companies also incur various types of operating expenses including:

- Agents training and recruitment,
- Commissions of agents,
- Staff salaries,
- Rent,
- Office stationery,
- Electricity charges,
- Miscellaneous etc.

As all these expenses are to be paid from the premiums collected by the insurers, thus these are loaded to the net premium.

Expenses are broadly classified into two types:

1. New Business Expenses, which are incurred at the beginning stage of the contract.
2. Renewal Expenses that are incurred during subsequent years.



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Initial business expenses can be substantial. Life insurers are required to hold certain margins as reserves by law to ensure that they meet their obligations even in their worse situations. Therefore, the initial expenses along with the reserve margins are typically higher than the initial premiums received by the life insurer. This is known as new business strain. The initial outflow is only recovered from subsequent annual premiums. Hence the life insurers cannot afford to have large number of their policies cancelled or lapsing in initial years, before the expenses are recovered. Another implication of new business strain is that life insurance companies begin to make profits only after a gestation period of some years.

1.11 DETERMINATION OF SURPLUS AND BONUS

Every life insurance company undertakes a periodic valuation of its assets and liabilities. The valuation is done with two objectives:

1. To assess the financial state of the life insurer, solvent or insolvent;
2. To determine the surplus available for distribution among policyholders / share holders

Surplus is the amount of assets in excess of liabilities. If liabilities are in excess of the assets, it's known as a strain.

Let us go a bit deeper into the meaning of surplus. For doing that, we will first understand what assets and liabilities mean for a life insurance firm.

Every life insurer makes provision for meeting future claims of insurance policies, expenses and other potential pay-outs that may arise. Further, the insurer is expected to receive premiums on these policies as well. Hence, liabilities are determined as 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 calculated by applying a suitable interest rate (discount rate).

Let us now see how the assets are valued, discussed in the next section.

1.12 WAYS OF VALUING ASSETS

Assets can be valued using the following methods:

1. **At Book Value** - the value at which the assets were actually acquired or purchased.
2. **At Market Value** - the current market price of insurer's assets.



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3. **At Discounted Present Value** - this method entails estimation of the future income stream from the assets and then, discounting these future values to arrive at the present value of the assets.

Since the whole process of computing liabilities and assets (at discounted PV) involves assumptions about factors like mortality, interest, expenses and persistency to arrive at the present value, the life insurance firms use the term surplus instead of profits. Thus, surplus depends upon the valuation of assets and liabilities. This valuation may differ in case of different life insurers depending upon their outlook of the risk.

- In case of a conservative valuation, liabilities would be overvalued and assets would be undervalued, hence reducing the amount of surplus declared. This might result in lesser distribution of bonuses to current policyholders. On the other hand, it also ensures financial soundness of the insurance company since the actual surplus would be higher than the declared one leading to its higher retention for the future which will benefit the future policyholders.
- In case of a liberal valuation, the exact opposite of the above will hold true.

The life insurance company has to strike the right balance between current and future policyholders.



INTEXT QUESTIONS 1.3

1. Mortality charges
 - a) Increase with increase in age
 - b) Are not affected by the health of the prospect
 - c) Are constant throughout the policy term
 - d) Will be same for all males of 25 years of age
2. Which of the following statements is true?
 - a) Interest rate is the discount factor used by insurers to calculate the present value of future claims
 - b) Interest rate is used to arrive at the interest amount due on the delayed premium payments.
 - c) Higher the mortality rate, higher would be the premiums.

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3. Which of the following consideration determine the amount of loading?
 - a) Adequacy
 - b) Equity
 - c) Competitiveness
 - d) All of the above
4. Which of the following is a classification of expenses?
 - a) New Business Expenses
 - b) Renewal Expenses
 - c) All of the above
 - d) None of the above
5. Which of the below is one of the ways of defining surplus?
 - a) Excessive liabilities
 - b) Excessive turnover
 - c) Excess value of liabilities over assets
 - d) Excess value of assets over liabilities
6. With regards to valuation of assets by insurance companies, _____ is the value at which the life insurer has purchased or acquired its assets.
 - a) Discounted future value
 - b) Discounted present value
 - c) Market value
 - d) Book value

1.13 ALLOCATING THE SURPLUS

Surplus serves various purposes of a life insurer:

- Supports company's operations
- Addition to company's capital or net worth

- Distribution to the policyholders who agreed to participate in the profits as per the contract.

Let us see the various considerations made by the life insurer before distributing the surplus.

1. **Solvency Requirements :** Firstly, life insurers are supposed to maintain a solvency margin which is defined as the portion of surplus assets over liabilities that are specifically set aside to serve as a cushion to meet any unforeseen deviations between actual and expected amounts.
2. **Free Assets :** Some portion of surplus is also allocated towards increasing the level of free assets. Free assets are unencumbered. In other words, they are not required for meeting any specific liabilities. Free assets can be used by the insurance company for purposes like business expansion.

Once these considerations are made, the divisible surplus is declared for distribution among the life insurer's policyholders and shareholders (if any). One of the popular methods of surplus distribution is 'Bonus'. Bonus is paid as an addition to the basic benefit payable under a contract.

Bonus has already been discussed in detail in section 11.4



Notes

1.14 INSURANCE AGENTS COMMISSION RATES

An agent is a person who represents the Principal. Here in Insurance sector, an agent is the one who represents an Insurance company and sells policies on its behalf in return for a commission. An insurance agent sells policies of only one company. The commission of the agents is based on the number, size and type of policies they have sold.

Commission of insurance agents is tied to policy premiums. They are governed by IRDAI's guidelines and Insurance Act, 1938.

As per Insurance Act, 1938, the insurance companies are allowed to pay a maximum commission of 40% of the first year's premium, 7.5% of the second year's premium and 5% from there on. Also, it is limited to 2% in case of single premium policies.

The insurers are not allowed to pay any rewards or remuneration in excess of the limits specified by regulatory authorities.

Insurance Regulatory and Development Authority of India (IRDAI) is an autonomous body set up under the IRDA Act, 1999 to protect the interests of policyholders and to regulate and develop the insurance industry.



Notes

1.15 HUMAN LIFE VALUE (HLV) - THE ASSET

An asset is any property (tangible or intangible) that has some value and yields return. Thus, the value the asset can be measured precisely in monetary terms as well as the amount of compensation for its loss or damage can also be determined.

For example, an insured car meets with an accident and the damages are estimated to be Rs. 50000. Thus, the insurer will compensate the policyholder for the amount of damages incurred.

But what if a person dies; how is the amount of loss estimated in case of death? Is he worth Rs. 50000 or Rs. 500000?

The answer to this question lies in the measure developed by Prof. Hubener seventy years ago. The measure is named as Human Life Value (HLV) which is widely used around the world by insurance companies.

The concept of human life value is based upon an individual's potential to earn income. It focuses on human capital and overall financial impact of losing someone. It calculates the expected future earnings based on specified criteria; and the overall financial loss caused to the family of the deceased in case of untimely death. The net future earnings are discounted using an appropriate interest rate to arrive at the Human Life Value or the present value of expected future earnings of the deceased.

Example

Mr. Kartik earns Rs. 12,00,000 a year and incurs an expenditure of Rs. 3,60,000 on household and personal needs. In case he dies prematurely, the net income his family would lose would be Rs. 8,40,000 per year. Suppose the rate of interest is 7% (expressed as 0.07).

The Human Life Value will be calculated as follows:

Human-Life-Value (H.L.V.) = Annual Contribution for Dependents / Rate of Interest
Thus, the human life value of Mr. Kartik's will be estimated at Rs 1,20,00,000.

This method helps in determining an approximate amount of protection one should have to cover the minimum financial needs of family members of the bread-earner. Surely, one's financial needs can be much more complex. This method only takes into account the sources of regular income.

1.16 MUTUALITY

Mutuality is the pooling principle of insurance. It is one of the ways of reducing risk in financial markets. It plays two specific roles in life insurance:

1. The first is it provides protection against the economic loss arising as a result of one's untimely death. This loss is shouldered and addressed through having a fund that pools the contributions of many who have entered into the life insurance contract.
2. The principle of risk pooling however goes beyond mortality risk. It can involve the pooling and evening out of financial risk as well. This is achieved by pooling the premiums, funds and consequently the risks of various kinds of contracts taken by individuals at different points of time. It is thus a case of pooling among different generations of policyholders. The outcome of this pooling is to try and ensure that in good as well as bad times the life insurer is able to pay a uniform rate of return (a uniform bonus) through smoothing out the returns across time.



INTEXT QUESTIONS 1.4

1. Which among the following is not a consideration with respect to allocation of the surplus by life insurers?
 - a) Mortality charge
 - b) Allocation towards free assets
 - c) Bonus and dividend distribution
 - d) Solvency margin
2. Which of the following statements is true?
 - a) An insurance agent can sell policies of more than one company.
 - b) The insurers may pay any rewards or remuneration to the insurance agents.
 - c) Commission of insurance agents is tied to policy premiums.
 - d) All of the above
3. Who developed the measure of Human Life Value?

a) Dr. Martin Luther King	b) Warren Buffet
c) Prof. Hubener	d) George Soros



Notes

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Notes

4. Which is the most appropriate statement(s) vis-a-vis HLV
 - a) Mr. A's annual earning is Rs.1.5 lacs and has proposed for a life cover of Rs.5 crore on his life.
 - b) Mr. B is a student and has proposed for a life cover of Rs25 lacs on his life.
 - c) Both are appropriate
 - d) Both are not appropriate
5. To ascertain HLV, Net earnings is calculated by
 - a) Adding all the income of the future years.
 - b) All future income less the amount required to be spent on self
 - c) Discounting the future income less the expenses, using an appropriate interest rate.
 - d) All of the above
6. Mutuality is the _____ principle of insurance. It is one of the ways of _____ risk in financial markets.
 - a) Pooling, Diversifying
 - b) Indemnity, Reducing
 - c) Pooling, Reducing
 - d) Proximity, Reducing



WHAT YOU HAVE LEARNT

Life insurance is a contract between the insurer and the insured to provide a life risk cover to the insured in return for specified premium payments. Insurance premium is the price of your insurance policy in exchange of which you get the policy coverage. Its calculation depends upon the mortality, expenses and interest. There are two primary types: Flexible and Level. Level premiums remain stable throughout the policy term. Bonus is the surplus distributed over and above the sum assured to the policyholders with 'participatory policies'. Discounts offered on premium rates, in insurance jargon are called as rebates. It's of two types: based on sum assured & on mode of premium. Mortality rates are decided using mortality tables which are prepared by Institute of Actuaries of India. Gross premium is the net premium plus an amount called loading. Surplus arises as a result of deviation in actual experience from the expectations. Surplus allocation could be towards maintaining solvency requirements, increasing free assets etc. Bonus is a way of distributing the divisible surplus among 'participatory' policyholders. The most common type of bonus is the reversionary bonus. Commission

of insurance agents is tied to policy premiums. Human life value is the present value of potential future earnings of the deceased. Mutuality is the pooling principle of insurance in order to reduce risk.



TERMINAL QUESTIONS

1. What is the purpose of a life insurance contract? Elaborate the various principles on which a life insurance contract is based. Give suitable examples.
2. What is a life insurance contract comprised of? Also discuss the various types of life insurance policies.
3. What factors impact the valuation of life insurance premium? How do level premiums differ from flexible insurance premiums?
4. What do you understand by 'bonus' in context of a life insurance contract? What are its various types?
5. Discuss the criteria for determining Net premium and Gross premium in a life insurance contract?
6. What do you understand by Surplus? What are the various ways in which a life insurance firm can allocate its surplus?
7. Explain the concept of Human Life Value in detail.



ANSWERS TO INTEXT QUESTIONS

1.1

1. (c) Maximization of Profit
2. (c) Financial protection against the risk of death
3. (b) IRDAI
4. (b) Shareholder
5. (c) Applicable to assets other than human life
6. (b) Risk
7. (c) As soon as you have any dependants, whenever in the future that might be



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1.2

1. (b) Price paid by the policyholder for purchasing the policy
2. (d) Death Benefit
3. (a) Environmental conditions
4. (a) Stable throughout the policy term
5. (b) Compound bonus
6. (b) It is paid to policyholders every year
7. (a) Sum assured chosen by the buyer

1.3

1. (a) Increase with increase in age
2. (d) Both a and c
3. (d) All of the above
4. (c) All of the above
5. (d) Excess value of assets over liabilities
6. (d) Book value

1.4

1. (a) Mortality charge
2. (c) Commission of insurance agents is tied to policy premiums.
3. (c) Prof. Hubener
4. (d) Both are not appropriate
5. (c) Discounting the future income less the expenses, using an appropriate interest rate.
6. (c) Pooling, Reducing



LEARNING OUTCOMES

After studying this chapter, you are able :

- To comprehend and analyse a life insurance contract and the basic terminologies associated with it (premium, bonus and its types, Human Life value and Mutuality etc.).

2**LIFE INSURANCE PRODUCTS****Notes****2.0 INTRODUCTION**

According to Philip Kotler "A product is anything that can be offered to a market for attention, acquisition, use or consumption and that might satisfy a need or want." Kotler has defined insurance products as unsought goods. Unsought goods are the ones which can be sold after putting a lot of personal selling, advertising, and marketing. But with time there has been a change in people's attitude towards various kinds of insurance. In fact, nowadays insurance is taken with various riders. A rider is a provision usually additional to the basic policy with the purpose of surging benefits to the insured such as accident cover rider, premium waiver rider, critical illness rider, and disability income benefit rider.

Life insurance products thus can be understood as those products that can be offered to a market to satisfy the different life insurance needs of people. There are different kinds of products having different features to satisfy different kinds of needs.

Life insurance is an intangible product where the insurance agent has to explain the benefit of different products to the potential customers so that they can understand its various features and can choose the product that best serves their purpose. Life insurance is not only restricted to its traditional role of providing financial protection against the death of a person but it also serves as investment option. It also helps people and their family on their retirement or after a period of time depending on what is being covered by the policy. This chapter will discuss various kinds of life insurance policies available to a person.



Notes



2.1 OBJECTIVES

After reading this lesson, you will be able to:

- Explain different types of life insurance policies
- Explain the concept of riders used in life insurance

2.2 OVERVIEW OF LIFE INSURANCE PRODUCTS

With time, life insurance products have undergone various changes for the benefit of insurance buyers. A person may consider various factors before selecting an insurance plan for him. Some of the factors are age of the person, age of family members and number of dependents in his family, amount of premium that he can afford, time period for which he wants to pay insurance premium, benefits from a particular insurance product, etc. Figure 2.1 shows the different types of Life Insurance products available in the market. Let us discuss these products in detail.

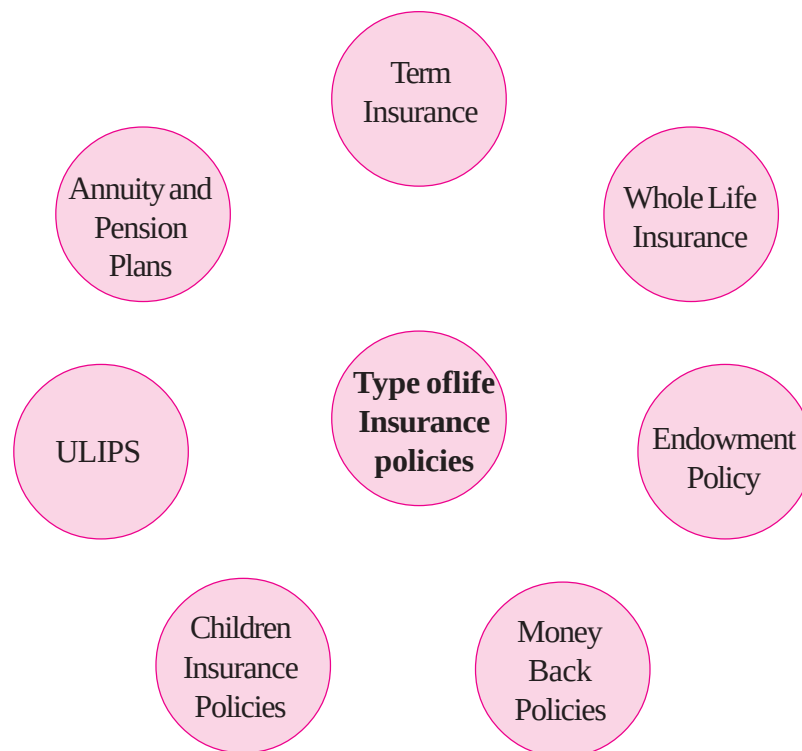


Figure 2.1: Type of Life Insurance Policies

2.3 TRADITIONAL LIFE INSURANCE PRODUCTS

Traditional life insurance plans are such that provide various advantages. These plans secure the insured and his family from risk, provide returns as well as tax benefits.

These plans provide sum assured in case of the death of the insured or some returns on maturity of the insurance plan.

These plans invest your money in very low risk financial instruments and thus returns are low. These products offer either guaranteed maturity amount or a bunch of bonus amounts. How much bonus you are going to get is not guaranteed. These bonuses are usually declared at various points during the term of the policy. These plans do not offer any flexibility to the insured. If you are not willing to continue with these plans you may surrender your policy and the surrender value is low in these plans. So these plans will be beneficial only if all premiums are paid till maturity. These plans can also be used as a tax saving instrument.

Traditional life insurance was developed with the aim of giving death benefit to the nominee or beneficiary in the event of the death of the person who is insured. But nowadays several type of products have evolved. Traditional insurance plans usually include term plans, endowment plans and Whole life insurance plans.

Traditional insurance plans are taken up for:

- Long term financial stability
- To be secured from future financial risk, expenses related to education of children, marriage of children, etc.
- To receive a guaranteed return against payment of premiums.
- Tax savings

2.4 TERM INSURANCE PLANS

Term Insurance is a type of life insurance that provides coverage for a fixed period of time or a specific number of years known as 'term of the policy'. If the insured dies during the term of the policy, a death benefit will be paid to the family of insured. In this sense, term insurance is also known as 'Pure Insurance' as it only provides the death benefit and there is no maturity benefit. No benefit will be received if a person survives till the completion of the term of the policy. The sum assured will be paid in case of the death of the insured. In case the insured stops paying premium then no benefit under such plans will be received. Under term insurance plans, protection is usually given up to 65 or 70 years of age. The minimum policy term is five years, with the maximum varying from twenty-five years to whole life span for equated monthly premium payments.



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Life Insurance



Notes

Most of the term insurance plans are renewable. Sometimes they can be converted into an endowment plan with an increase in premium. Term insurance plans usually have a low premium in comparison to other plans. Term insurance plans can also come as an income replacement plans. In this, the financial benefit is given as a series of regular interval payments like monthly, quarterly, etc for a predefined duration. Examples of some term insurance plans are 30 plus life option, Poorna Suraksha by SBI, TATA Sampurna Raksha Lumpsum, etc.

A term insurance plan may come with a disability protection rider. In this case, if insured faces an unfortunate event of disability during the time period of term insurance then the insurance company will pay some amount to the insured. However, on the death of insured such payment will stop.

Term insurance plan can be renewable and convertible. In the case of renewability, the plans have the option to be renewed when the duration of the term plan ends. In renewable plan at the time of renewing, premium will be recalculated keeping in mind the age and health of insured as well as the term of the renewed plan. In case of convertible plans, the term insurance plans can be converted into a "Whole Life Plan" without providing fresh evidence of insurability. On conversion premium amount is revised which would be on a higher side.

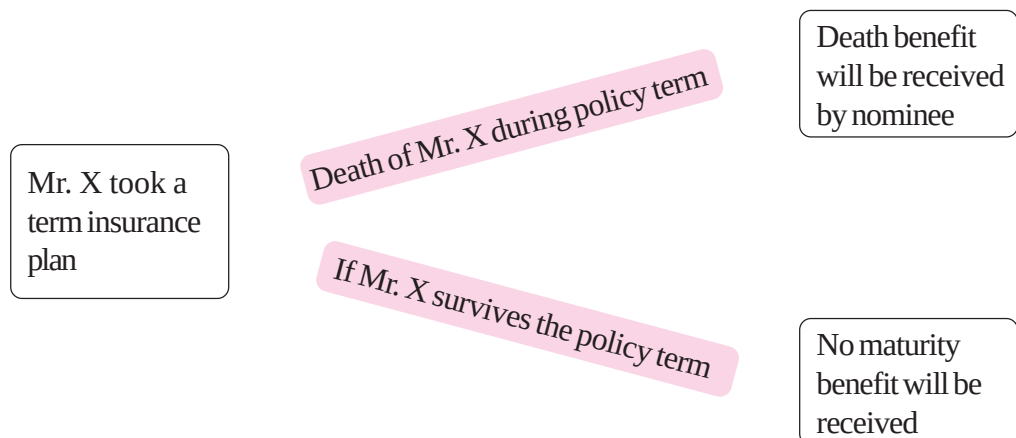


Figure 2.2: Benefits of Term Insurance

Term insurance plan can be of different types like decreasing term assurance or increasing term assurance or term insurance with return of premium.

- In decreasing term assurance, death benefit decreases as the number of year passes. A 20 year decreasing term policy may thus offer a benefit of Rs. 2,00,000 for death in the first year, with the amount decreasing by Rs. 10,000 on each



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policy anniversary, to finally come to zero at the end of the 20th year. The premium payable here remains the same, only the death benefit is decreasing. These kinds of plans are beneficial for those who may have taken some loan, as the amount outstanding on the loan decreases with each EMI payment, risk also reduces.

- In case increasing term assurance, death benefit increases as the number of year passes. The death may increase by some percentage or a specific amount. As the death benefit increases, premium amount also increases.
- Term insurance with return of premiums are the plans where it is assured that you will at least get the return of premium you have paid. It gives you a satisfaction that you have not lost anything in case you survive the term. Here the premium would be more if you compare it without the return of premium plans.

Basic purpose of term insurance is to give financial benefit to an insured's family/nominee in the event of insured's death. The premium on term insurance plans is generally lower than other plans.



INTEXT QUESTIONS 2.1

1. Which of the following factors should be considered before buying an Insurance policy?
 - a) Age of the person and its family members
 - b) Number of dependents in his family,
 - c) Benefits from a particular insurance product
 - d) All of the above
2. Which of the following is not a type of life insurance policy?
 - a) Children Insurance Policies
 - b) ULIPS
 - c) Annuity and Pension Plans
 - d) None of the above

Life Insurance



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3. Which of the following is not a traditional insurance policy?
 - a) Term plans
 - b) Endowment plans
 - c) ULIPS
 - d) Whole life insurance plans
4. Which of the following policy has only death benefit and no survival benefit?
 - a) ULIPS
 - b) Endowment Plans
 - c) Term Plans
 - d) All of the above
5. _____ is where the death benefit decreases as the number of year passes.
 - a) Decreasing term assurance
 - b) Increasing term assurance
 - c) Term insurance with return of premiums
 - d) All of the above

2.5 WHOLE LIFE INSURANCE

Whole Life Insurance policy is a life insurance policy which is guaranteed to remain in force for the insured's entire lifetime, provided required premiums are paid, or to the maturity date. There is no fixed term of cover in whole life policy but the insurer offers to pay the agreed upon the death benefit when the insured dies, no matter whenever the death might occur.

The premiums in these policies are usually more than those of term life insurance where the premium is fixed only for a limited term. Whole life insurance policy premiums are fixed and based on the age of the person taking a policy. The premium in whole life policy can be paid throughout one's life or for a specific period which is generally less than one's lifetime and are available with a par term of 5, 10, 15, 20 yrs or pay till 60 yrs of age options.

The premium usually does not increase with age. Some examples of whole life plan in India are SBI-Shubh Nivesh, HDFC Life Sampoon Samridhi plus-whole life insurance, etc. The policy term is usually 100 years minus age of entry.

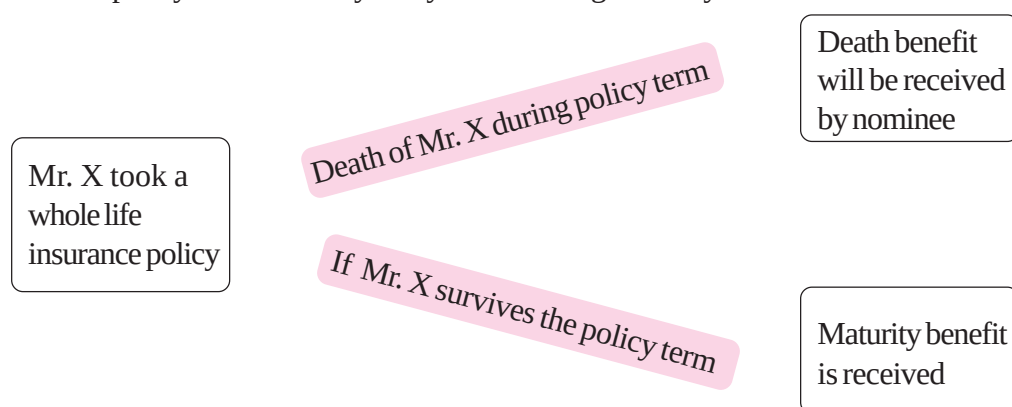


Figure 2.3: Benefits of Whole Life Insurance

This policy gives guaranteed death benefits throughout the whole life of the policyholder. Coverage is till the time insured lives, pays a premium and he doesn't surrender the policy.

The term of a whole life insurance policy usually extends up to 100 years. The policy will be in force till the time premium is paid. The amount that is covered by the policy will be received by the family or nominee of insured on his death. But if the insured survives till the age of hundred years then he will receive the matured endowment coverage as a maturity benefit. Every year when you pay a premium, some portion of that premium is utilised to provide you protection and remaining stays invested in the company. If the profit or dividend is earned on the remaining amount, you will be entitled to receive bonus. The growth in investments is returned to you if you want to withdraw or at the time of maturity. A facility of loan is also available once you complete three years of the policy and paying regular premiums.

Benefit from these policies is usually tax-free. As well as a deduction can be claimed under section 80C which gives tax benefit on the premium you are paying for this policy. There are certain whole life insurance policies where the option is given to avail loan against it.

Death benefit Stated face amount. But in case of participating policy or if the policy is having some rider then benefit may increase

Maturity Policy matures on death or at the age of usually 100 years whichever is earlier. The age of 100 years may change as per the plan of the company.

Life Insurance



Notes



Notes

2.5.1 Benefits of whole Life Insurance Policy

The main benefits of whole life insurance plans are:

- It provides a comprehensive risk cover against death to the policyholder. Thus, a death benefit is paid to the nominee in the event of the policyholder's death.
- It provide coverage to the policyholder till he reaches the age of 100 years.
- The premium rate remains constant for the duration of the policy term.
- Whole life insurance plans also acquire a cash value. Thus, policyholders can avail a loan against them. Borrow without a credit check on the basis of the built up cash value in the policy. The amount of loan taken out of cash value created will be deducted from the death benefit if it is not paid back.
- Tax benefits can be availed when you purchase a whole life insurance plan.

2.6 ENDOWMENT ASSURANCE

Endowment is actually a combination of insurance and investment. The endowment policy has the features of both death and survival benefits. These plans are preferred by a person who wants to set aside a surplus from their income at regular interval and commit it to their future. Endowment insurance plans are those which fulfil both the needs, i.e. a life cover as well as saving under the same plan. These are one of the traditional forms of life insurance. Endowment plans can be with profit as well as without profit. These plans are preferred by many as these are risk-free assured investments. Endowment plans are taken by different individuals for meeting the expenses related with old age, having an education fund or for meeting marriage expenses.

2.6.1 Benefits of Endowment Plan

- Financial protection
- Savings
- Tax benefits
- Loan against the policy in case of emergency



Notes

	TERM PLAN	ENDOWMENT PLAN
Maturity Benefits	Not Available	Yes
Death Benefits	Yes (Sum assured)	Yes (Sum assured bonus+ additional bonus(if any))
Premium amount	Low	Comparatively very High
Liquidity	No	Yes. After some years some amount can be withdrawn
Investment consideration	No (not considered as investment because no other benefit is received other than the death cover.	Yes because maturity benefit is available here.
Tax benefits	Yes	Yes

Mr. X took an endowment plan

Death of Mr. X during policy term

Death benefit will be received by nominee

If Mr. X survives the policy term

Maturity benefit will be received

Figure 2.4: Benefits of Endowment Insurance

Maturity benefits = sum assured+bonus+additional bonus

Death benefit = sum assured +accrued bonus+additional bonus (If any)

2.7 MONEY BACK PLANS

In a money back plan, the insured person gets a percentage of sum assured at regular intervals, instead of getting the lump sum amount at the end of the term. It is an endowment plan with the benefit of liquidity. This is again a combination of an insurance and investment.

Life Insurance



Notes

A money back plan is ideal for those who want a guaranteed return on their investment and are looking for regular pay-outs at the same time in addition to an insurance cover for themselves. The difference in this policy from other policies is that here the amount is not received only at the maturity of policy or death of the insured but this policy pays an amount that is called as survival benefit over the lifetime of the policy.

The Survival benefit is like another income source for the policyholder. One must understand that the survival benefits only accrue if the policyholder is alive. In case the policyholder passes away during the tenure of the policy, the sum that will be paid to the nominees will be the amount of sum assured with revisionary or additional bonuses, if any.

And if the policyholder survives the whole term of this insurance policy then on the maturity of the policy the sum assured and bonuses if any is received. Keep it in mind that till maturity the policyholder has got some money backs also.

Two kinds of bonuses are available under the money back plans.

- **Revisionary Bonus-** This is declared as a percentage of the sum assured every year by an insurance company. The revisionary bonus is given along with sum assured at the time of maturity of the policy or on the death of the insured.
- **Additional Bonus-** This bonus is given on the basis of the performance of the insurance company from which insurance has been taken. Also, it is dependent on the timely payment of all the premium during the tenure of the policy.

The survival benefit starts after a few years of starting this policy. Say Mr. X buys a money back plan of 20 years where he will get first money back if he keeps on paying a premium for the first five years. That is at the end of the first five years, he will get some amount back. Then after the next five years (say), he will get money back and so on if he survives till the time period of the policy. But in case if he dies in between then the nominee will get the sum assured apart from the money back which is already received. Bonuses can also be added to sum assured in death benefit or maturity benefit.

Thus, the money back plans offer regular income along with a maturity benefit just like standard life insurance policies. Some examples of money back policies in India are LIC Money back Policy-20 years, SBI Life -Smart Money Back Gold, Bajaj Allianz cash Assure, etc.

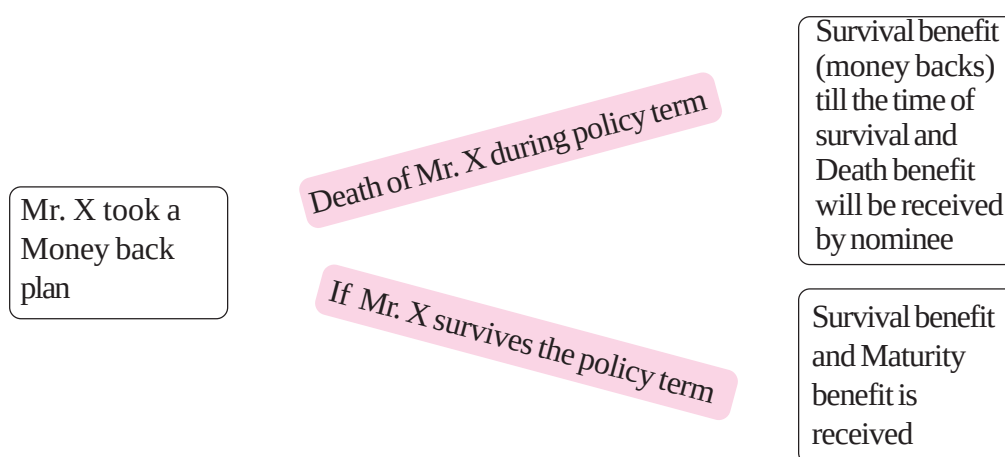


Figure 2.5: Benefits of Money Back Insurance

2.8 CHILDREN PLANS

A Child Insurance Plan is like a combination of insurance and investment plans. These plans ensure a secure future for your child. Life cover is available as a lump sum payment at the end of policy term. Not just this, these plans also provide flexible pay-outs at important milestones of your child's education. While one may not want to think about unfortunate situations like death or serious medical illness, it's important that you shield your child's future against such incidents. These Plans ensure that your child's future financial needs are taken care of even in your absence. These plans are basically taken by parents whose children are of fifteen years or less. Infact, many plans offer the facility of partial withdrawal where parents like to withdraw the sum assured in multiple fragments whenever they need it to come across the financial needs of child at certain important moments.

Some examples of such plan in India are MAX life Child Insurance Plans, Bajaj Allianz Young assure, etc.

2.8.1 Benefit of Children Plan

- Financial security during the crucial years of child's life like higher education, marriages. Even after the demise of parent.
- Investment on the basis of children's education needs along with other personal factors of insurance taker. Thus it offers a perfect blend of investment and saving in a single plan.
- Tax benefits can be availed for the premium paid.



Notes



INTEXT QUESTIONS 2.2

1. _____ is a life insurance policy which is guaranteed to remain in force for the insured's entire lifetime, provided required premiums are paid, or to the maturity date.
 - a) Term Insurance
 - b) Whole Life Insurance
 - c) Endowment
 - d) ULIP
2. _____ provide coverage to the policyholder till he reaches the age of 100 years.
 - a) Term Insurance
 - b) Whole Life Insurance
 - c) Endowment
 - d) ULIP
3. _____ is a plan in which the insured person gets a percentage of sum assured at regular intervals, instead of getting the lump sum amount at the end of the term.
 - a) Term Insurance
 - b) Whole Life Insurance
 - c) Endowment
 - d) Money Back Plan
4. _____ provide flexible pay-outs at important milestones of your child's education.
 - a) Term Insurance
 - b) Children Plans
 - c) Endowment
 - d) Whole Life Insurance

2.9 ANNUITY

An annuity plan is usually taken up to have a steady income during retirement. As an investment product, an annuity is a financial instrument that pays out a sum of money to its owner over the course of a number of years. If you have an annuity, you're guaranteed at least a certain amount of money every year until the annuity expires or you become deceased. This amount is a payment plus interest, which can accrue at different rates.

The interest rate you earn depends on the type of annuity you have. The most popular types are:

- Fixed Annuities: which earn interest at a fixed rate set at the time you purchase the annuity.
- Variable Annuities: which earn interest at a rate tied to market trends that may increase or decrease over the life of the annuity.

If the beneficiary chooses to receive the death benefit as an annuity, that means he or she wants to divide up the payments across a number of years of his or her choosing. Instead of receiving a lump sum of money, the beneficiary can choose to turn the death benefit into an annuity by using the lump sum to purchase the annuity, or what's called annuitization.

The annuity pay-out begins immediately after payment of a single lump sum amount (known as the purchase price). The plan allows one to choose the retirement age and gives a steady retirement income as long as the annuitant is alive. This helps to maintain a suitable lifestyle.

For example: if Mr. X has paid a lump sum amount say Rs 10 lakh to the insurance company under such a plan then in return the insurance company will pay him Say Rs70,000 every year for the rest of his life. Mr. X can choose to take these Rs 70000 on a monthly, quarterly half yearly or on an annual basis. One must note here that in the example above it is assumed that Mr..X. will get Rs 70,000. But what amount will be received in an actual annuity loan is dependent upon the terms and conditions of the plan of the insurance company from which this kind of plan has been taken.

Options in the Annuity Plan

The annuities also offer some options.

1. Investing in a lump sum and in return get a regular amount till the end of insured's life
2. Insured get a regular amount plus the company return the amount to insured's nominee



Notes

Life Insurance



Notes

3. The third option is that no amount is given to insured but after the death of insured the insurer will pay to the nominee till his/her death.

These plans are better than Fixed deposits as in fixed deposits the interest rate vary from time to time. But in annuity plans interest rate will not fluctuate which is important in the retirement period. Thus there is more security of income during retirement.

2.10 ULIPS

ULIP (Unit Link Insurance Policies) is a combination of insurance and investment. Here policyholder can pay a premium monthly or annually. A small amount of the premium goes to secure your life and rest of the money is invested in the market just like a mutual fund. Policyholder goes on investing through the term of the policy - 5, 10 or 15 years and accumulates the units. ULIP offers investors options that invest in equity and debt. An aggressive investor can pick equity oriented fund option whereas a conservative one can go with debt option. "If you have a long term ULIP, go for equity oriented fund option called a growth option

A ULIP plan is such that it offers the flexibility to invest in equity or debt and insurance benefits which makes them an attractive option. Example of some of the ULIPs in India are Bajaj Allianz future gain, SBI Life Wealth Assure, LIC Market Plus-I Growth Fund etc.

ULIPs can also be purchased for various purposes like ULIP for retirement, children education, health benefits etc. ULIP is different from traditional plans majorly on following basis

- In ULIP, returns are solely dependent on the market performance which is not the case with traditional plans.
- In ULIP, money is invested in debt, equity or hybrid funds but in case of traditional plans it is invested in debt instruments.
- ULIP is market linked so there is high risk element in comparison to traditional plans.

2.11 RIDERS IN LIFE INSURANCE PRODUCTS

A rider in an insurance policy are like add on that adds benefits to the terms of a basic insurance policy. Riders provide insured with benefit of an additional coverage, or they may even limit coverage.

A rider is an attachment in an insurance policy that gives the policy holder supplementary coverage. Riders basically provide more financial benefit to the policy holder or nominee



in the event of a particular happening for which rider is taken. One must know that having rider may increase the amount of premium to be paid. Riders basically helps to strengthen an insurance policy. But which rider is available with what policy and by which company has to be checked by the policy taker.

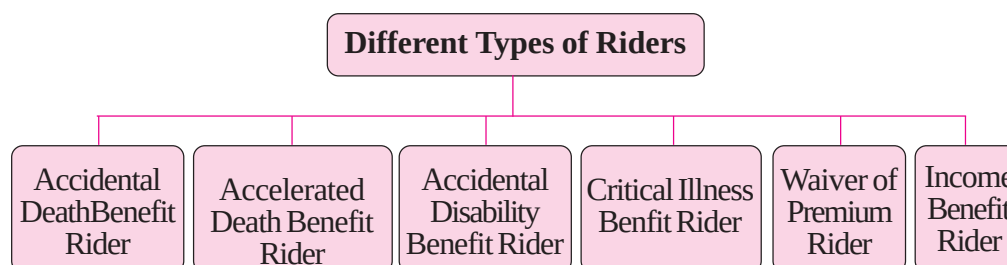


Figure 2.6: Different Type of Riders

Following are some of the important riders:

Accidental Death Benefit Rider

This rider secures against accidental death, i.e. If the insured dies by meeting an accident, then the nominee of the insured will receive an additional amount with sum assured. This additional amount is dependent on the sum assured and the terms and conditions of the insurance company from which policy has been taken.

Accelerated Death Benefit Rider

Under this rider if the insured suffers some terminal illness then the insured family can have a part of sum assured in advance. This helps them to meet medical expenses.

Accidental Disability Benefit Rider

If this rider is there with the insurance policy, then on becoming partially or permanently disabled, the policy holder will receive some amount which is some percentage of sum assured for some years say next five to ten years after the accident caused disability.

Critical Illness Benefit Rider

On diagnosis of a critical illness, which is pre specified in policy at the time of taking the policy with the rider, the policy holder will receive a lump sum. In some policies the coverage amount reduces by the amount paid to policy holder under this rider.

Waiver of Premium Rider

In case the policy holder couldn't pay the premium due to income loss or becoming disable then the future premiums are waived off under this rider. It is like insuring your premium payments.

Life Insurance



Notes

Income Benefit Rider

This rider helps the insured family to get some regular income for some period of time say five or ten years after the insured dies in addition to sum assured. But one must understand the policy and all the terms and conditions in detail before adding any rider.



INTEXT QUESTIONS 2.3

1. _____ is usually taken up to have a steady income during retirement.
 - a) Annuity Plan
 - b) Children Plans
 - c) Endowment
 - d) Whole Life Insurance
2. _____ is a plan where a small amount of the premium goes to secure your life and rest of the money is invested in the market just like a mutual fund.
 - a) Annuity Plan
 - b) ULIP
 - c) Endowment
 - d) Whole Life Insurance
3. _____ rider secures against accidental death.
 - a) Accidental Death Benefit Rider
 - b) Accidental Disability Benefit Rider
 - c) Accelerated Death Benefit Rider
 - d) Critical Illness Benefit Rider
4. _____ plan offers the flexibility to get benefit of investment in equity and debt along with the insurance benefit.
 - a) ULIP
 - b) Children plan
 - c) Endowment Plan
 - d) Term Plan



Notes

5. _____ is declared as a percentage of the sum assured every year by an insurance company.
 - a) Additional Bonus
 - b) Revisionary Bonus
 - c) Sum Insured
 - d) All of above
6. _____ is a provision usually additional to the basic policy with the purpose of increasing benefits to the insured?
 - a) Premium
 - b) Rider
 - c) Exclusion
 - d) None of the above



WHAT YOU HAVE LEARNT

Term insurance is the most basic type of insurance. The insured's family gets a lump sum amount in case of his death. But nothing will be received if the insured survives the term. Whole life Insurance gives coverage for a lifetime. Endowment plans are preferred by a person who wants to set aside a surplus from their income at regular interval and commit it to their future. In a money back plan, the insured person gets a percentage of sum assured at regular intervals, instead of getting the lump sum amount at the end of the term. Children Plans and Annuity Plans help people to take care of their future needs and the needs of their family members. LIP is a combination of insurance and investment. A rider in an insurance policy are like add on that adds benefits to the terms of a basic insurance policy.



TERMINAL QUESTIONS

1. Select any two life insurance Company of your choice. Make a list of all the kinds of life insurance plans offered by them. Compare the amount of premium and Sum assured on all the plans of both the companies.
2. What is a life insurance policy? Explain various kinds of life insurance policy
3. What are ULIPs? How they are different from other insurance policies?
4. What are the benefits of whole life insurance policy?

Life Insurance



Notes

5. Differentiate between Term Plan and Endowment Plan.
6. Write short notes on following:
 - a) Children Plan
 - b) ULIPs
 - c) Annuity
 - d) Riders



ANSWERS TO INTEXT QUESTIONS

2.1

1. (d) All of the above
2. (d) None of the above
3. (c) ULIPS
4. (c) Term Plans
5. (a) Decreasing term assurance

2.2

1. (b) Whole Life Insurance
2. (b) Whole Life Insurance
3. (d) Money Back Plan
4. (b) Children Plans

2.3

1. (a) Annuity Plan
2. (b) ULIP
3. (a) Accidental Death Benefit Rider
4. (a) ULIP
5. (b) Revisionary bonus
6. (b) Rider



LEARNING OUTCOMES

After studying this chapter, you are able :

- To explain the different type of life insurance policy to the client and the importance of riders in life insurance policy to the client

3

FIRE & CONSEQUENTIAL LOSS INSURANCE (PART-1)

**Notes**

3.0 INTRODUCTION

Business enterprises may take great caution and use all the latest technology at their business premises for avoiding any loss due to fire or other perils but the possibility of accident cannot be entirely negated. In case of any fire, the fire and water used to extinguish the fire can destroy the building as well as the stock, and other goods present inside the building. This may create a big financial and mental burden on the business enterprises and organisations may not be able to rebuild their business due to lack of funds. Thus, buying a fire insurance for your business becomes essential as well as recommended. In this chapter you will learn how property, fire and Consequential Loss Insurance can help the business enterprises avoiding a big financial loss caused due to various factors.



3.1 OBJECTIVES

After reading this lesson, you will be able to:

- Explain fire insurance
- Define consequential loss insurance

3.2 MEANING OF FIRE INSURANCE

The term fire in fire insurance is interpreted in the literal and popular sense. There is fire when something burns. In other words fire means visible flames or actual ignition. Simmering/ smoldering is not considered fire in Fire Insurance. Fire produces heat and light but either of them alone is not fire. Lightening is not a fire but if it ignites something,

Life Insurance



Notes

the damage may be due to fire. Under section 2(6A) Insurance Act 1938, the fire insurance business is defined as follows:

"Fire insurance business means the business of effecting, otherwise than independently to some other class of business, contracts of insurance against loss by or incidental to fire or other occurrence customarily included among the risks insured against in fire insurance policies".

Example: The following are the items which can be burnt/ damaged through fire:

- Buildings
- Electrical installation in buildings
- Contents of buildings such as machinery, plant and equipment, accessories, etc.
- Goods (raw materials, in-process, semi-finished, finished, packing materials, etc.) in factories, godowns etc.
- Goods in the open
- Furniture, fixture and fittings
- Pipelines (including contents) located inside or outside the compound, etc.

The owner of abovementioned properties can insure against fire damage through fire insurance policy which provides financial protection for property against loss or damage by fire.

Commercial enterprises are broadly divided into two types:

- Small and Medium Enterprises [SMEs] and
- Large Business Enterprises

By meeting these consumers' needs, the general insurance industry has historically expanded to a significant extent.

It's important to carefully match insurance products with customers' demands when selling general insurance to businesses. The products that are provided must be properly understood by the agents. Let's take a quick look at a few of these general insurance options.



3.3 FIRE INSURANCE

Commercial buildings, property owners, people who hold property in trust or on commission, and people or financial institutions with a financial interest in the property are all eligible for fire insurance policies.

Any movable or immovable property that is present at a specific location, such as buildings, machinery, plant, furniture, fixtures, fittings, and other contents, stocks and stock in process, including stocks at suppliers' or customers' premises, and machinery that has been temporarily removed from the location for repairs, can be insured. To repair and refresh the damaged property and return the business to normal operations, financial relief is necessary. This is where fire insurance comes into play.

In India, in addition to fire, additional risks are also covered by fire insurance policies.

3.3.1 Perils under Fire Policy

Some of the perils covered by the fire policy are discussed below. The fire policy for commercial risks covers the perils of:

- Fire
- Lightning
- Explosion / implosion
- Riot strike and malicious damage
- Impact damage
- Aircraft damage
- Storm, tempest, cyclone, typhoon, hurricane, tornado, flood and inundation
- Subsidence and landslide including rock slide
- Bursting and overflowing of water tanks, apparatus and pipes
- Missile testing operations
- Leakages from automatic sprinkler installation
- Bush fire

Commercial insurance differs from individual and retail coverage in two significant ways.

Module - 2

Life Insurance



Notes

FIRE & CONSEQUENTIAL LOSS INSURANCE (PART-1)

- a) Compared to individuals, businesses or organisations have substantially greater insurance demands. The reason is because the value of a business's assets is far higher than the value of an individual's assets. Their destruction or loss could have a negative effect on the business's very existence and future.
- b) Legal or other regulations frequently dictate or make necessary the need for business company insurance. For instance, insurance for plants and assets may be required when setting up assets with a bank loan. In India, there are many professionally operated corporations, many of which are multinationals. They must uphold international quality standards, which includes implementing suitable risk management plans and purchasing insurance to safeguard company assets.

Subject to certain exclusions, the policy will cover any loss resulting from the aforementioned hazards.

Exclusions

- a) War and war like activities
 - i. Nuclear perils
 - ii. Ionization and radiation
 - iii. Pollution and contamination losses
- b) Perils that are covered by other policies in General Insurance
 - i. Machinery Breakdown,
 - ii. Business Interruption

3.3.2 Add-On Covers

However some perils can be covered by payment of additional premium:

- Earthquake,
- Fire and shock;
- Deterioration of stock in the cold storages following power failure as a result of insured peril,
- Expenditure involved in removal of debris,
- Architect, consulting engineers fee over and above the amount covered by the policy,
- Forest fire,
- Spontaneous combustion and impact damage due to own vehicles.



INTEXT QUESTIONS 3.1

1. A fire policy for commercial or business risks covers the perils of_____
 - a) Explosion
 - b) Implosion
 - c) Both of the above
 - d) None of the above
2. Which of the following is not an exclusion under fire insurance?
 - a) Nuclear perils
 - b) Ionization and radiation
 - c) Machinery Breakdown
 - d) Subsidence and landslide
3. What is the standard period for fire insurance policy?
 - a) 6 months
 - b) 12 months
 - c) 4 months
 - d) 18 months

3.3.3 Variants of Fire Policy

Fire insurance plans are often given out for 12 months. Insurance companies only provide long-term policies, or those that last more than a year, for homes. Sometimes short-term policies are also issued, and these policies are covered by the short-term scales.

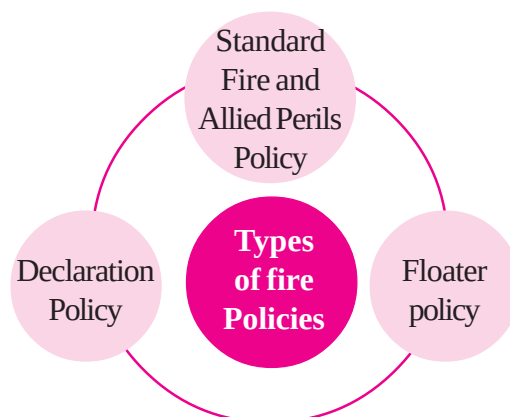


Figure 3.1: Types of fire policies

Life Insurance



Notes



Notes

In India, under fire insurance policy, in addition to fire, other perils are also included and the policy is known as "Standard Fire and Allied Perils Policy".

A) Standard Fire and Allied Perils Policy:-

Perils Covered:-

1. Fire Excluding destruction or damage caused to the property insured by
 - i) its own fermentation, natural heating or spontaneous combustion.
 - ii) its undergoing any heating or drying process.
 - iii) burning of property insured by order of any Public Authority.
2. Lightning
3. Explosion/Implosion

Excluding loss, destruction of or damage: -

1. To boilers (other than domestic boilers), economizers or other vessels, machinery or apparatus (in which steam is generated) or their contents resulting from their own explosion/implosion, caused by centrifugal forces.
2. Aircraft Damage
3. Loss, Destruction or damage caused by Aircraft, other aerial or space devices and articles dropped there from excluding those caused by pressure waves.
4. Riot, Strike and Malicious Damage
5. Physical damage or destruction by external violent means directly caused to the property insured.
6. Storm, Cyclone, Typhoon, Tempest, Hurricane, Tornado, Flood and Inundation
7. Impact Damage

Loss of or visible physical damage or destruction caused to the property insured due to impact by any Rail/ Road vehicle or animal by direct contact not belonging to or owned by :-

- a) The Insured or any occupier of the premises or
 - b) Their employees while acting in the course of their employment
8. Subsidence and Landslide including Rock slide



Loss, destruction or damage directly caused by Subsidence of part of the site on which the property stands or Land slide/Rock slide excluding:

- a) the normal cracking, settlement or bedding down of new structures
 - b) the settlement or movement of made up ground
 - c) coastal or river erosion
 - d) defective design or workmanship or use of defective materials
 - e) demolition, construction, structural alterations or repair of any property or ground works or excavations
9. Bursting and/or overflowing of Water Tanks, Apparatus and Pipes
 10. Missile Testing operations
 11. Leakage from Automatic Sprinkler Installations Excluding loss, destruction or damage caused by
 - a) Repairs or alterations to the buildings or premises
 - b) Repairs, Removal or Extension of the Sprinkler Installation
 - c) Defects in construction known to the Insured.
 12. Bush Fire Excluding loss, destruction or damage caused by Forest Fire.

Exclusions

1. This Policy does not cover (not applicable to policies covering dwellings) Excess applicable will be as mentioned in the policy schedule. The Excess shall apply per event per insured.
2. Loss, destruction or damage caused by war, invasion, act of foreign enemy hostilities or war like operations (whether war be declared or not), civil war, mutiny, civil commotion assuming the proportions of or amounting to a popular rising, military rising, rebellion, revolution, insurrection or military or usurped power.
3. Loss, destruction or damage directly or indirectly caused to the property insured by
 - a) Ionizing radiations or contamination by radioactivity from any nuclear fuel or from any nuclear waste from the combustion of nuclear fuel



Notes

- b) The radioactive toxic, explosive or other hazardous properties of any explosive nuclear assembly or nuclear component thereof
- 4. Loss, destruction or damage caused to the insured property by pollution or contamination excluding
 - a) Pollution or contamination which itself results from a peril hereby insured against.
 - b) any peril hereby insured against which itself results from pollution or contamination.
- 5. Loss, destruction or damage to bullion or unset precious stones, any curios or works of art for an amount exceeding Rs.10000/-, goods held in trust or on commission, manuscripts, plans, drawings, securities, obligations or documents of any kind, stamps, coins or paper money, cheques, books of accounts or other business books, computer systems records, explosives unless otherwise expressly stated in the policy.
- 6. Loss, destruction or damage to the stocks in Cold Storage premises caused by change of temperature.
- 7. Loss, destruction or damage to any electrical machine, apparatus, fixture, or fitting arising from or occasioned by over-running, excessive pressure, short circuiting, arcing, self-heating or leakage of electricity from whatever cause (lightning included). This exclusion may apply to only to the particular electrical machine, apparatus, fixture or fitting so affected and not to other machines, apparatus, fixtures or fittings which may be destroyed or damaged by fire so set up.
- 8. Expenses necessarily incurred on
 - (i) Architects, Surveyors and Consulting Engineer's Fees and
 - (ii) Debris Removal by the Insured following a loss, destruction or damage to the Property insured by an insured peril in excess of 3% and 1% of the claim amount respectively.
 - a) Loss of earnings, loss by delay, loss of market or other consequential or indirect loss or damage of any kind or description whatsoever.
 - b) Loss or damage by spoilage resulting from the retardation or interruption or cessation of any process or operation caused by operation of any of the perils covered.



Notes

- c) Loss by theft during or after the occurrence of any insured peril except as provided under Riot, Strike, Malicious and Terrorism Damage cover.
- d) Any Loss or damage occasioned by or through or in consequence directly or indirectly due to earthquake, Volcanic eruption or other convulsions of nature.
- e) Loss or damage to property insured if removed to any building or place other than in which it is herein stated to be insured, except machinery and equipment temporarily removed for repairs, cleaning, renovation or other similar purposes for a period not exceeding 60 days.

B) Declaration Basis Policies

- ❖ This policy is issued for the maximum value of stock to be insured. At the beginning of the contract, three-fourths of the premium payable is charged from the insured in advance. Every month the policyholder is required to declare the value of present stock. In case of any loss by fire, the compensation is made on the basis of declared value. At the end of the insured period, based on the values stock declared, the total of premium payable is worked out as average.
- ❖ Wholesalers, retailers or distributors often taken this type of policy. A declaration policy takes care of the frequent fluctuations in stock or stock values. Stock stored at a warehouse or factory may include raw materials or finished goods.
- ❖ In the declaration policy for a warehouse or a factory, the minimum sum insured can be for one or more location. But this amount of sum insured must not be less than a pre-defined amount in the policy for at least one of the locations. The policy does not allow a reduction in the sum insured.
- ❖ In case of a warehouse or a factory, the monthly declarations are to be submitted to the factory and warehouse insurance company latest by the last day of the next month. These declarations can be based upon:
 - ❖ Average of the value at risk
 - ❖ Highest value at risk for the particular month
 - ❖ In case of failure to submit the declaration within the stipulated period, the insurers consider that the full sum insured under the policy is declared.



Notes

- ◆ Another important factor that the declaration policy states is that, when there is a refund of premium based on adjustments like declarations or cancellations, the refund will not exceed 50% of the total premium.
- ◆ The basis for valuation of the stock or the inventory stored in the warehouse or the factory value close to the market price.

C) Floater Policy

It is a policy which covers loss by fire caused to property belonging to the same person but located at different places under a single sum and for one premium. Such a policy might cover goods lying in two warehouses at two different locations. This policy is always subject to 'average clause'.

Basic features:-

- ◆ Takes care of frequent changes in values at various locations.
- ◆ Single sum insured for all the stocks in all the locations.
- ◆ Nominal premium loading to cover all the stocks in all the locations

3.3.4 Special Clauses

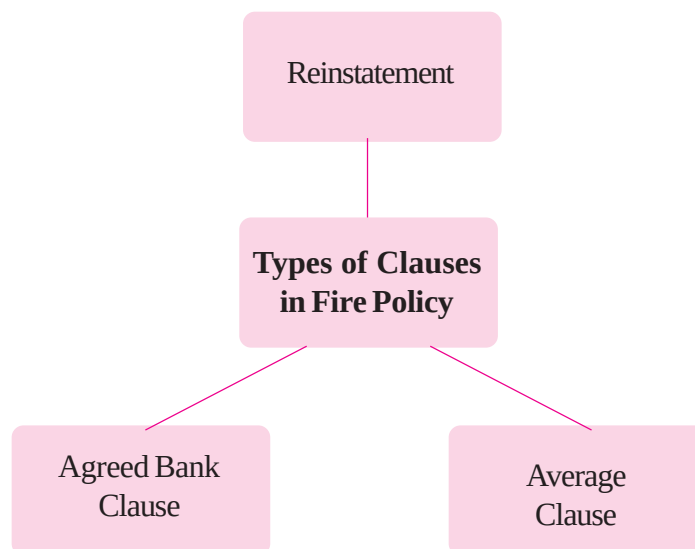


Fig. 3.2: Types of clause in Fire policy

1. Reinstatement Clause

Reinstatement Clause in a Fire insurance policy makes it different from a traditional fire insurance policy. In fire insurance the principle of indemnity can be modified



in the case of building, machinery and other fixed assets whereby, subject to the sum insured representing the value of similar new property, it can be insured under 'Reinstatement Value' clause.

In case of reinstatement value policy, the basis of loss settlement is the value of new property without taking any depreciation into account. This type of insurance enables the owner to replace his property without any financial strain on his own resources and is quite commonly taken by industrialists and building owners.

Each building has a definite built-up area and ascertainable constructional specification. Any civil engineer or architect can examine the current cost of construction, keeping all relevant factors in view. For arriving at the cost of buildings, various publications such as the CPWD rates are available as guideline

2. Average Clause

To cater to the concerns of under-insurance, there is an average clause in fire policy. This means that in case of loss the insured has to bear a part of the loss. Underinsurance implies when the insured has insured the property less than its actual value. The insurer will only bear ratable proportion of the loss. In other words, for the difference between the actual value of subject matter and the amount for which it is insured, the insured has to be his own insurer.

Example: Suppose a property worth Rs. 4,00,000 is insured for Rs. 2,50,000 and the fire policy contains the average clause. Now, if half the property is destroyed by fire (loss amount- Rs 1,00,000), the insurer will pay only Rs. 62,500 which is calculated as per the following formula.

Insured amount (Rs.2,50,000) x Actual loss(Rs. 1,00,000) / Actual value of the property(Rs.4,00,000)

3. Agreed Bank Clause

All policies in which a Bank has a partial interest are to be made out in the name of the Bank and Owner or Mortgagor and the Agreed Bank Clause incorporated in the policy. The salient features of the clause are :

- (a) The claim is payable to the bank whose receipt shall be a complete discharge and binding on all parties insured.
- (b) Any notice under the policy is sufficient if given by or to the bank.
- (c) Any settlement, compromise etc. in relation to dispute if made with the bank shall be valid and binding on all parties insured.



Notes

FIRE & CONSEQUENTIAL LOSS INSURANCE (PART-1)

- (d) Any alteration or increase in risk does not invalidate the insurance, provided the bank notifies the same as soon as it comes to its knowledge and pays additional premium

The All India Fire Tariff states this clause as under:-

"It is hereby declared and agreed: -

- a) That upon any monies becoming payable under this policy the same shall be paid by the Company to the Bank and such part of any monies so paid as may relate to the interests of other parties insured hereunder shall be received by the Bank as Agents for such other parties.
- b) That the receipts of the Bank shall be complete discharge of the Company therefore and shall be binding on all the parties insured hereunder. N.B.(Note Well): The Bank shall mean the first named Financial Institution/ Bank named in the policy.
- c) That if and whenever any notice shall be required to be given or other communication shall be required to be made by the Company to the insured or any of them in any manner arising under or in connection with this policy such notice or other communication shall be deemed to have been sufficiently given or made if given or made to the Bank.
- d) That any adjustment, settlement, compromise or reference to arbitration in connection with any dispute between the Company and the insured or any of them arising under or in connection with this policy if made by the Bank shall be valid and binding on all parties insured hereunder but not so as to impair rights of the Bank to recover the full amount of any claim it may have on other parties insured hereunder."



INTEXT QUESTIONS 3.2

1. What are the policies that cover storage of items in many locations under a single sum insured?
 - a) Declaration policies
 - b) Floater policies
 - c) Reinstatement policies
 - d) None of the above



2. What are the policies for stocks of goods that are subject to fluctuation in quantity called?
 - a) Declaration policies
 - b) Floater policies
 - c) Reinstatement policies
 - d) None of the above
3. Which of the following is not a peril under a Fire policy?
 - a) Lightning
 - b) Aircraft damage
 - c) Storm, tempest, cyclone, typhoon, hurricane, tornado, flood and inundation
 - d) War and Nuclear perils
4. The monthly declarations for a warehouse or a factory are to be submitted to the insurance company latest by the last day of the next month. These declarations can be based upon:
 - (i) Average of the value at risk
 - (ii) Highest value at risk for the particular month
 - (iii) Profits of previous year
 - (iv) Rent of warehouse
 - a) i & ii
 - b) ii & iii
 - c) iii & iv
 - d) i & iv
5. Which of the following clause caters to the issue of underinsurance in Fire policy?
 - a) Reinstatement Clause
 - b) Average Clause
 - c) Agreed Bank Clause
 - d) None of the above



Notes

3.4 CONSEQUENTIAL LOSS (CL) INSURANCE / BUSINESS INTERRUPTION INSURANCE

Business Interruption insurance is also known as Consequential Loss Insurance or Loss of Profit Insurance. Insurance against fire offers protection against material or property loss or damage to buildings, machinery, plants, fixtures, and other property caused by insured risks. The insured's business may be completely or partially interrupted as a result, causing varying economic losses during the disruption.

3.4.1 Coverage under Consequential Loss (CL) Policy or Business Interruption Policy

Consequential Loss (CL) Policy [Business Interruption (BI)] offers indemnity for loss of gross profit, which is made up of Net Profit plus Standing Charges, as well as the increased cost of operations or working incurred by the insured to get the business back to normal as quickly as possible to reduce the final loss. The risks and circumstances covered are the same as those covered by the fire policy.

Example

If the sugar mill factory is damaged by an earthquake, the company will lose money because of the lost production. If the loss was caused by an insured danger, both the additional expenses and the lost income can be protected.

This insurance must be purchased alongside a normal fire and special perils policy since claims under this policy can only be honoured in conjunction with a claim under a standard fire and special perils policy.



INTEXT QUESTIONS 3.3

1. A business interruption insurance policy can be taken only in combination with _____.
 - a) Standard fire and special perils policy
 - b) Standard fire and marine policy
 - c) Standard and special perils policy
 - d) Standard Engineering and marine policy



2. Consequential Loss (CL) Policy Provides indemnity for loss of gross profit comprising of _____ + _____ along with the increased cost of operations or working incurred by the insured to get the business back to normal.
- a) Net profit , Standing charges
 - b) Net income , standing charges
 - c) Net profit + salaries
 - d) Net income + salaries



WHAT YOU HAVE LEARNT

A fire insurance policy is appropriate for businesses, the property owner, and people or financial institutions with a financial interest in the property. Fire insurance plans are often given out for 12 months. Reinstatement value policies, Declaration policies, and Floater policies are examples of fire policy variants. Consequential Loss (CL) Policies or Business Interruption (BI) Policies provide indemnity for loss of what is referred to as gross profit, which includes Net Profit plus Standing Charges as well as the increased cost of working incurred by the insured to get the business back to normalcy as quickly as possible to reduce the final loss.



TERMINAL QUESTIONS

1. What are the perils covered under Fire insurance? Also list down the exclusions under fire insurance policy.
2. Explain in detail various types of fire policies.
3. Describe in brief
 - a) Reinstatement Clause
 - b) Average Clause
 - c) Agreed Bank Clause
4. Define Consequential Insurance Policy.



Notes



ANSWERS TO INTEXT QUESTIONS

3.1

1. (c) Both of the above
2. (d) Subsidence & Landslide
3. (b) 12 months

3.2

1. (b) Floater policies
2. (a) Declaration Policies
3. (d) War and Nuclear perils
4. (a) i & ii -Average of the value at risk & Highest value at risk for the particular month
5. (b) Average Clause

3.3

1. (a) Standard fire and special perils policy
2. (b) Net profit, Standing charges



LEARNING OUTCOMES

After studying this chapter, you are able :

- To explain the concepts of fire and consequential insurance along with its types.

**4**

MISCELLANEOUS INSURANCE (PART - 2)

4.0 INTRODUCTION

In the previous chapter you have studied about the fire insurance and its various policies which made you understand the importance of taking a fire insurance policy for any commercial or business enterprises or a firm. There also exist a different set of customers who have other needs for safety and protection. These are the commercial or business establishments or firms that are involved in or deal with diverse varieties of products and services. In this chapter we shall consider the insurance products available to cover the risks faced by this segment. You will be able to learn burglary insurance cover, coverage of losses caused due to dishonesty of employees called fidelity guarantee insurance, banker's indemnity insurance and jeweller's block policy insurance.



4.1 OBJECTIVES

After reading this lesson, you will be able to:

- Understand burglary insurance
- Explain Miscellaneous Insurance other than Life, Fire and Marine
- Explain burglary insurance, money insurance, fidelity guarantee insurance, banker's indemnity insurance and jeweller's block policy

4.2 MISCELLANEOUS INSURANCE

Miscellaneous Insurance refers to those insurance contracts other than those of Life, Fire and Marine insurance. It covers a range of risks, the few of which are burglary insurance; fidelity guarantee insurance; money insurance; bankers' indemnity insurance;

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jeweller's block insurance; and banker's indemnity insurance.

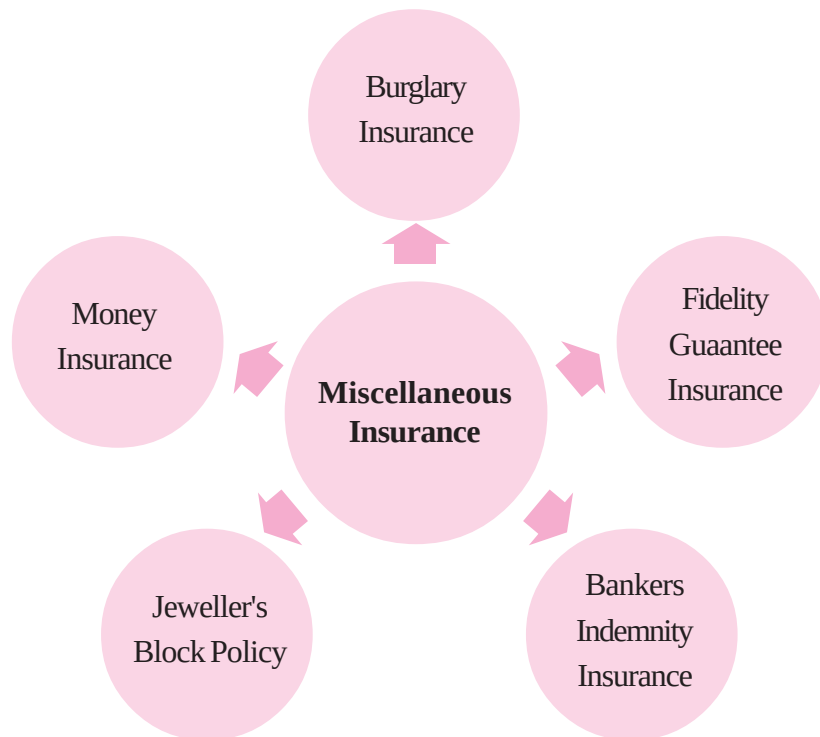


Figure 4.1: Types of Miscellaneous Insurance

4.2.1 Burglary Insurance

The policy is intended for commercial buildings such as factories, shops, offices, warehouses, and godowns that may also include stock, commodities, fixtures, and furniture, as well as money in a locked safe that is susceptible to theft. The following are the areas covered:

1. Risks protected by burglary insurance
 - a) A loss of personal possessions following a real, violent, forceful entry into the premises or a loss observed following a violent, forcible withdrawal from the premises.
 - b) Burglar damage to insured assets or premises. Only when a piece of insured property is stolen from the insured premises and not from another location is it covered.

Types of cover under burglary insurance:

A) Cash cover

Cash cover is a crucial component of burglary insurance coverage. It only works as long as the money is kept safe in a safe that is both burglar-proof and of a



reliable make and design. The following list includes the typical terms and conditions for providing cash cover:

- a) Money stolen from the safe after the original key was used to access it. Only when such a key has been gained through force, violence, or threats of violence is it covered. This is typically referred to as a "key clause."
- b) A comprehensive list of the cash quantities in the safe is maintained secure somewhere other than the safe. The maximum amount for which the insurer is liable is indicated by such documents.

B) First Loss Insurance

The chance of losing the entire stock due to a single event is regarded as remote in circumstances where low value items may be purchased in large quantities (such as cotton in bales, grain, sugar, and many others). The premium is charged to cover the total stock at risk while accounting for the value of the property, goods, or stock that could be burglarized. This value is determined as the probable maximum loss. It is anticipated that a second burglary won't occur right away after the first one, or that the insured may decide to add extra safety precautions as a result of its recurrence.

- C) Similar to fire insurance, declaration cover and floater cover are also options for stocks.

Exclusions

- Theft by employees, family members or other persons who are lawfully on the premises
- Larceny or ordinary theft.
- Losses that are covered by a fire or plate glass policy.

Extensions

- Riot, strikes and terrorism risks at extra premium.

Premium

Rates of premium for burglary policy depend upon:

- The nature of insured property,
- The moral hazard of the insured himself,
- Previous claims experience etc.

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- Safety measures (e.g. watchmen, burglar alarm),
- Construction and location of premises,
- In addition to details given in the proposal form, a pre-acceptance inspection is done by insurers where high values are involved.

4.2.2 Money Insurance

Cash handling is an integral part of any business. It is designed to guard against financial loss for industrial businesses and banks. Both inside and outside the building, money is in danger. It might be illegally taken away whether making a withdrawal, deposit, payment, or collection.

Coverage of Money Insurance

Losses that could happen when handling cash, checks, postal orders, or postage stamps are covered by money insurance policies. Typically, the policy offers protection through two sections:

a) Transit Section

It covers loss of cash while being transported outside by the insured or her authorised staff as a result of theft, robbery, or other similar actions.

Two amounts are specified in the transit section:

- "Limit per carrying"**: The greatest sum that insurers may be forced to pay in respect of any loss
- "Estimated amount in transit during the policy period"**: It represents the amount to which the rate of premium is to be applied in order to determine the amount of premium.

Like with fire insurance, policies can be granted on a "declaration basis." As a result, insurers assess a provisional premium on the expected quantity in transit and then adjust it when the policy expires depending on the actual amount that was transported throughout the policy period as reported by the insured.

b) Premises Section

This section deals with the theft of cash from a person's home or locked safe as a result of burglary, home invasion, holdup, etc. Other aspects of the policy are typically the same as those of the above-discussed burglary insurance.

Important Exclusions

- a) Shortage due to error or omission,
- b) Loss of money that has been entrusted to other than authorized person and
- c) Riot strike and terrorism: This can be covered as an extension by paying an extra premium.

Extensions

On payment of additional premium the policy may be extended to cover:

- a) Dishonesty of persons carrying cash,
- b) Riot, strike and terrorism risks
- c) Disbursement risk, which is the loss suffered during payment of wages to employees

Premium

The premium amount is set based on the insured, the company's capacity to carry cash at any one moment, the form of transportation, the distance travelled, the safety precautions taken, etc. If a declaration is made within 30 days of the policy's expiration, the premium can be adjusted depending on the actual cash carried throughout the course of the year.

**INTEXT QUESTIONS 4.1**

1. The premium for burglary policy depends on_____
 - a) Nature of insured policy
 - b) Moral hazard of the insured himself
 - c) Construction and location of the premises
 - d) All of the above
2. Which of the following is exclusion under burglary insurance?
 - a) Larceny
 - b) Theft by employees or family members
 - c) Loss that are covered by fire or plate glass policy
3. Which of the below is covered under a money insurance policy?



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- a) Shortage due to error or omission
 - b) Loss of cash from one's premises due to burglary
 - c) Loss of money that has been entrusted to other than authorized person
 - d) Riot strike and terrorism
4. Money insurance policy is covered under which of the following sections?
- a) Transit Section
 - b) Premises Section
 - c) None of the above
 - d) All of the above

4.2.3 Fidelity Guarantee Insurance

Companies experience financial loss as a result of what are referred to as "white collar crimes," such as employee fraud or dishonesty. Employers are protected by fidelity guarantee insurance from financial loss brought on by employee fraud or dishonesty, including forgery, embezzlement, larceny, misappropriation, and default.

Coverage under Fidelity Guarantee Insurance

Cover is granted against a direct pecuniary loss and does not include consequential losses.

- a) The loss should be in respect of moneys, securities or goods
- b) The act should be committed in the course of the duties specified;
- c) The loss has be discovered within 12 months of expiry of the policy or death retirement resignation or dismissal of the employee, whichever is earlier
- d) No cover is provided in respect of a dishonest employee who has been re-employed

Types of Fidelity Guarantee Policy

There are various types of fidelity guarantee policies, as discussed below:

a) Individual Policy

When only one person is required to be ensured, this kind of policy is employed.



It is necessary to specify the employee's name, title, and guarantee amount.

b) Collective Policy

This policy includes a schedule detailing the employees' names to whom the guarantee applies, a notation on each employee's responsibilities, and distinct individual quantities guaranteed.

c) Floating Policy or Floater

The names and responsibilities of the people who will be insured are included in a schedule of this policy, but there are no individual guarantees; instead, a certain amount of guarantee is "floated" over the entire group. Therefore, a claim against any one employee will lower the floated guarantee, unless the original amount is restored by paying an additional premium.

d) Positions Policy

This is similar to a collective policy, with the exception that the name is not mentioned and only the schedule spells out "positions" that are to be guaranteed for a given amount.

e) Blanket Policy

This policy applies to all employees without identifying them by name or position. The insurers don't make any inquiries regarding the personnel. Such procedures are only appropriate for an enterprise with a sizable workforce and the organisation conducts adequate background checks on all new hires. In the event of a claim, the references the employer collects must be made available to the insurers. The policy is only given to reputable large organisations.

Premium

The type of business profession, the employee's status, the check-and-supervision system, and the rate of premium are all factors.

4.2.4 Bankers Indemnity Insurance

This comprehensive cover was drafted for the banks, NBFCs and other institutions who deal with operations involving money, considering the special risks faced by them regarding money and securities.

Coverage under Bankers Indemnity Insurance

There are different variations to this policy based on the requirement of banker.

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Notes

- a) Money securities lost or damaged whilst within the premises due to fire, burglary, riot and strike.
- b) Loss suffered due to any cause whatsoever including negligence of the employees, when the property is carried outside the premises in the hands of authorized employees.
- c) Forgery or alteration of cheques, drafts, fixed deposit receipts etc.
- d) Dishonesty of employees with reference to money/securities or in respect of goods pledged.
- e) Dispatches by registered post parcels.
- f) Dishonesty of appraisers.
- g) Money lost while in the hands of agents of the bank like "Janata Agents", "Chhoti Bachat Yojana Agents".

Since the insurance is provided on a discovery basis, it will apply to any period during which a loss is detected rather than just the time during which it occurred. However, a cover ought to have been there when the loss actually happened.

Only losses that occurred within the previous two years of the date of discovery are typically covered, if the insurance coverage was continuous from the earlier date the loss occurred.

Important exclusions

- a) Trading losses
- b) Negligence
- c) Software crimes and
- d) Dishonesty of the partners / directors

Sum insured

The sum insured, which would typically float over the first five sections, must be fixed by the bank. "Basic sum insured" is what this is known as. Additionally, the policy permits a single mandatory and automatic reinstatement of the sum insured by payment of an additional premium.

Rating

The premium calculation is based on:

- a) Basic sum insured
- b) Additional sum insured
- c) Number of staff
- d) Number of branches

4.2.5 Jeweller s Block Policy

India has become a major trading hub for jewellery, particularly diamonds, in recent years. Raw diamonds from imports are polished, cut, and exported. It covers all risks for a jeweller whose line of work is selling high-value items in limited quantities, such as jewellery made of gold and silver, articles set with diamonds and precious stones, wristwatches, etc. The trade entails keeping big quantities of these pricey commodities on hand and transporting them between locations.

Coverage of Jeweller s Block Policy

Jewellers block policy covers such risks. It is divided into four sections. Coverage under Section 1 is compulsory. The insured can avail of other sections at her option. It's a package policy.

- a) **Section I:** Covers loss of or damage to property whilst in the premises insured, as a result of fire, explosion, lightning burglary, house-breaking, theft, hold-up, robbery, riot, strikes and malicious damage and terrorism.
- b) **Section II:** Covers loss or damage whilst the property insured is in the custody of the insured and other specified persons.
- c) **Section III:** Covers loss or damage whilst such property is in transit by registered insured parcel post, air freight etc.
- d) **Section IV:** Provides cover for trade and office furniture and fittings in the premises against the perils specified in Section I.

Each section is separately rated for calculating premium.

Important Exclusions

- a) Dishonesty of agents, cutters, goldsmiths,
- b) Property kept during public exhibition
- c) Lost whilst being worn / carried for personal purpose



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- d) Property not kept in safe outside business hours
- e) Property kept in display windows at night
- f) Loss due to infidelity of employees or members of the insured family is not covered.

Fidelity guarantee cover should also be taken by the insured for full protection.

Premium

Based on the merits of each case, risks are graded. Different premium rates are used for each sector, and there are discounts for things like a private strong room, a round-the-clock watchman, a closed-circuit TV system, and other safety measures.

Type of policy	Types	Risk coverage	Exclusions	Premium	Extensions
Burglary Insurance	• Cash cover • First Loss Insurance	Loss of property following actual forcible and violent entry into the premises damage to insured property or premises by burglars	Theft by employees, family members or other persons who are lawfully on the premises, nor does it cover larceny or ordinary theft. It also excludes losses that are covered by a fire or plate glass policy.	Nature of insured property, the moral hazard of the insured himself, construction and location of premises, safety measures (e.g. watchmen, burglar alarm), previous claims experience etc.	Riot, strikes and terrorism risks



Notes

Type of policy	Types	Risk coverage	Exclusions	Premium	Extensions
Money Insurance	Cover the losses that may occur while cash, cheques / postal orders / postal stamps are being handled	The policy normally provides cover under two sections a) Transit section b) Premises section	Shortage due to error or omission Loss of money that has been entrusted to other than authorized person and Riot strike and terrorism	Dishonesty of persons carrying cash Riot, strike and terrorism risks Disbursement risk, which is the loss suffered during payment of wages to employees	Cash carrying liability of the company at any one time, the mode of conveyance, distance involved, safety measures taken etc.
Fidelity Guarantee Insurance	• Individual policy • Collective policy • Floating policy or floater • Positions policy • Blanket policy	Insurance indemnifies employers against the financial loss suffered by them due to fraud or dishonesty of their employees by forgery, embezzlement, larceny, misappropriation and default.	• Consequential losses. • No cover is provided in respect of a dishonest employee who has been re-employed	Type of business occupation, status of the employee, the system of check and supervision	

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Notes

MISCELLANEOUS INSURANCE (PART - 2)

Type of policy	Types	Risk coverage	Exclusions	Premium	Extensions
Bankers Indemnity Insurance	Money securities lost or damaged Loss suffered due to negligence of the employees, Forgery or alteration of cheques, drafts, fixed deposit receipts Dishonesty of employees Dispatches by registered post parcels. Dishonesty of appraisers	This comprehensive cover was drafted for the banks, NBFC's and other institutions who deal with operations involving money, considering the special risks faced by them regarding money and securities.	Trading losses Negligence software crimes and dishonesty of the partners / directors	Basic sum insured Additional sum insured Number of staff Number of branches	
Jewellers Block Policy	Section I Section II Section III Section IV	Covers loss of or damage to property whilst in the premises insured, as a result of fire, explosion, lightning	Dishonesty of agents, cutters, goldsmiths, b) Property kept during public exhibition c) Lost whilst	Section wise	Section II Section III Section IV



Notes

Type of policy	Types	Risk coverage	Exclusions	Premium	Extensions
		burglary, house-breaking, theft, hold-up, robbery, riot, strikes and malicious damage and terrorism.	being worn / carried for personal purpose d) Property not kept in safe outside e) Property kept in display windows at night f) Loss due to infidelity of employees or members of the insured family is not covered.		

Table 26.1: Overview of Miscellaneous Insurance



INTEXT QUESTIONS 4.2

1. Fidelity guarantee insurance indemnifies _____.
 - a) Employers against the financial loss suffered by them due to fraud or dishonesty of their employees
 - b) Employees against the financial loss suffered by them due to fraud or dishonesty of their employer
 - c) Employees and employers against the financial loss suffered by them due to fraud or dishonesty of third party
 - d) Shareholders against the financial loss suffered by them due to fraud or dishonesty of the company management

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Notes

2. Which of the following is a fidelity guarantee insurance policy?
 - a) Positions Policy
 - b) Blanket Policy
 - c) Collective Policy
 - d) All of the above
3. Which of the below can be covered under a bankers indemnity insurance policy?
 - a) Money securities lost or damaged whilst within the premises due to fire
 - b) Forgery or alteration of cheques
 - c) Dishonesty of employees with reference to money
 - d) All of the above
4. The premium calculation for bankers indemnity insurance policy is based on:
 - a) Basic sum insured
 - b) Number of staff
 - c) Number of branches
 - d) All of the above
5. In case of a Jeweller's Block Policy, damage to property insured when it is in transit by registered parcel will be covered under_____.
 - a) Section I
 - b) Section II
 - c) Section III
 - d) Section IV
6. Which of the following is an exclusion under Jeweller's Block Policy?
 - a) Dishonesty of agents, cutters, goldsmiths,
 - b) Property kept during public exhibition
 - c) Lost whilst being worn / carried for personal purpose
 - d) All of the above



WHAT YOU HAVE LEARNT

Burglary insurance is designed for commercial buildings like factories, stores, offices, warehouses, and go-downs that could have valuables like cash locked up in a safe that could be stolen. The purpose of a money insurance policy is to provide coverage for any potential losses that may arise from handling cash cheques, postal orders, or postage stamps. A money insurance policy offers protection under the transportation and premises sections. The hazards associated with transferring costly things between different locations in big quantities are covered by the jewellers block policy. The Jewellers Block Policy has four distinct sections. Employers are protected by fidelity guarantee insurance from financial loss brought on by employee fraud or dishonesty, including forgery, embezzlement, larceny, misappropriation, and default. Individual policies, collective floating policies, positional policies, and blanket policies are a few examples of fidelity guarantee policy types. A comprehensive insurance plan called a "bankers indemnity policy" was created for banks, NBFCs, and other organisations that deal with financial transactions, taking into account the unique risks that concern money and securities that they face.



TERMINAL QUESTIONS

1. Describe Burglary Insurance. Also mention the types of risk coverage.
2. Explain Banker's Indemnity insurance in detail.
3. Explain Jeweller's Block insurance in detail.
4. Describe Fidelity Guarantee Insurance Policy.
5. Explain Money Insurance and its coverage.



ANSWERS TO INTEXT QUESTIONS

4.1

1. (d) All of the above
2. (d) All of the above
3. (b) Loss of cash from one's premises due to burglary
4. (d) All of the above

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Notes

4.2

1. (a) Employers against the financial loss suffered by them due to fraud or dishonesty of their employees
2. (d) All of the above
3. (d) All of the above
4. (d) All of the above
5. (c) Section III
6. (d) All of the above



LEARNING OUTCOMES

After studying this chapter, you are able :

- To explain the concept of burglary insurance, money insurance, fidelity guarantee insurance, banker's indemnity insurance. Jeweller's block policy to the client.

5

SCOPE OF FINANCIAL PLANNING, INVESTMENT PRODUCTS & RISK PROFILING



Notes

5.0 INTRODUCTION

Financial Plan is a written document that clearly defines the road-map or strategies to achieve your financial goals, reduces financial risk & money-related uncertainties of future. It can help you in maintaining a good financial health for your family. Financial Planning helps you to take better control of your financial situation, enhances the quality of life and increases your confidence. This chapter will focus on the components of financial planning like Cash flow planning; Tax planning; Investment planning; Insurance planning; Retirement planning; Debt planning and management; and Estate Planning. You will also learn about different investment options which can help you in achieving your financial goals. The chapter will also focus on understanding the major components of Risk profiling.



5.1 OBJECTIVES

After reading this lesson, you will be able to:

- Explain the scope and components of financial planning
- Elaborate different investment products available in our country
- Create a Risk profile of your client

5.2 SCOPE OF FINANCIAL PLANNING/ COMPONENTS OF FINANCIAL PLANNING:

Financial planning should cover all areas of the client's financial goals and needs. It should result in the achievement of each of the client's financial goals as required. The

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Notes

SCOPE OF FINANCIAL PLANNING , INVESTMENT PRODUCTS & RISK PROFILING

key components or important elements of financial planning are:

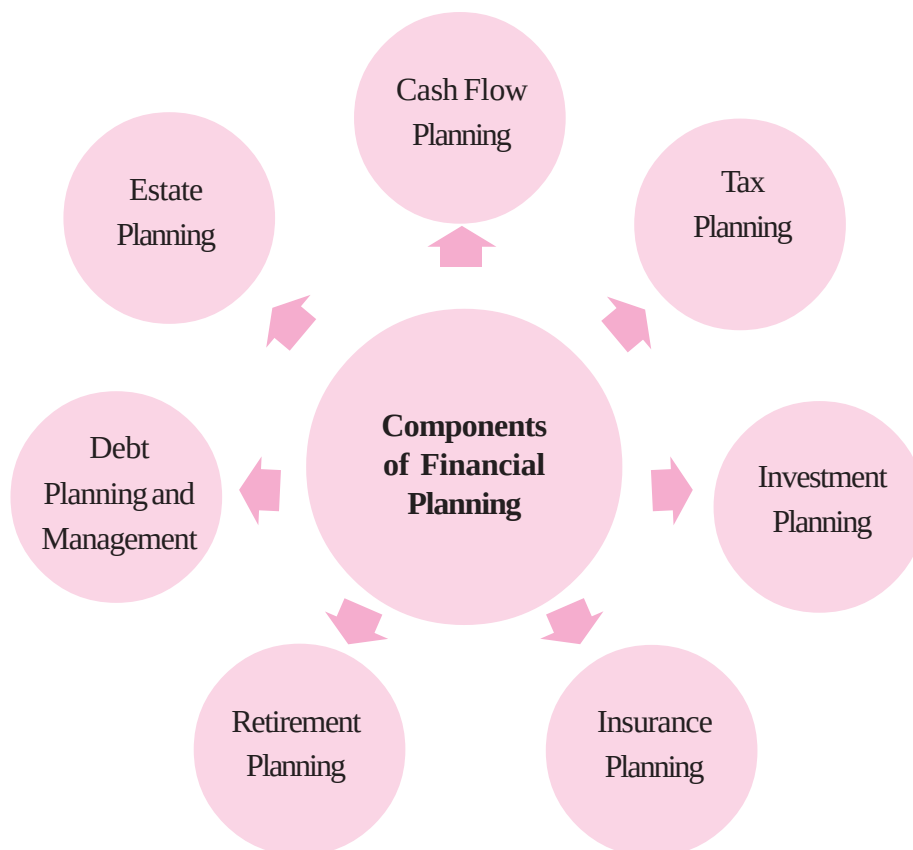


Figure 5.1: Scope of Financial Planning

5.2.1 Cash Flow Planning

Cash flow planning is a process of balancing the cash inflows with that of the cash outflows. Your cash flows would include your assets and incomes whereas cash outflows would include your expenses including your current and future liabilities. It is important for you to expertly control what goes in and what goes out of your bank account. Cash flow plans can be prepared for a month, quarter or a year. It is an active and ongoing process.

If you want to create wealth for yourself, you have to make sure that you are spending less than you earn. Many people, whether of high or low income group, for fulfilling their present needs, they start using credit cards and buying goods on EMIs. They fall into the trap of over-spending and end up creating unnecessary debt for themselves which shall be avoided to create wealth.



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A financial planner needs to prepare a Cash Flow statement of its client which provides a picture of the inflow and outflow of money in the client's life. For this, a list of all income sources as well as total expenses shall be considered. The difference between total income from all sources and total expenses would account for the savings which are vital in helping towards the creation of financial resources to meet the various financial goals and needs. In case there are no or few savings, the goals and needs of the client may not be fulfilled in the future and as such, it would be the role of the financial planner to suggest corrective actions which might be taken.

Cash flow planning also helps you in determining the return needed on investments to meet your future goals. Cash flow planning may help you in understanding how likely you may achieve your goals or whether you need to consider trade-offs, such as saving a little more, changing investment risk, altering the time frame, buying a different house etc.

5.2.2 Tax Planning

Tax planning is an important element of financial planning and should not be addressed in isolation. Whether you earn your income from salary or business, you need to pay Tax. Every individual should plan to save taxes as rightly said by experts 'Money saved is Money earned'. Proper tax planning will help you in saving tax, leaving more money in your hand for meeting your future goals. Tax planning has two parts:

- a) Reducing your tax liability on income earned by you from different sources like salary, interest and so on.
- b) Reducing your tax liability by investing your savings in tax saving investment instruments like Public Provident Fund (PPF), National Pension Scheme (NPS), etc. which directly reduces the tax payable on your income.

One should not leave tax planning till the end of the financial year as it is not the right approach. This usually leads to either falling short of the amount you are required to save or buying the wrong product to save taxes. One should also be aware of the investment options which can help you in reducing your tax liability like avenues mentioned in section 80C, 80D and other sections of income tax act 1961.

5.2.3 Investment Planning

Investment planning is one of the major component of financial planning. Investment planning involves deciding how best to put your money or savings to work for achieving your financial goals. It begins with identification of your goals and objectives and then

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we need to match these goals with our available financial resources. There are many investment vehicles which can help you in achieving your goals, most common being cash, equities, bonds, property and mutual funds. So according to the funds available we can invest in these vehicles to achieve our goals and objectives. Thus, Investment planning is the process of matching your financial goals and objectives with your financial resources.

You may create your own investment plan or may take a help of a financial planner to make it better for yourself on the basis of your goals and available resources. A financial planner can help you in setting clear and measurable goals, and can help you in matching the most suitable mix of investments to each specific goal in the most efficient way. When making an investment decision, one must look at different parameters which can help you in deciding the right product for achieving your goals. These parameters are:

- a) Return Potential
- b) Risks that you are taking
- c) Liquidity offered by the investment product or lock in
- d) Tax treatment and tax benefits
- e) Convenience with which you can make an investment

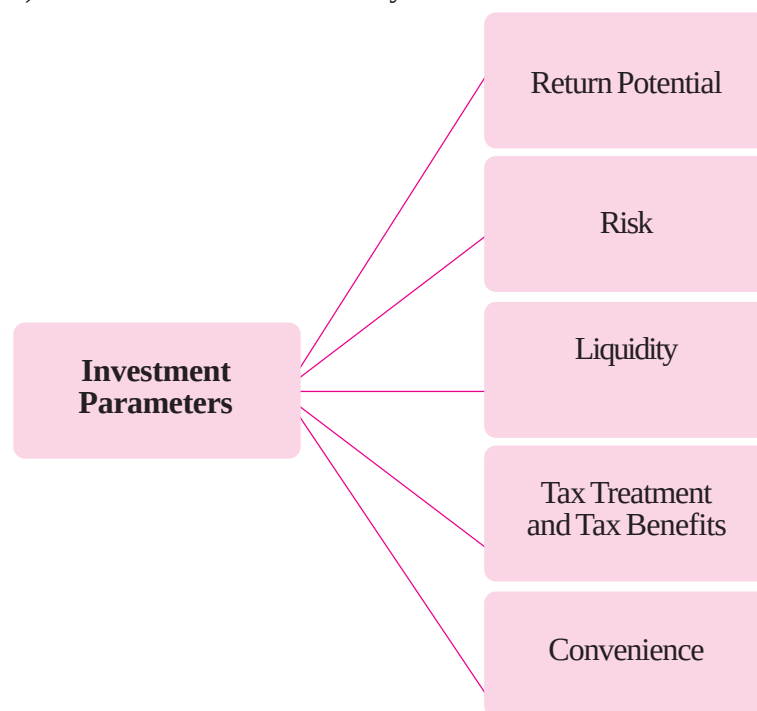


Figure 5.2: Investment Parameters

5.2.4 Insurance Planning

Insurance planning is required to protect yourself, your family, your loved ones, your home, your assets or your business against unexpected events. Insurance planning is an important component of a comprehensive financial plan that includes evaluating risks and determining proper insurance coverage to mitigate these risks. The idea behind buying an insurance is to help you recover in the case of an unexpected loss. The main goal of insurance planning is to identify and analyse risk factors in life and seek proper coverage to attain a peace of mind if any uncertainty happens. In this way, insurance may ease your financial burdens that can occur at the time of any uncertainties. One should develop a strategic plan for its life and health insurance needs. One should buy insurance to protect its assets, your family and /or your business.



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5.2.5 Retirement Planning

Retirement is one of the most important life events, many of us will ever experience. To ensure that there are sufficient financial resources to provide a desired lifestyle in the retirement years is very important. Retirement planning is the process of determining retirement income goals and the actions and decisions necessary to achieve those goals. Realizing a comfortable retirement is an incredibly extensive process that takes sensible planning and years of persistence. One must take calculative steps for planning his / her retirement.

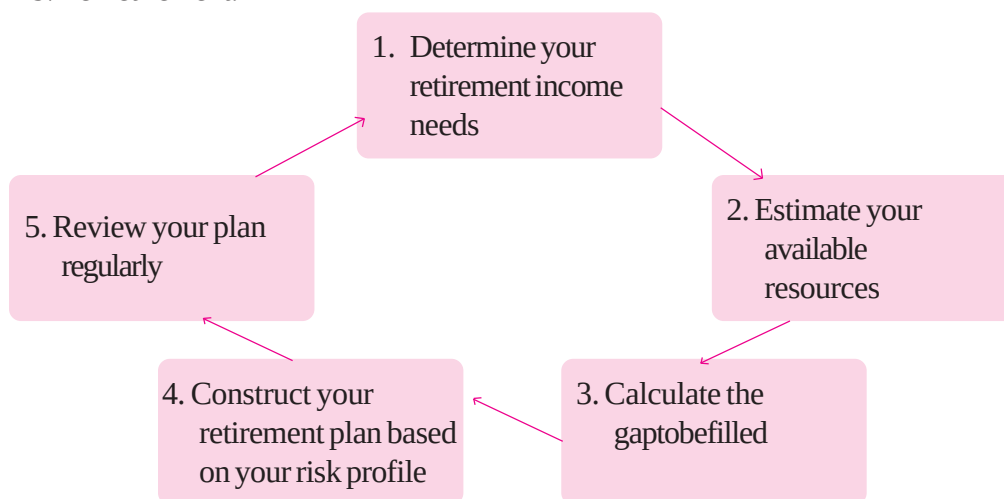


Figure 5.3: Steps to Retirement Planning

There are different investment vehicles that can help you in achieving your retirement goals, such as Employer Provident Fund, PPF, Pensions; Social Security Schemes; Real Estate and Personal Investments.



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5.2.6 Debt Planning and Management

Financial Planning actually begins with managing your loans and debt. Managing your loans is not about reducing your debt but about managing your debt. For creating wealth, it is important to spend less money than you earn. But most of the people today can't manage their money, have too much debt and live well beyond their means. It is important for you to develop an appropriate budget to help you achieve your short, medium and long term goals. People take loans like House Loans, education loans, personal loans, loans for business, Car loans, etc. It is not only about these big loans but small loans like credit cards, buying goods on EMIs also adds significantly to your debt. Managing these debts properly adds significantly to your 'bottom line.' When you save money on debt repayments you free yourself from a financial burden and the money you save can be utilised for making contributions towards four future goals. A financial planner can help you in creating a budget and can suggest strategies to reduce your expenses so that your cash outflows could be reduced for better management of your loans.

5.2.7 Estate Planning

Estate planning is a process of creating a definite plan for the orderly administration and disposition of property and wealth after the owner dies. Estate planning is the preservation and the distribution of your wealth or assets, both during your life and after your death. Your estate is all the property that you own which include cash, jewellery, cars, houses, land, stocks, paintings, life insurance proceeds, business interests, retirement, investment and savings accounts, etc.

Estate planning is important if you want to preserve family wealth, providing surviving spouse and children, funding the education of your children or grand children, or leaving your legacy behind for a charitable trust.

An estate plan can be as simple as creating a will and naming a beneficiary, or as complicated as having several trusts for different purposes in addition to the will. Estate planning can be accomplished through a variety of methods, including:

- Creating revocable Living Trusts
- Last Will / Probate (establishing a validity of a will)
- Lifetime Gifting
- Joint Ownership
- Beneficiary Designations, etc.

Estate planning helps you in passing on your wealth and assets to your loved ones and heirs, in a hassle free manner. Estate Planning will help your family to avoid any disputes and fights. You have the family settlement in advance where property and assets are divided in an amiable manner. A probate might prevent lengthy court battles.



INTEXT QUESTIONS 5.1

1. Which of the following is true for a financial plan:
 - a) It is a written document
 - b) It defines the road-map or strategies to achieve your financial goals
 - c) It enhances the quality of life and increases your confidence
 - d) All of the above
2. Which of the following is not the component of financial planning?
 - a) Cash Flow Planning
 - b) Hospitalisation Planning
 - c) Retirement Planning
 - d) Estate Planning
3. _____ is a process of balancing the cash inflows with that of the cash outflows.
 - a) Retirement Planning
 - b) Estate Planning
 - c) Cash Flow Planning
 - d) Investment Planning
4. _____ involves deciding how best to put your money or savings to work for achieving your financial goals.
 - a) Insurance Planning
 - b) Estate Planning
 - c) Cash Flow Planning
 - d) Investment Planning



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5. Which of the following is an important parameter of an Investment?
 - a) Return Potential
 - b) Risk
 - c) Liquidity
 - d) All of the above
6. _____ includes evaluating risks and determining proper insurance coverage to mitigate these risks.
 - a) Insurance Planning
 - b) Estate Planning
 - c) Cash Flow Planning
 - d) Investment Planning
7. _____ ensures that there are sufficient financial resources to provide a desired lifestyle in the retirement years
 - a) Insurance Planning
 - b) Estate Planning
 - c) Retirement Planning
 - d) Cash Flow Planning
8. _____ is a process of creating a definite plan for the orderly administration and disposition of property and wealth after the owner dies.
 - a) Insurance Planning
 - b) Estate Planning
 - c) Retirement Planning
 - d) Cash Flow Planning

5.3 FINANCIAL PRODUCTS

Financial products are investment vehicles that can help you growing the amount of money you have to meet your financial goals, such as retirement, children's education, marriage and so on. These investment vehicles can be categorised into two different baskets: Financial and non-financial assets. Financial Assets may include market linked products like equity shares, mutual funds, NPS; and fixed income products like PPF, bank deposits or other small saving schemes. Non-financial assets are the traditional

products like gold or real estate. Large number of financial products are available in our country. Before you invest in any investment product, you should learn about its potential risks, limitations, costs, liquidity, tax benefits as well as other characteristics of the products. Let us discuss few popular investment products.

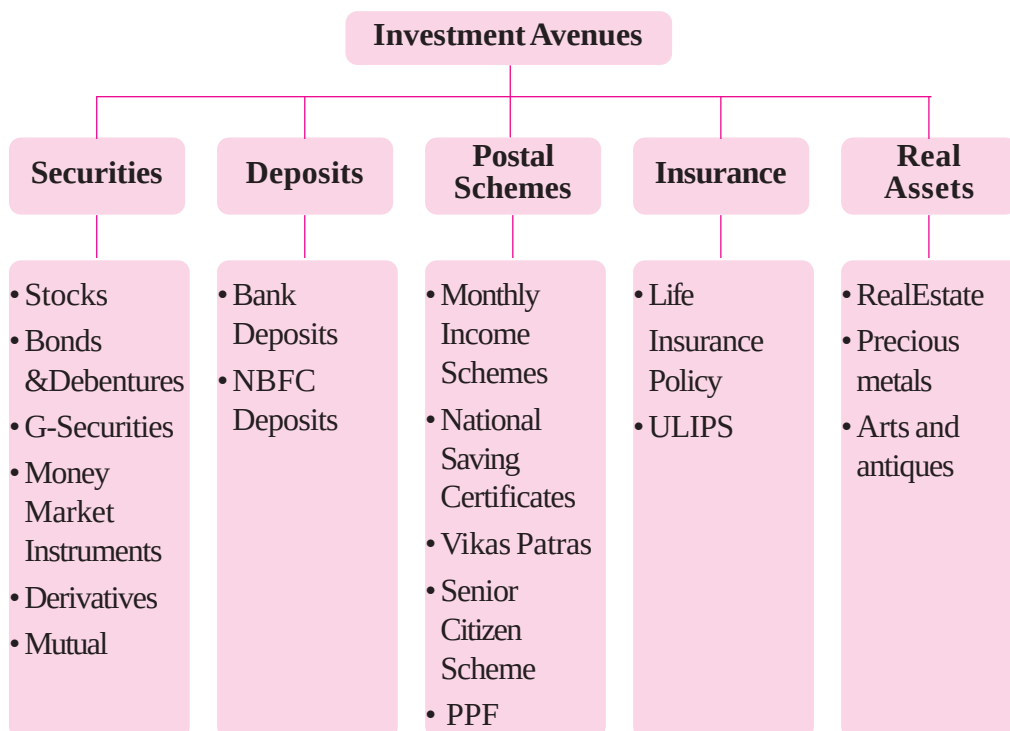


Figure 5.4: Investment Avenues in India

5.3.1 Direct Equity / Equity Shares

A major source of capital for an organisation may be in the form of equity shares. In a company form of organisation, the total capital of the business is divided into smaller units or shares known as equity share. When an investor subscribes to the equity share of a company, he becomes the shareholder. The profits of the organisation is to be divided among the shareholders as dividends. Investors earn returns in equity investments by way of dividends and capital appreciation. Along with these monetary benefits, the equity shareholders also get voting rights in the critical matters of the company as they are the owners of the company where in the ownership is limited to the extent of the shares held by them. Investors can buy equity shares either during the Initial Public Offerings (IPO) or trade these on a stock exchange.

To invest in direct equities, you have to open a demat account. Investments in equity shares is a risky affair as risk of losing a significant portion of capital is high and the return potential is also high. Equity shares are good investment vehicles when the

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investment horizon is long, i.e more that 5-7 years. One should have a knowledge about the market to select the right equity share for investments.

5.3.2 Hybrids

These instruments can also be bought from the stock exchanges and includes:

- **Preferred Stock / Preference Shares** are the shares which entitle you to receive dividend at a fixed rate. The dividend shall be first paid to the preference shareholders before it is paid to the equity shareholders. In the event of liquidation or winding up of the company, your claim as a preference share holder to the company's surplus will be higher than that of the equity holders, but however, below the claims of the company's creditors, bondholders / debenture holders.
- **Cumulative Preference Shares:** A type of preference shares on which dividend accumulates if remains unpaid. Cumulative preference shares give you a right to dividends that may have been missed in the past. All arrears of preference dividend have to be paid out before paying dividend to the equity shareholders.
- **Cumulative Convertible Preference Shares:** A type of preference shares where the dividend payable on the same accumulates, if not paid. After a specified date, these shares will be converted into equity capital of the company.

5.3.3 Corporate Debt

Corporates or companies also issues instruments to raise debt capital which is a cheaper source of finance for the companies. These are Debentures and Bonds.

- **Debentures:** Debentures are the instruments issued by companies to raise debt capital. As an investor, you lend your money to the company, in return for its promise to pay you interest at a fixed rate (usually payable half yearly on specific dates) and to repay the loan amount on a specified maturity date say after 5/7/10 years (redemption). Normally specific asset(s) of the company are held (secured) in favour of debenture holders. This can be liquidated or sold, if the company is unable to pay the interest or principal amount. Unlike loans, you can buy or sell these instruments in the market.
- **Bonds:** Bonds are financial instruments similar to debentures. These are issued by companies, financial institutions, municipalities or government companies and are normally not secured by any assets of the company (unsecured). These bonds offer a higher rate of interest as compared to debentures as there is no collateral and the risk of investment is high. When issued by the companies,

these bonds are known as Corporate Bonds. Whereas if issued by the government are known as Government Bonds.

5.3.4 Government Securities / Gilt Securities

Government securities are instruments issued by the government to borrow money from the market. These are also known as gilts or gilt edged securities. "Government security" means a security created and issued by the Government for the purpose of raising a public loan or for any other purpose as may be notified by the Government. Depending upon the expiry date, government securities are divided into short term and long term securities.

Short term government securities are Treasury bills. They have a maturity of less than one year. There are three main treasury bills in India - 91 days, 182 days and 364 days.

Long term government securities are known as government bonds or dated securities. They have a maturity period of five years, ten years, fifteen years etc.

5.3.5 Derivatives

A derivative is a contract between two parties which derives its value/price from an underlying asset. Derivatives are based on wide range of underlying assets. These include:

- Metals such as Gold, Silver, Aluminium, Copper, Zinc, Nickel, Tin, Lead
- Energy resources such as Oil and Gas, Coal, Electricity
- Agri commodities such as wheat, Sugar, Coffee, Cotton, Pulses and
- Financial assets such as Shares, Bonds and Foreign Exchange.

There are four types of derivatives i.e. Forward, Futures, Options and Swaps. One can buy futures and options in a stock exchange as these are standardised instruments also known as exchange traded instruments whereas forwards and Swaps are not standardised and are traded 'Over The Counter' and not in exchanges. Derivatives are complex instruments and are meant for those investors who understand financial markets.

5.3.6 Mutual Funds

A mutual fund is formed when an Asset Management Company (AMC) pools investments from various individual and institutional investors with common investment objectives. A fund manager professionally manages the pooled investment by strategically investing in different investment avenues to generate maximum returns for the

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investors. The assets managed by AMC is known as Asset Under Management (AUM). Anyone with an investible surplus of as little as few thousand rupees can invest in mutual funds.

As per Association of Mutual Funds in India (AMFI), "A mutual fund is a pool of money managed by a professional Fund Manager. It is a trust that collects money from a number of investors who share a common investment objective and invests the same in equities, bonds, money market instruments and/or other securities. And the income / gains generated from this collective investment is distributed proportionately amongst the investors after deducting applicable expenses and levies, by calculating a scheme's Net Asset Value or NAV. Simply put, the money pooled in by a large number of investors is what makes up a Mutual Fund."

There are different categories of mutual funds on the basis of investment objectives. Two popular categories are:

- **Equity mutual funds:** As per AMFI, "An equity fund is a mutual fund scheme that invests predominantly in equity stocks. In the Indian context, as per current SEBI Mutual Fund Regulations, an equity mutual fund scheme must invest at least 65% of the scheme's assets in equities and equity related instruments. Equity funds are very popular amongst the retail investors among various categories of mutual fund products. There are different types of equity mutual fund schemes and each offers a different type of underlying portfolio that have different levels of market risk."

Equity oriented Mutual Funds can be categorised into Large Cap Funds, Mid-Cap Equity Funds, Small Cap Funds, Micro Cap Funds, Multi Cap Equity Funds or Diversified Equity Funds, Thematic Equity Funds and Equity Linked Saving Schemes (ELSS) which are popularly known as Tax Saver Funds.

- **Debt mutual funds:** As per AMFI, "A debt fund is a mutual fund scheme that invests in fixed income instruments, such as corporate and government bonds, corporate debt securities, and money market instruments etc. that offer capital appreciation. Debt funds are also referred to as Income Funds or Bond Funds. Debt funds are ideal for investors who want regular income, but are risk-averse. Debt funds are less volatile and, hence, are less risky than equity funds. If you have been saving in traditional fixed income products like Term Deposits, and looking for steady returns with low volatility, debt mutual funds could be a better option, as they help you achieve your financial goals in a more tax efficient manner and therefore earn better returns."



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5.3.7 Money Market Instruments

As per the Reserve Bank of India (RBI), "the term 'Money Market' is used to define a market where short-term financial assets with a maturity up to one year are traded." Money Market instruments includes Call / Notice Money Market; Treasury Bills, Commercial Papers, Certificate of Deposits, Commercial Bills and Repurchase Agreements (Repo). Institutions like Commercial Banks, Non-banking Finance Corporations (NBFCs) and acceptance houses are the components which make up the money market. Money market is a highly liquid market and deals in instruments with short term maturity with large volume trades between institutions.

5.3.8 National Pension System (NPS)

The National Pension System (NPS) is a long term retirement - focused investment product managed by the Pension Fund Regulatory and Development Authority (PFRDA). The objectives of NPS are to provide old age income with Safe and reasonable market based returns over the long term and extending old age security coverage to all citizens. NPS helps an investor in generating market based return where he/she can invest in Active choice Equity (E), Corporate Debt (C), Government Securities (G) or Alternate Investments (A) or Auto choice. There are two accounts, i.e. Tier I account is mandatory non-withdrawable retirement account whereas opening of Tier II account is optional which is just like your savings account.

5.3.9 Public Provident Fund (PPF)

Public Provident Fund (PPF) scheme is a long term investment scheme backed by the Government of India which offers safe returns that are fully exempted from Tax. Anyone who wants to save taxes and earn guaranteed returns should open a PPF account. The PPF has a minimum tenure of 15 years, which can be extended in blocks of 5 years. The interest rate on PPF w.r.t. 01.07.2023 to 30.09.2023 was 7.1% and changes every quarter under the announcement by Ministry of Finance, Department of Economic Affairs. A depositor can also avail loan against balance in the PPF account.

5.3.10 Bank Fixed Deposit (FD)

A Bank Fixed Deposit (FD) is one of the popular investment vehicle which offers you safety and returns better than your savings account. As per your need, you may opt for monthly, quarterly, half-yearly, yearly interest options in these fixed deposits. Under the Deposit Insurance and Credit Guarantee Corporation (DICGC) rules, each



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depositor in a bank is insured up to a maximum of Rs. 1 lakh for both principal and interest amount.

5.3.11 Senior Citizens Saving Scheme (SCSS)

As the name suggests, only senior citizens can invest in SCSS. SCSS can be availed from a post office or a bank by anyone above the age of 60. SCSS has a five-year tenure, which can be further extended by three years once the scheme matures. Currently, the interest rate that can be earned on SCSS w.r.t. 01.07.2023 to 30.07.2023 was 8.2% per annum (earlier 7.4%), payable quarterly and is fully taxable. The upper investment limit is Rs 30 lakh (earlier 15 lakh) and one may open more than one account.

5.3.12 RBI Taxable Bonds

These bonds are popularly known as RBI or GOI bonds and are available through the year through nationalised banks. A few private sector banks are also allowed to sell these investments. The interest rates on these bonds are announced by RBI.

5.3.13 Post Office Schemes

There are various investment options offered by the post offices. The interest rates offered on these schemes are reviewed and fixed quarterly by the government. The USP of these schemes is their sovereign guarantee i.e., it is backed by the central government. These schemes include Post Office Savings Account ; National Savings Recurring Deposit Account ; National Savings Time Deposit Account ; National Savings Monthly Income Account ; Senior Citizens Savings Scheme Account ; Public Provident Fund Account ; National Savings Certificates Account ; Kisan Vikas Patra Account ; Sukanya Samriddhi Account. The interest rates on these schemes are available on the website of Indiapost.

5.3.14 Insurance

There are few products which offers some returns like endowment policies, child insurance, pension plans, or ULIPS. But most of the financial planners would suggest you to not mix your investment with Insurance. It is always better to separate these two goals, i.e. investment and insurance. Traditional products like endowment, child insurance, retirement or pension plans offers you some returns as maturity benefits whereas ULIPS or Unit Linked Insurance Policies offers you market based returns along with the insurance.

5.3.15 Real Assets

One can also invest in real estate, precious metals and arts and antiques. The house that you live in is for your self-consumption and usage and it should never be considered as an investment. But the second property that you are willing to buy may be considered as an investment. The value of the property and the rent it may earn depends on the location of the property. Investments in real estate generate returns in two ways - capital appreciation and rentals. Investment in real estate is highly illiquid as it cannot be immediately sold and one needs to first find a buyer for the property and the sale will also take time.

Precious metals like gold, silver, and platinum have been recognized as valuable for a very long time. Gold is the most popular way of investing in precious metals. One should take invest in Gold using Gold Bonds or Gold ETFs which are the smarter way of investing in Gold.

Hard assets, such as art, antiques, gems and collectibles, etc. are yet another way to diversify your investments. The value of these assets depends so heavily on supply and demand, economic conditions, and the quality and condition of a given piece itself, it will be difficult to predict whether it will generate a return or not.

**INTEXT QUESTIONS 5.2**

1. Which of the following instrument entitle you to receive dividend at a fixed rate.
 - a) Equity Shares
 - b) Preferred Stock / Preference Shares
 - c) Debentures
 - d) Fixed Deposits
2. Which of the following instrument is issued by companies to raise debt capital.
 - a) Equity Shares
 - b) Debentures
 - c) GILT Securities
 - d) All of the above

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3. _____ is a contract between two parties which derives its value/ price from an underlying asset.
 - a) Mutual Funds
 - b) Debentures
 - c) Derivative
 - d) Preference Share
4. AMC and AUM are terms related with _____.
 - a) Mutual Funds
 - b) Debentures
 - c) Derivative
 - d) Preference Share
5. _____ is a mutual fund scheme that invests in fixed income instruments, such as Corporate and Government Bonds, corporate debt securities, etc.
 - a) Equity Linked Saving Schemes (ELSS)
 - b) Thematic Equity Funds
 - c) Debt oriented Funds
 - d) Large Cap Funds
6. _____ is a market where short-term financial assets with a maturity up to one year are traded.
 - a) Equity Market
 - b) National Pension Scheme
 - c) Money Market
 - d) Bonds

5.4 RISK PROFILE AND INVESTMENTS

Risk profiling is a process for finding out the optimal level of investment risk for you by balancing risk required, risk capacity and risk tolerance. Various parameters can be utilised to evaluate your risk-taking capacity and, accordingly, allocate money to different asset classes.

Important parameters that can help you in creating your risk profile includes age of an investor, number of dependents, financial commitments, investment horizon, liquidity requirements, current loans/ liabilities, stability of your income, time horizon and understanding of investments and financial markets.

Usually, risk profiling is undertaken by a financial planner through a formal questionnaire which contains questions that probe their risk-taking capacity and suitability.

Risk required, risk capacity and risk tolerance are the important components one must study to create a risk profile of its client.

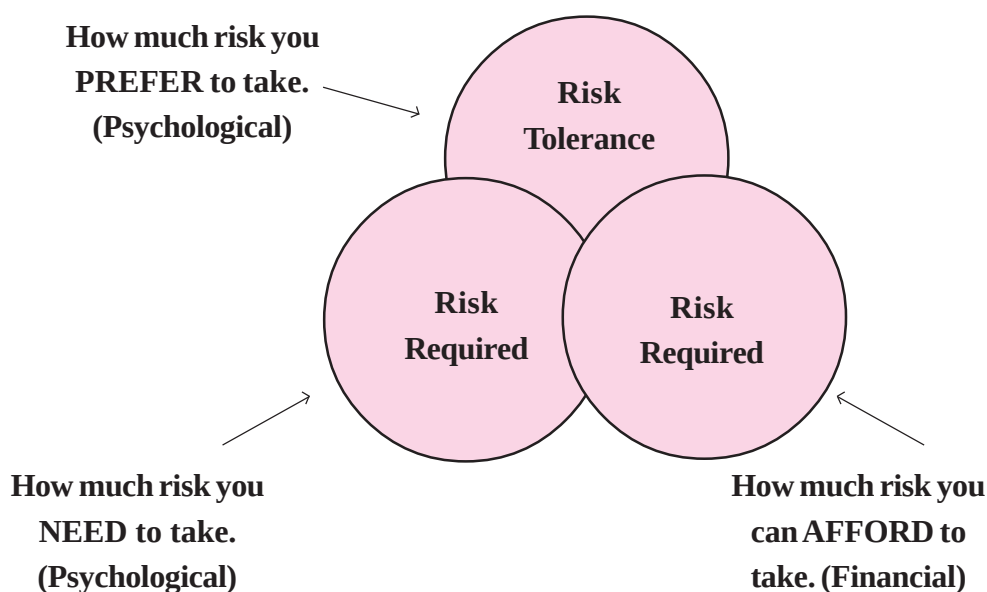


Figure 5.5: Components of Risk Profiling: Risk required, Risk capacity and Risk Tolerance

- **Risk Required** is the financial risk associated with the return that you need to earn in order to achieve your financial goals from the financial resources available,
- **Risk Capacity** is the level of financial risk you can afford to take and may be measured by looking at your financial background or current financial position, and
- **Risk Tolerance** is the level of psychological risk you prefer to take or you are comfortable with.

Risk required and risk capacity are financial characteristics which can be calculated using some financial planning software. Risk tolerance is a psychological characteristic which is best determined by way of a psychometric test. There should be a match



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between the Risk Required, Risk Capacity and Risk tolerance while suggesting a financial product to your client.

For example, if a person with a high risk tolerance and finely balanced financial situation is looking for investments in direct equity. You need to counsel your client explaining the consequences of investments in equity which may generate low or negative returns if the market is not performing well.

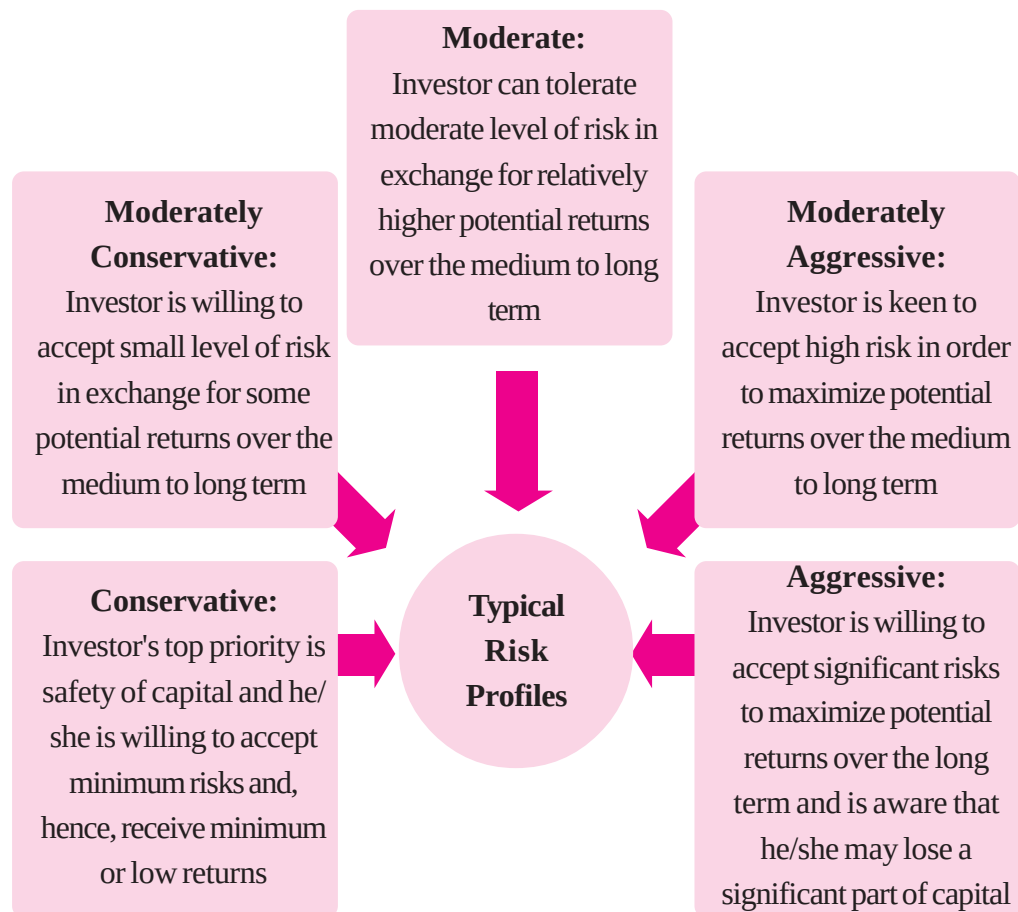


Figure 5.6: Typical Risk Profiles

Risk profiling requires each of these characteristics to be separately assessed so that they can be compared to one another. Each of these three risk aspects has an impact on the selection of an appropriate investment strategy. On the basis of these characteristics, customers can be categorised into Aggressive, Moderately Aggressive, Moderate, Moderately Conservative and Conservative Customers.

The next step is to match the investment products as per the risk profiles of the client and make a portfolio of suitable products so as to achieve their financial goals.



INTEXT QUESTIONS 5.3

1. _____ is the risk associated with the return required to achieve the client's goals from the financial resources available
 - a) Risk Tolerance
 - b) Risk Required
 - c) Risk Capacity
 - d) All of above
2. _____ is the level of financial risk the client can afford to take, and
 - a) Risk Tolerance
 - b) Risk Required
 - c) Risk Capacity
 - d) All of above
3. _____ is the level of risk the client is comfortable with.
 - a) Risk Tolerance
 - b) Risk Required
 - c) Risk Capacity
 - d) All of above
4. Risk profiling is a process for finding the optimal level of investment risk for your client considering .
 - a) Risk Tolerance
 - b) Risk Required
 - c) Risk Capacity
 - d) All of above



WHAT YOU HAVE LEARNT

Financial Plan is a written document that clearly defines the road-map or strategies to achieve your financial goals, reduces financial risk & money-related uncertainties of future. The elements which defines the scope of financial planning are Cash flow

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planning; Tax planning; Investment planning; Insurance planning; Retirement planning; Debt planning and management; and Estate Planning. Cash flow planning is a process of balancing the cash inflows with that of the cash outflows. Whether you earn your income from salary or business, Tax planning helps you in reducing your tax liability on income earned by you as well as by investing your savings in tax saving investment instruments. Investment planning involves deciding how best to put your money or savings to work for achieving your financial goals. Insurance planning includes evaluating risks and determining proper insurance coverage to mitigate these risks. Retirement ensures that there are sufficient financial resources to provide a desired lifestyle in the retirement years. Financial Planning begins with managing your loans and debt which is not only about reducing your debt but about managing your debt. An estate planning is a process of creating a definite plan for the orderly administration and disposition of property and wealth after the owner dies.

Financial products are investment vehicles that can help you growing the amount of money you have to meet your financial goals, such as retirement, children's education, marriage and so on. There are many investment options which can help you in achieving your financial goals like equity shares; hybrids like preference shares, cumulative preference shares, Cumulative Convertible Preference Shares; Corporate Debt like Debenture and Bonds; Government securities; Derivatives; Mutual Funds; Money Market Instruments; National Pension System (NPS); Public Provident Fund (PPF); Bank Fixed Deposit (FD); Senior Citizens' Saving Scheme (SCSS); RBI Taxable Bonds; Post Office Schemes; Insurance and Real Assets. Before you invest in any financial product, you should learn about its potential risks, limitations, costs, liquidity, tax benefits as well as other characteristics of the products.

Risk profiling is a process for finding out the optimal level of investment risk for you by balancing risk required, risk capacity and risk tolerance. Important parameters that can help you in creating your risk profile includes age of an investor, number of dependents, financial commitments, investment horizon, liquidity requirements, current loans/ liabilities, stability of your income, time horizon and understanding of investments and financial markets. Risk required is the financial risk associated with the return that you need to earn in order to achieve your financial goals from the financial resources available. Risk capacity is the level of financial risk you can afford to take and may be measured by looking at your financial background or current financial position, and Risk tolerance is the level of psychological risk you prefer to take or you are comfortable with.



TERMINAL QUESTIONS

1. What do you understand by 'Financial Planning'? What are the components of a good financial plan?
2. What are the investment avenues available in our country which can help you in achieving your financial goals?
3. How to create a risk profile of an individual? What are the important parameters that help gauge an investor's risk profile?
4. Explain the meaning of Risk Require, Risk capacity and Risk tolerance. Why there should be a match between these three while suggesting a financial product to your client.



ANSWERS TO INTEXT QUESTIONS

5.1

1. (d) All of the above
2. (b) Hospitalisation Planning
3. (c) Cash Flow Planning
4. (d) Investment Planning
5. (d) All of the above
6. (a) Insurance Planning
7. (c) Retirement Planning
8. (b) Estate Planning

5.2

1. (b) Preferred Stock / Preference shares
2. (b) Debentures
3. (c) Derivative
4. (a) Mutual Funds
5. (c) Debt oriented Funds
6. (c) Money Market

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5.3

1. (b) Risk Required
2. (c) Risk Capacity
3. (a) Risk Tolerance
4. (d) All of above



LEARNING OUTCOMES

After studying this chapter, you are able :

- To explain the scope of financial planning, Categorise and suggest different investment products and create a risk profile of its client.

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LIFE INSURANCE APPLICATION PROCESS

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6.0 INTRODUCTION

Imagine yourself as an insurance agent and a prospect approaches you for buying a life insurance policy. He has never bought a life insurance policy and needs your advice. You need to explain him the steps involved in identifying the best insurance policy as per his requirements. Also you have to explain him the process involved in applying for the life insurance where few forms and documents are to be completed. These documents are very important for insurance contract between insurance company and policy holder. In this chapter we will discuss about the documents required at the proposal stage of taking insurance policy and its significance.



6.1 OBJECTIVES

After reading this lesson, you will be able to:

- Enumerate Life Insurance Application Process
- Explain the documents required at the time of Proposal
- Explain the contents of prospectus and proposal form
- Explain the significance of KYC and other relevant documents

6.2 LIFE INSURANCE - PROPOSAL STAGE DOCUMENTATION

There are large number of forms and documents in the Life Insurance Industry. There are some specific documents which are to be filled or completed at the time of buying an insurance policy. These documents are required for insurance contract between

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insurer and insured. The documents required at the insurance proposal stage are as follows:

1. Prospectus
2. Proposal form
3. Agent's report
4. Medical examiner's report
5. Moral hazard report
6. Age proof
7. Know Your Customer (KYC) documents

6.2.1 Prospectus

A life insurance contract is issued on the basis of proposal form also known as application form which is filled by the proposer, a person who wants insurance. The proposer can be different from the insured. For example father proposing to insure his minor children. The proposal form is filled up by proposer and insurance company or insurer accepts that proposal form. The application and the supporting documents must meet the criteria for a legally binding contract.

Definition "An insurance company's prospectus is a formal legal document that contains information about the insurance product".

The prospectus is very simple which is issued by life insurer. It consists of detail of the life insurance company, different insurance products with their terms and conditions. Due to complex life insurance plans and their terms and conditions, prospectus is not enough for the insurance prospect to take informed decision regarding purchase of life insurance plan

According to IRDAI regulations, the prospectus of Insurer should consist of following details:

- The terms and conditions
- The various plans offered by insurer
- Scope of benefits - guaranteed and non-guaranteed
- The entitlements
- The exceptions

- Whether the life insurance policy is "participative" (with bonus) or "non-participative" (without bonus)
- Availability of riders and its scope

A prospectus is not a single book where all the plans offered details are present. Some insurance companies print separate pages for each plan offered citing the benefits, obligations and terms and conditions of the particular policy.

6.2.2 Proposal Form

According to IRDAI (Protection of Policyholders Interests) Regulations, 2002 the proposal form is defined as:

"It means a form to be filled in by the proposer for insurance for furnishing all material information required by the insurer in respect of a risk, in order to enable the insurer to decide whether to accept or decline, to undertake the risk, and in the event of acceptance of the risk, to determine the rates, terms and conditions of a cover to be granted."

Material fact is every information, which is very important and would impact the judgement of a underwriter in insurance company for risk assessment. The underwriter decision for accepting or rejecting the proposal is based on disclosed material information.

The life insurance policy is the legal contract between insured and life insurer. It also contains proposal and acceptance like any other contracts. The proposal form is an application document for the insurance. These are printed by Insurers and made available through insurance agents and in most of the cases insurers have the proposal format on their website. The proposer is the person requesting insurance and he/she must completely fill and sign the proposal form themselves.

The proposer should declare in the proposal form that the answers are dictated by him in case the proposal form is filled by some other person. Declaration and signature of other person is required if the signature of proposer is in different language as printed in proposal form. The declaration should mention that the contents of question asked in proposal form are explained to proposer and accordingly the answers are recorded. The proposer's signature must be witnessed. The proposer who is illiterate must attach a left thumb impression in place of a signature, and another person must witness to it. This problem occurs in nations like India where various languages are spoken outside the business language of the insurance industry and also because of low literacy rates. These terms are crucial in order to hold the proposer accountable for the statements they make in the insurance proposal form and to turn it into an enforceable contract.



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Both parties to contract are responsible for the facts stated in proposal form. Any inability to recognize its limitations may have a negative effect when it comes time to settle claims.

Insurance request and an offer to enter the insurance contract are two functions of proposal. The proposer provides following information in the proposal form:

- Proposer Information like name, date of birth, address, occupation of proposer etc.)
- Name and other particulars
- Family history of the insured person
- Sum insured opted
- Insurance Plan and its duration
- Mode of premium
- Nominee details

The completed proposal form is given to the insurance company along with:

- The personal statement of health which consists of information regarding past illness and hospitalization history and habits of proposer
- The confidential report of the agent

In the insurance proposal form the proposer declares in the end that all the statements and answers are true and complete. The insurance contract will become null and void if any statement provided in proposal form founds to be untrue.

Life Insurance Individual standard proposal form was prescribed by insurance regulator as Insurance Regulatory and Development Authority of India (IRDAI) (Standard Proposal Form for Life-Assurance) Regulations, 2013. The copy of standard proposal form is attached in annexure.

The proposal form was specified by the IRDAI, but the insurer was free to choose the form's layout and contents.

The IRDAI regulations require a copy of the proposal to be given to policy holder with the policy.

A copy of standard proposal form for life insurance prescribed by IRDAI is attached in Annexure A for reference.

**INTEXT QUESTIONS 6.1**

1. Which of the following paperwork is not needed during the proposal phase?
 - a) Prospectus
 - b) Proposal form
 - c) Claim form
 - d) Medical examiner's report
2. An insurance company's _____ is a formal legal document that contains information about the insurance product
 - a) Claim form.
 - b) Proposal form
 - c) Prospectus
 - d) None of the above
3. According to IRDAI regulations, which of the following should be stated in the prospectus by Insurance companies?
 - a) The various plans offered by insurer
 - b) Scope of benefits - guaranteed and non-guaranteed
 - c) The entitlements and exceptions
 - d) All of the above
4. Which of the following are the functions of the proposal form?
 - a) It is a request for insurance
 - b) It is an offer to enter the contract
 - c) This helps the insurance company to assess the risk of proposer.
 - d) All of the above

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5. Insurance Regulatory and Development Authority of India (IRDAI) (Standard Proposal Form for Life-Assurance) Regulations was passed in
 - a) 2000
 - b) 2018
 - c) 2008
 - d) 2013
6. Which one of the following statements is correct?
 - a) The information in the proposal form is used for underwriting.
 - b) Wrong information in the proposal form can nullify the insurance contract.
 - c) Both (a) and (b) statements are correct.
 - d) Both (a) and (b) statements are wrong.

6.2.3 Agent's Confidential Report

The insurance agent is also known as primary underwriter. The insurance company needs the agent's confidential report to evaluate the risk and acceptability of the insurance proposal. It contains details on the lifestyle and financial situation of the proposer. Health, habits, occupation, income, and family information are also included in this report. The major goal of this report is to give extra information to the underwriter so they can assess the risk and, if necessary, find moral risks.

6.2.4 Medical Examiner's Report

In order to assess the applicant's health, generally the empanelled medical officer of insurance company medically examines the applicant. The medical officer in his medical examiner report records the details regarding blood tests, height, blood pressure, weight etc. The types and number of medical examinations are based on the age of the policy holder and the sum insured amount. As the age and the amount of sum insured increases the rigor of medical examination also enhances. The rigor medical examination consists of tests like echo, cardiac tests, radiology etc. Government medical officers are available at remote areas for this purpose. Proposers who require special diagnostic tests and if high sum insured is involved then senior specialist medical officers are authorized to examine the case.

Medical examination requirement is waived off for those proposers who satisfy certain conditions. Over time, insurers have established a policy in this regard. These restrictions



are gradually eased as a result of positive claim experiences and an expansion of the insured population pool. There are many proposals which are accepted by underwriters of insurance company without medicals, known as non-medical cases. The requirements for accepting proposals for a specific amount insured on a non-medical basis vary depending on the insurance company as well as the insurance product within the same insurance company.

The non-medical insurance plans simplify the risk assessment process, cause less inconvenience for the parties involved, and save the insurer money on medical expenses. When the proposer is not considered under non-medical underwriting then he is asked to go for medical examiner report. This situation arises when sum insured under the policy or age of proposer is at higher side or the facts disclosed by proposer results in medical underwriting.

Non-medical insurance involves a thorough proposal form that has been filled out and a more comprehensive report from the agent and other officials. On the basis of agent's confidential report and statements in proposal form the risk is assessed by the underwriter. The insurance company can still ask for medical examination in case where proposer comes under non-medical case, based on the personal details on the proposal form, agent confidential report and medical history of the proposer. The non-medical plan is available to employees working in government agencies, state corporations, etc. that typically undertake medical examinations prior to hiring, provide a good working environment, pay fair salaries, and maintain leave records.

6.2.5 Moral Hazard Report

Life insurance contract is between a policy holder and an insurance company that pays a pre-defined amount of money known as sum insured if the insured individual death takes place during policy term.

Definition: The risk that someone's behaviour may change because of buying a life insurance policy and this change would raise the chance of a loss is known as moral hazard.

For Example

Recently, Rohit bought a life insurance plan. He then made the decision to go for skydiving in which is considered to be one of the high risky places in the world. He had previously turned down such excursions.

Life insurance companies want to safeguard themselves from the likelihood that someone would try to gain from the purchase of life insurance by committing suicide or killing

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someone else. Hence, life insurance underwriters would look for any indicators of such a risk.

To safeguard themselves from moral hazard the life insurer would ask for moral hazard report by life insurer official. The reporting authority representing the insurance shall ascertain the proposer's identity before submitting the report. The official should meet him/her at his/her home before submitting the moral hazard report. The reporting officer should conduct impartial investigations into the health and habits, employment, earnings, social background, and financial condition, among other factors, of the life assured.

6.2.6 Age Proof

With the increasing age, the mortality risk of an individual also increases in life insurance. The likelihood of dying also rises with age. A 65-year-old would have a higher chance of dying in the coming year than a 25-year-old. Because of this, insurance firms consider age when determining the risk profile of a life that needs to be insured. Therefore, the proposer's age is a key factor in determining the probability of death, and the premium is calculated for each age group in accordance. So, the importance of checking an acceptable document of age proof to confirm the exact age becomes apparent in life insurance.

Valid age proofs may be standard or non-standard.

a) Standard age proofs

Documents used as standard age proofs include:

- ◆ Certified extract from School or college records
- ◆ Birth certificate extracted from municipal records
- ◆ Passport within validity period
- ◆ PAN Card
- ◆ Certified extract from Service register in case of employees of Government or quasi Government institutions and reputed commercial and educational institutions.
- ◆ Certificate of Baptism
- ◆ Aadhar Card
- ◆ Identity card issued by Defence Department in case of defence personnel
- ◆ Driving license within validity period



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- ❖ Any other document where date of birth has been proved on the basis of one of the other standard proofs of age acceptable to the insurance companies.

b) Non-standard age proofs

If standard age proofs mentioned above are not available with proposer then insurer allows them to submit the non standard age proof. Insurance company may charges some extra premium for nonstandard age proofs. or restrict the terms to safeguard against the possibility of the correct age being higher than what is stated.

Documents used as non-standard age proofs include:

- ❖ Self-declaration Affidavit
- ❖ Village Panchayat Certificate
- ❖ Ration Card
- ❖ Horoscope



INTEXT QUESTIONS 6.2

1. Standard age proofs is/are as follows:
 - a) Municipal records extracted birth certificate.
 - b) Passport within validity period
 - c) PAN Card
 - d) All of the above
2. Non- Standard age proofs is/are as follows:
 - a) Horoscope
 - b) Ration card
 - c) Certificate from village panchayat
 - d) All of the above

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3. _____ is also known as primary underwriter of Insurance.
 - a) Agent
 - b) TPA
 - c) Surveyor
 - d) None of the above
4. As the age and the amount of sum insured increases _____
 - a) The number of pre policy medical tests also increases
 - b) The number of pre policy medical tests decreases
 - c) No medical tests are conducted
 - d) All the above are correct
5. _____ is the possibility that an individual's behavior might change as a result of purchasing a life insurance policy and such a change would increase the probability of a loss.
 - a) Physical Hazard
 - b) Moral Hazard
 - c) Morale Hazard
 - d) None of the above

6.2.7 Anti-Money Laundering (AML)

Definition

"Money laundering is the process of passing cash obtained illegally through financial systems to make it appear as though it was obtained legally".

To curb money laundering-related operations the Prevention of Money Laundering Act (PMLA), 2002 brought in force with effect from 1st July 2005.

AML program features-

Insurers are required to create a formal, risk-based AML programme that covers the relevant insurance products. The programme must have the following elements:

- Appointment of designated Principal compliance officer
- Recruitment and training of employees, insurance agents and brokers

- Internal rules, regulations, and checks that are specific to the institution's AML risks.
- Internal audit or control

Suspicious Activity Reporting (SAR) requirements is also important for an insurance company along with AML program implementation.

IRDAI has given clear guidelines to all insurance companies to prevent money laundering through insurance products and immediately reporting of any suspicious transactions which come to their notice.

"Illustrative list of Suspicious Transactions: (Source IRDAI)

1. Customer insisting on anonymity, reluctance to provide identifying information, or providing minimal, seemingly fictitious information
2. Cash based suspicious transactions for payment of premium over and above Rs 5 lakh per person per month. It should also consider multiple DDs each denominated for less than Rs 50,000/-
3. Frequent free look surrenders by customers;
4. Assignments to unrelated parties without valid consideration;
5. Policy from a place where he does not reside or is employed;
6. Frequent request for change in addresses
7. Inflated or totally fraudulent claims e.g. by arson or other means causing a fraudulent claim to be made to recover part of the invested illegitimate funds
8. An established trend or pattern or frequent overpayment of premium with a request for refund of the overpaid amount
9. Frequent cancellation of policies for the return of premium by an insurer's cheque."

If there is any cash transaction done more than ten lakh in a month through one or multiple insurance policies it need to be reported to Financial Intelligence Unit-India (FIU-IND). It a government investigation body to track cases related to possible money laundering.

The insurer/agents/corporate agents need to maintain the records related to transactions types and documents related to verification of identity of clients for 10 years



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6.2.8 Know Your Customer (KYC)

KYC is a process which is required to verify the identity of applicants. To prevent frauds, money laundering and identity threat all insurance companies and banking are asking for KYC from their customers. The main objective of know your customer is to prevent the insurance companies from money laundering activities and frauds. Therefore it is important for the insurance companies to make reasonable effort for ascertaining the real identity of customer through KYC. Customer also includes insurance policy holder or proposer, beneficiaries and assignee.

The general insurers should check KYC norms at the claim settlement stage also where claim amount or refund of premium is more than one lakh rupees per claim or refund of premium. This is done to prevent the threat of money laundering at the claim stage of general insurance company.

Insurance company should verify documents related to identity, address and recent photograph of customers as per KYC norms compliance.

Following documents should be submitted by applicant with the proposal form as per KYC norms:

1. Recent Photographs
2. Standard age proof
3. Address Proof- Aadhar Card, Driving License, Passport, Telephone Bill, Electricity Bill, Bank Passbook etc.
4. Proof of identity - Aadhar Card, Driving License, Passport, Voter ID Card, PAN Card, Photo Identity Proof of Central or State Government, etc.
5. Documentation verifying income in the event of high value transactions.

6.2.9 Free-look Period

Whenever a policyholder purchases a fresh life assurance plan and after receiving the policy comes to know that benefits, terms and conditions under the insurance policy are not right for him/her. Under free look period the policy holder has the right to return the policy within 15 days of receiving it from the date of receipt of the policy document and get a refund. The time period for the Free-look Period is 15 days. Free look period is also known as cooling period.

The Insurance Regulatory and Development Authority of India (IRDAI) introduced the free-look period, a consumer-friendly clause that permits policyholders to cancel the policy without incurring fines.

However, there are some conditions.

- a) After receiving the policy document, he or she has 15 days to apply this option.
- b) He/she must write to inform the insurer.
- c) The premium refund will be adjusted for the proportionate risk premium for the term of coverage, the insurance company's charges for the medical examination, and the charges of the stamp duty.



INTEXT QUESTIONS 6.3

1. Money laundering is the process of passing cash obtained_____ through financial systems to make it appear as though it was obtained_____.
 - a) Illegally, Illegally
 - b) Legally, Legally
 - c) Illegally, Legally
 - d) Legally, Illegally
2. Which of the following doesn't qualify as an address proof?
 - a) Driving License
 - b) Passport
 - c) PAN Card
 - d) Aadhar Card
3. Under free look period the policy holder has the right to return the policy within _____days of receiving it from the date of receipt of the policy document and get a refund if he/she is not satisfied with insurance policy.
 - a) Sixty days
 - b) Forty-five days
 - c) Thirty days
 - d) Fifteen days



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4. Cash that has been obtained unlawfully is being moved through financial institutions to give the impression that it has been legally acquired. This is known as
 - a) Money Laundering
 - b) Free Look Period
 - c) KYC
 - d) None of the above
5. The Prevention of Money Laundering Act (PMLA) of 2002 becomes effective as of
 - a) 1st July 2005
 - b) 1st July 2002
 - c) 1st July 2000
 - d) 1st July 2010



WHAT YOU HAVE LEARNT

In this lesson you have understood the process of life insurance application and documents required at the time of proposal stage. The possibility that a customer's behaviour may change as a result of buying a life insurance policy and that this change would raise the chances of a loss is known as moral hazard. School or college documents, birth certificates obtained from municipal records, and other documents are examples of those that are commonly used to prove an individual's age. Each insurer must have an AML policy and submit a copy of it to IRDAI. The designation of a chief compliance officer and internal policies, procedures, and controls should be part of the AML programme. Insurance companies must ascertain the real identity of their clients. As part of the KYC process, KYC documents like address proof, a PAN card, and photos, among others, must be gathered.



TERMINAL QUESTIONS

1. Visit the website of few life insurance companies and collect their Prospectus and Life Insurance Proposal Form.
 - a) Identify the important information provided in the prospectus & the Proposal forms and make a comparative analysis.
 - b) Take a proposal form of any Life Insurance company and fill it as a proposer
2. What do you mean by free look period in insurance? How and why it is exercised?
3. Which are the standard age proofs?
4. What is a proposal form? Which types of the questions are asked in proposal forms?
5. What is the significance of Know Your Customer (KYC) in Insurance industry?
6. Which are non-standard age proofs? Which documents can be utilized as non-standard age proofs?



ANSWERS TO INTEXT QUESTIONS

6.1

1. (c) Claim form
2. (a) Prospectus
3. (d) All of the above
4. (c) Both of the above
5. (d) 2013
6. (c) Both (a) and (b) statements are correct.

6.2

1. (d) All of the above
2. (d) All of the above
3. (a) Agent
4. (a) The number of pre policy medical tests also increases
5. (b) Moral Hazard

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6.3

1. (c) Illegally, Legally
2. (c) PAN Card
3. (d) Fifteen Days
4. (a) Money Laundering
5. (a) 1st July 2005



LEARNING OUTCOMES

After studying this chapter, you are able :

- To explain the process of Life Insurance Application, KYC and other relevant documents that are required at the time of proposal.

**7**

DOCUMENTATION POLICY CONDITIONS PART-I

7.0 INTRODUCTION

You have studied about the few documents which are related with the Policy in the previous chapter. This chapter focuses on some specific topics like Policy conditions and privileges; Grace period; Policy revival measures; Non-forfeiture provisions; Special policy provisions and endorsements; and Provisions related to nomination and assignment.



7.1 OBJECTIVES

After reading this lesson, you will be able to:

- Explain the Policy conditions and privileges
- Explain the concepts like Grace period, Policy revival measures and Non-forfeiture provisions
- Recall the Special policy provisions and endorsements

7.2 POLICY CONDITIONS AND PRIVILEGES

There are some important concepts which you need to understand while dealing with issues related with Insurance. There are four types of policy conditions and privileges.

These are:

Explanatory Conditions: they clarify the conditions of the policy

Restrictive Conditions: these limit the scope of the assurance



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Privileges: these increase the insurance's advantages and grant privileges.

Supplementary Benefits: these provide extended or supplementary benefits

Explanatory Conditions are for the insured's information; they clarify the policy conditions. For example, there would be a condition that in the event that the policyholder failed to pay the premium by the deadline or if any of the information provided by the policyholder on the proposal, personal statement or declaration was untrue, then the policy would be null and void and all benefits under the policy will cease; any premiums paid will also be forfeited as per the Insurance Act 1938.

For example- An explanatory condition on a policy document would be a clause that advises the insured, that should death occur, any premium instalments due for the remaining part of the policy year will be deducted from the total amount of claim.

Restrictive Conditions are created to remove specific hazards that aren't considered when calculating the premium. If such a risk arises, the guarantee is only good for the surrender value, the refund of premiums, or a portion of the sum insured as specified in the terms. These restrictive conditions are decided by the underwriter and have to be agreed by the policyholder.

For Example- The fact that no claim will be paid if a person whose life is insured commits suicide within the first year is a standard restriction across all policies. Ordinarily, this restriction lasts for a year after the policy's start date. In some nations, the suicide clause is in effect for two years following the day the policy was issued. Suicide does not qualify for the payment of accident benefits. There is a clause that states that no loans are payable in some types of insurance.

Hazardous occupations often do not result in restrictions, but an increased premium is charged to cover the additional risk that the life insured is exposed to as a result of their line of work. An occupation in aviation is one such instance. In the event of death as a consequence of an accident while the life insured is engaged in aviation, double accident and disability benefits are not available unless the person was a passenger on a commercial airline. Failure to notify some insurers of a change in work may result in the cancellation of accident payments or other benefits obtained through riders.

Foreign travel and residency may be prohibited under some policies. The LIC policy is not subject to any travel or residency constraints in India. When moving outside of the country and death takes place within five years or as a result of war, some insurer do not provide coverage. War deaths were previously not covered by LIC insurance policy. With the exception of double accident benefits, they are no longer subject to war limits.

The privileges and supplementary benefit will be explained in next chapter.

As per the Insurance Act 2015, it is mandatory for every insurer to maintain a record of all policies issued by the insurer. The following shall be included in all records:

- ***the name and address of the policy-holder, the date when the policy was effected and a record of any transfer, assignment or nomination of which the insurer has notice***
- ***a record of claims, every claim made together with the date of the claim, the name and address of the claimant and the date on which the claim was discharged, or; in the case of a claim which is rejected, the date of rejection and the grounds thereof; This record may be maintained in such form including electronic mode, specified in Regulations made under this Act."***

All policies shall also to be issued in electronic [dematerialised or Demat] form. The ordinance provides that

"Every insurer shall, in respect of all business transacted by him, endeavour to issue policies above a specified threshold in terms of sum assured and premium in electronic form, in the manner and form to be specified by the regulations made under this Act."

7.3 GRACE PERIOD

Every life insurance contract has a condition that must be met in order for the death benefit to be paid both the policy must be in force and all premiums must have been paid. A policyholder may pay the premium for a longer length of time after the due date during a grace period.

The grace period is generally 15 days for monthly mode of payment and not less than 30 days for other modes like quarterly, half yearly & yearly premium. If the last day of the grace period is a holiday, the next working day will be considered as last day of grace period. Generally standardized time period for grace period is 1 month or 31 days.

Even if the premium is not paid, the policy is still in effect during the days of grace. After reducing the final outstanding premium from the death benefit, the claim is fully paid if death occurs during the grace period.

If the premium is not paid even after the grace period has passed, the policy will lapse. The death benefit will not be paid by the insurer in any way.



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For example Manish is not able to pay his monthly insurance premium when it is due. It is due on 22.8.2022, but he will be able to pay the premium only by 30.8.2022. He calls his insurance agent and asks her what he should do. The insurance agent tells Manish that he has a 15-day grace period to pay his insurance premium and there will be no extra charge to pay the premium within that grace period. She also assured Manish that his insurance coverage will not cease as long as his insurance payment is received within a grace period of 15 days.

7.4 POLICY LAPSE AND REVIVAL

If the insured does not pay the insurance premium on specified date or even not pay after the grace period, the insurance policy will be treated to be lapsed. After the policy expires, all benefits to the policyholder will be discontinued. The policy becomes discontinued or lapses when payments and servicing are excessively delayed.

There is no benefit to both insurance company and insured if the policy lapses. The policy holder loses both the entire benefits and insurance coverage for which they had paid a premium. The insurance company loses the future expected revenue or earnings. The insurance agent too loses his commission earnings.

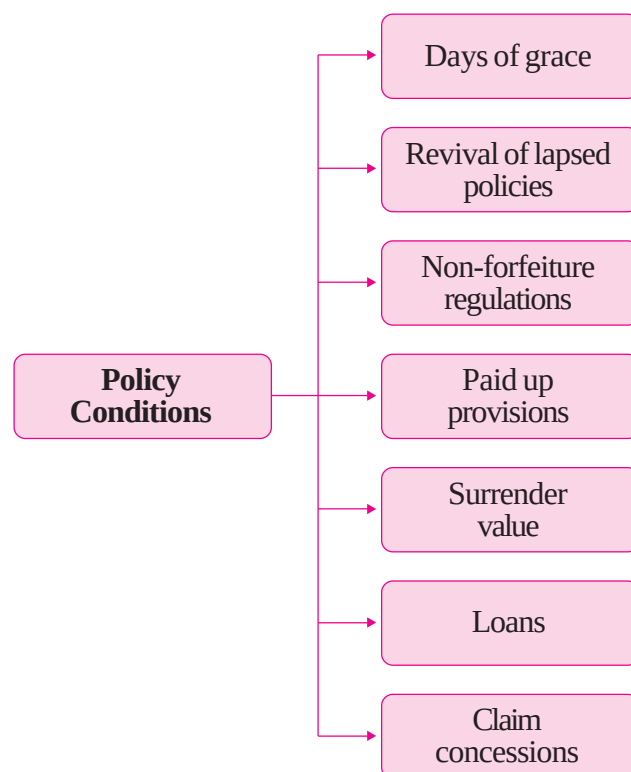


Figure 7.1: Policy Conditions



There is always a risk of adverse selection against the insurance company in life insurance. Generally people with adverse health would like to continue with policy whereas healthy people will discontinue their policies. In this way if the policy lapses and all adverse life are there with insurance company then huge liability comes on insurance company to pay the claims.

Hence lapsation of policy affects all the stakeholders. So, all life insurance companies give the policy holder to revive the policy which has lapsed. This is called revival of life insurance policy. There are many options given by insurer to continue the policy of insured. The procedure for revival may vary from insurer to insurer.

Definition- "The process by which a life insurance company reinstates (or revives) a policy that has either been cancelled due to non-payment of premiums or continuing due to one of the non-forfeiture clauses."

Revival of the policy is accomplished with certain conditions. They are as follows:

- a) Policy holder need to pay all overdue premium along with interest from due date of premium.
- b) Insurer risk should not enhance.
- c) The revival of policy should be done within stipulated time period as per the conditions set by insurer. In India generally this should be done within 5 years after the lapse date.
- d) Continued insurability of insured is required as evidence like good health condition, sound financial condition and no moral hazard involved etc
- e) Policy holder need to pay any outstanding loan amount

Under the following conditions, the life insurance company requires a medical exam or any other proof of insurability:

- a) If the grace period has been over a long period of time and the lapsed policy has been in effect for about a year.
- b) If the life insurance company suspects policy holder health condition or any other problem. If the life insurance policy sum insured is higher in that case insurer will ask for fresh medical examination.

The policy holder should take a rationale decision whether to exercise revival option or not because for the purpose of revival, he or she must pay a substantial amount of money in the form of past premium arrears and interest. The



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policyholder must decide whether to revive the policy or purchase a new one. Revival of policy is a good option for insurance as lapsation of policy is not good for both insurance company and insured.

7.4.1 Different Revival Measures

Subject to the requirements of proof of continued good health and insurability and arrears of premium, the insurers offer offers different schemes of revival. Some insurers do have innovative schemes.

The norms and types of revival may vary from one insurer to another. The different ways to revive the policy are as follows:

1. Ordinary Revival

The most straight forward revival option offered to policy holders is the ordinary revival scheme, which entails paying arrears premium plus interest. When the insurance policy has accumulated surrender value, it is impacted. A straightforward declaration of the insured's good health may be requested by the insurance.

2. Special Revival

Revival under this scheme may be allowed if the given conditions are met

The policy should not have acquired any surrender value

And

The policy should have lapsed at least six months before and not more than 3 years before the date of revival

And

Revival under this scheme has not been effected under the same policy on a previous occasion

Figure 7.2: Special Revival conditions



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For policyholders who want to revive their policies but are unable to pay all past-due premiums plus interest, there is a special revival scheme.

In simpler words, this scheme is available for those who did not pay the premium amount for a maximum of 3 successive years only. If this policy is to be reinforced after two years, the date of policy will be taken 2 years ahead. As such the policy maturity date also will go 2 years ahead. So the premium amount will be increased a little and the difference amount along with interest has to be paid.

Revival under this scheme (as followed by one of the insurers) may be allowed if the given conditions are satisfied:

3. Loan Cum Revival

Loan cum revival includes simultaneously extending a loan and reviving a life insurance policy. This scheme is beneficial for those policy holders who would like to utilize loan amount for paying arrears of premium. Only if the policy has accumulated sufficient surrender value from which the loan can be advanced can it be executed.

This type of option is not available with all the insurer and it may vary from one insurer to another.

The procedure is as follows:

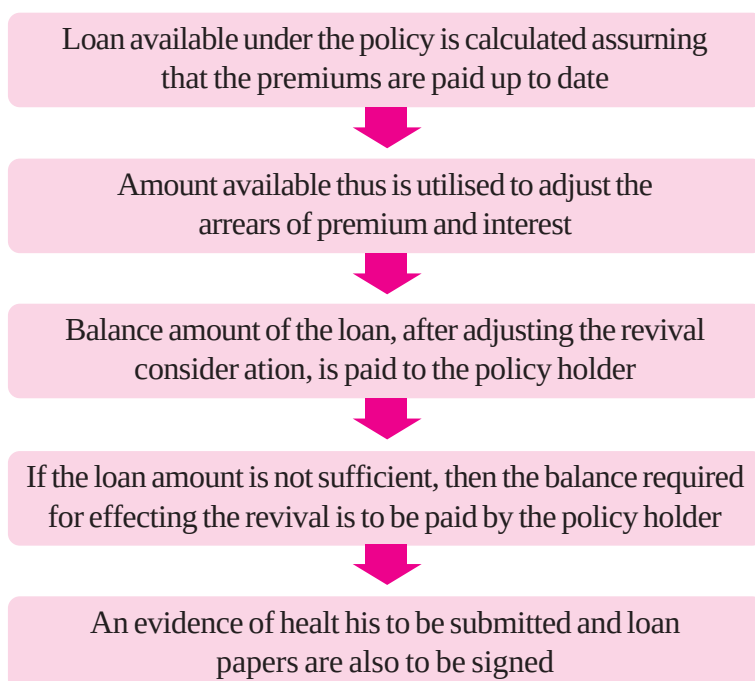


Figure 7.3: Loan cum Revival Scheme



Notes

4. Instalment Revival

Instalment revival scheme is for those policy holders who would like to avail revival option but are not comfortable with paying lump sum arrears of premium and neither can the policy be revived under special revival scheme. The arrears of premiums are calculated in the same manner as under ordinary revival scheme.

Life insured can pay the insurance premium as per the payment mode opted by him. The policy holder has to pay initially six-monthly premiums, two quarterly premiums, one half yearly premiums or the half of the yearly premium. The balance arrears will be spread over the remaining due dates in the current policy year and two full policy years thereafter. The policy document will be endorsed suitably. The criterion that there be no outstanding loans under the policy at the time of revival may be imposed.

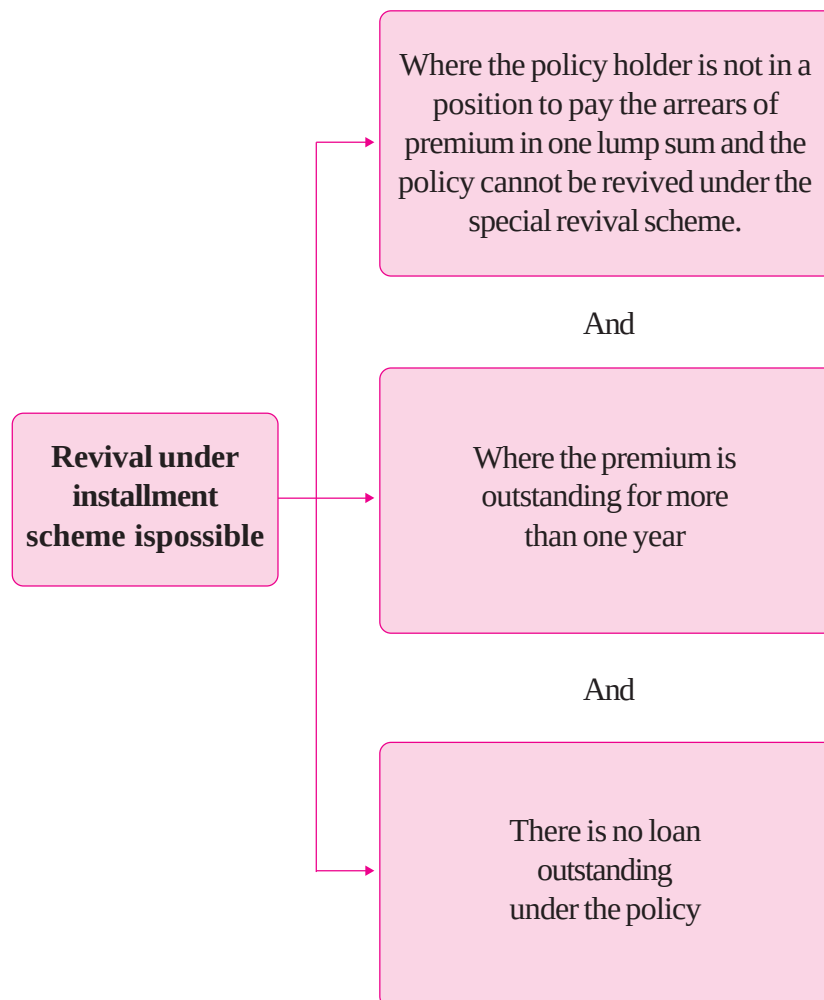


Figure 7.4: Revival under Installment Scheme

**INTEXT QUESTIONS 7.1**

1. If the insured does not pay the insurance premium on specified date or even not pay after the grace period, the insurance policy will be treated to be _____
 - a) Lapsed
 - b) Revival
 - c) Surrendered
 - d) None of the above
2. Which of the following clarify the conditions of the policy?
 - a) Explanatory conditions
 - b) Restrictive conditions
 - c) Privileges
 - d) Supplementary benefits
3. Which of the following limit the scope of the assurance?
 - a) Explanatory conditions
 - b) Restrictive conditions
 - c) Privileges
 - d) Supplementary benefits
4. Which of the following are the conditions that are designed to eliminate certain risks?
 - a) Explanatory
 - b) Extended
 - c) Supplementary
 - d) Restrictive

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7.5 NON-FORFEITURE PROVISIONS

Non forfeiture provisions are the important provisions under section 113 of Insurance Act 1938. In the event of a policy lapsing because of non-payment of premium, the following options are available:

- payment of surrender value or cash value
- reduced paid-up value for the remaining term of the policy
- Automatic advance of future premiums until the surrender value is exhausted
- Extended term insurance cover available on the basis of the net surrender value

Reduced paid up value option

Under the option of the reduced paid-up value, the policy continues to be in force, with the only change that the SA (Sum Assured) will stand reduced to a lower figure. The reduced SA is such that it bears the same ratio to the full SA, as the number of premiums actually paid bears to the total number originally stipulated to be paid.

When a policy is paid up, it is free from future payment of premiums. The paid up value becomes the reduced SA payable on maturity or on death, as per the conditions of the policy. If other benefits related to the SA are payable, the benefits will now be related to the paid-up value. Insurance companies may provide for a minimum amount that must be acquired as paid up value. If the paid up value (reduced SA), as calculated above is less than the stipulated minimum, this option would not be available. The surrender value will be paid and the policy closed.

Automatic advance of future premiums options

The option of automatic advance of future premiums becomes possible by notionally advancing loans, equal to the premium fallen due, from the surrender value available on the date of lapse. This can continue as long as the total premiums advanced, is less than surrender value. (Incidentally, the surrender value will increase with every premium advanced and treated as paid). At a stage when surrender value is not sufficient to advance the premium falling due, the policy will be finally closed and any surrender value left over will be paid to the policyholder.

Many insurers prior to nationalization and some in India now, offer this option of automatic advance premium from surrender value. There are few advantages and disadvantages attached to this option:

- The advantage is that the policy continues without any reduction in benefits. Bonus also will be added.
- The disadvantage is that after some time the surrender value gets exhausted and at that stage the policyholder gets practically nothing. It is as if all the premiums paid till then have gone waste. There is a sense of having been 'cheated'. People do not understand that they had a risk cover for a longer period.

Because of the likely intense disappointment, insurers offer this option only on specific request. This option will be useful in cases where the default in payment of premium is because of some temporary difficulties, expected to be overcome very soon. In case of policies of some insurers, this condition operates unless the policyholder opts for a paid up policy.



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Extended Term Insurance cover option

Extended term insurance is a type of life insurance designed to make traditional life insurance products more attractive. Here are the basics of extended term life insurance and how it works.

Under the option of Extended Term Insurance cover, the insurer converts the policy into a single premium term insurance for the full sum assured of the policy for such a period as the net surrender value will purchase at the insured's age at the time of lapsation of the policy. Under the extended term cover option, the policy remains in full force for the full SA, for a limited period, instead of a reduced amount of insurance remaining in force for the entire policy period, as provided in the option of paid up value. The amount required to be advanced from the surrender value under this option, would be less than the premium advanced under the automatic advance of the premium option. Therefore, the benefit would last a little longer. But the sense of being cheated at some time cannot be avoided. Generally, insurers in India do not allow this option.

Surrender Values

Life insurance company generally show the surrender values accumulated at different time in form of chart and also tells the methods used to calculate surrender values in policy document. The formula considers plan and type of life insurance, policy term and duration of premium paying period.

The policyholder gets some percentage of premium from the life insurance company if he decides to cancel the policy before it matures is known as the Surrender Value. Guaranteed Surrender Value is surrender value calculated as a proportion of premiums paid.

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As per Section 113 of Insurance Act 1938, all policies which have been in force for at least three years, are entitled to receive a guaranteed surrender value, which must be shown on the policy document. What the policyholder ultimately receives is a net surrender value. Surrender Value is a percentage of paid-up value.

For Example-LIC policies promise a guaranteed surrender value of not less than 30 per cent of the total amount of premium paid, excluding premiums for the first year. The actual surrender value in any case will be more than this minimum value. The formula may differ from one company to the other and from one product to another.

For example-

Sum Insured	Rs 50000
Age	35 years
Date of commencement	1/9/90
Term	20 years
Mode of payment	a) Yearly b) Halfyearly c) Quarterly d) Monthly
Last premium	1/9/2001
paid Surrender Value factor	60 percent

Calculate the Paid up value and Surrender value of the life insurance policy.

The paid up value is calculated as under:

Paid-up Value = (No. of instalments paid / Total no of Instalments payable) * Sum Insured + Bonus (If Any)

Surrender Value (SV) = Paid- Up Value * Surrender Value Factor / 100

a) Mode of Payment is yearly

$$\text{No. of Instalments paid} = (1/09/2001 - 1/09/1990) + 1 = 12$$

(Note: Because the instalments on 1/09/1990 is also paid)

$$\text{Total no. of instalments payable} = 20$$

$$\text{Paid up value} = 12/20 * 50000$$

$$= \text{Rs } 30000$$



Notes

Surrender value = Rs 30000 * 60/100

= Rs 18000

b) Mode of Payment is half yearly

No. of Instalments paid = (1/09/2001 - 1/9/1990) + 1

= 11*2 + 1 = 23

(Note: Because the instalments on 1/09/1990 is also paid)

Total no. of instalments payable = 20 * 2 = 40

Paid up value = 23/40 * 50000

= Rs 28750

Surrender value = Rs 28750 * 60/100

= Rs 17250

c) Mode of Payment is quarterly

No. of Instalments paid = (1/09/2001 - 1/9/1990) + 1

= 11*4 + 1 = 45s

(Note: Because the instalments on 1/09/1990 is also paid)

Total no. of instalments payable = 20 * 4 = 80

Paid up value = 45/80 * 50000

= Rs 28125

Surrender value = Rs 28125 * 60/100

= Rs 16875

d) Mode of Payment is monthly

No. of Instalments paid = (1/09/2001 - 1/9/1990) + 1

= 11*12 + 1 = 133

(Note: Because the instalments on 1/09/1990 is also paid)

Total no. of instalments payable = 20 * 12 = 240

Paid up value = 133/240 * 50000

= Rs 27708



Notes

$$\begin{aligned}\text{Surrender value} &= \text{Rs } 27708 * 60/100 \\ &= \text{Rs } 16624.8\end{aligned}$$

7.6 POLICY LOANS

Loans

There are many benefits of purchasing an insurance policy. One of those benefits is the availability of loans against an insurance policy. A policyholder may apply for a loan through this service and put up his insurance policy as security. As the loan granted is only up to a specific percentage of surrender value, the loan amount will be determined by the insurance policy's overall surrender value.

When a loan is taken by the policyholder, the policy gets assigned absolutely to the insurer. However, nomination continues to be valid even after the assignment in this case. All insurance products do not offer the facility of loans.

Features of loan against insurance policy

Loan Amount: Typically, 90% of the surrender value of a life insurance policy is granted as the loan amount. The loan was often approved for up to 85% of the surrender value of a fully paid-up policy. This formula may change depending on the insurance company. The rate of interest on outstanding loan charged is generally paid half-yearly to coincide with the due date of premium.

Regular premium payments will result in a growth in the policy's surrender value, which can be used to offset the outstanding loan amount and interest on any existing loans. The loan can only be taken out for a minimum of six months. The loan interest must be paid for a minimum of six months if the policyholder wants to repay the loan earlier.

If the policyholder dies within six months of taking the loan, the interest will be charged up to the date of death of the life assured. If the policy matures within six months of taking a loan under the policy, then the interest will be charged up to the date of maturity only.

The loan could be repaid over the course of the policy. At the time of a death claim, the loan payment might be modified and delayed. The legal heirs of the life assured receive the balance that remains after the loan has been repaid.



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Additional loan against insurance policy

Throughout the policy's term, the policyholder may take out more than one loan. Additional loan that is being granted along with previous loan generally does not exceed 90 % (85% for fully paid up policies) of the surrender value. Overdue interest on previous outstanding loan is deducted while granting additional loans.

Insurance plans that are not eligible for loan against insurance policies

- Annuities and pension plans are not eligible for loans as they do not acquire adequate surrender value.
- The insured cannot take loan on Money back policy because the insured receives periodic returns of a portion of the sum assured.
- In child plans, loan cannot be granted during the deferment period (when the child is a minor). Certain plans of life insurance do not offer a loan facility under certain products.

The insured cannot take loan on Money back policy because the insured receives periodic returns of a portion of the sum assured.

The difference between policy loan and commercial loan is as follows-

Policy loan	Commercial loan
No legal obligation to repay the loan: The policy owner is not legally obligated to repay the loan, She can repay all or part of the loan at any time she chooses. 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 commercial loan creates a debtor-creditor relationship in which the borrower is legally obligated to repay the lender.
No credit check is required: Since the insurer does not really lend its own funds to the policyholder, it is not necessary to perform a credit check on the debtor when the latter applies for the loan. The insurer needs to only ensure that the loan does not exceed the eligible amount (90% of SV as suggested above).	The creditor does a thorough credit check on the debtor



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INTEXT QUESTIONS 7.2

1. How long must the premiums be paid as required by law before the policy has a guaranteed surrender value?
 - a) Insured need to pay insurance premiums for at minimum six continuous years.
 - b) Insured need to pay insurance premiums for at minimum three continuous years.
 - c) Insured need to pay insurance premiums for at minimum four continuous years.
 - d) Insured need to pay insurance premiums for at minimum two continuous years.
2. What is it known as when a lapsed policy is made active again?
 - a) Policy Activation
 - b) Policy Revival
 - c) Policy Survival
 - d) Policy Renewal
3. Special revival scheme is available if the policy has not lapsed for more than _____ Years
 - a) 2
 - b) 5
 - c) 3
 - d) 4



WHAT YOU HAVE LEARNT

There are four types of policy conditions and privileges. Explanatory conditions clarify the conditions of the policy, restrictive conditions limit the scope of the assurance, privileges add to the benefits of the insurance and provide privileges, and supplementary benefits provide extended or supplementary benefits. A grace period is an extension



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of the time after the due date that a policyholder is given to pay the premium. Generally standardized time period for grace period is 1 month or 31 days. The policy continues to remain in force during days of grace, even if premium is not paid. If the insured does not pay the insurance premium on specified date or even not pay after the grace period, the insurance policy will be treated to be lapsed. The process by which a life insurance company reinstates (or revives) a policy that has either been cancelled due to non-payment of premiums or continuing due to one of the non-forfeiture clauses. There are different schemes of revival offered by the Insurers like Ordinary revival, Special revival, Loan cum revival and Instalment revival.



TERMINAL QUESTIONS

1. Explain four types of policy conditions and privileges.
2. What do you understand by 'Grace Period'? What will happen to the policy if the premium is not paid during the days of grace?
3. Write a note on Policy lapse and its revival. Under which conditions you can revive the policy?
4. Write a note on the different schemes of revival offered by the Insurers.



ANSWERS TO INTTEXT QUESTIONS

7.1

1. (a) Lapsed
2. (a) Explanatory conditions
3. (b) Restrictive conditions
4. (d) Restrictive

7.2

1. (b) Insured need to pay insurance premiums for at minimum three continuous years
2. (b) Policy revival
3. (c) 3



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LEARNING OUTCOMES

After studying this chapter, you are able :

- To explain different Policy conditions and privileges this could be explained to the client or policyholder and to memorize the Special policy provisions and endorsements.

8

DOCUMENTATION POLICY CONDITIONS PART-II

**Notes**

8.0 INTRODUCTION

If a person who is having an insurance policy dies, after his death who will get the sum assured or the benefits of the policy and in what proportion? Shall he declare the person to whom the money shall be given after his death? These are few questions which need to be answered. You must have nominated someone at the time of opening a Bank Account, i.e. naming a person to whom the money will be given after your death. This process is known as nomination. In an Insurance policy also, you need to nominate a person or persons who is entitled to get the claim amount or sum insured by insurer after the death of policy holder. In this chapter, you will study specific provisions related to Nomination and Assignment. The chapter will also help you understand terms like Free Look Period, Alterations and Claim Concession.



8.1 OBJECTIVES

After reading this lesson, you will be able to:

- Recall the Special policy provisions and endorsements.
- Explain the Provisions related to nomination and assignment.
- Explain terms like Free Look Period, Alterations and Claim Concession.

8.2 SPECIAL POLICY PROVISIONS AND ENDORSEMENTS

8.2.1 Nomination

As per section 39 of Insurance Act 1938, in Insurance policy, you need to nominate a

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person or persons who is entitled to get the claim amount or sum insured by insurer after the death of policy holder. This process is similar to the nomination in the bank accounts where you have to propose a nominee to whom the amount will be given after the death of a person or an account holder.

Life insurance policy holders may nominate 1 or more than 2 persons as nominee at the time of buying the policy or at a later stage. There is a general practice of appointing spouse, children and parents as the nominee. Every proposal form of a life insurance policy does ask for the details of Nominee and Appointee if the Nominee is minor.

Nomination Details:	
Nominee's Full Name	
Age	Relationship
Appointee's Name (if Nominee is minor)	Appointee's Signature
Appointee's address	

Figure 8.1: Extract of Proposal Form for Nomination Details

You can change the nominees of the policy if you wish to, by making another endorsement in the policy during the policy period. The nominee will get the death claim benefit only when policy holder dies. He doesn't have any right to take whole or partial benefit in case policy holder survives.

The insured should appoint an appointee in case the nominee is a minor. The consent of the appointee is to be taken by taking his signature on the policy. As soon as the minor nominee reaches the age of 18, the appointee loses their status. The appointee can also be changed at any time by the insured. If the insured death takes place then his legal heirs is entitled for claim amount if the nominee is minor and appointee was not assigned in the policy.

It is important to note that, "If there are many nominees, the death claim will either be paid to all of them together or to the survivor or survivors if there are any. No particular share may be determined for each nominee. To be effective, nominations made after the start of the policy must be notified to the insurers."

As per the amendment in the Insurance Act, "an insurer can accept any change in the nomination or cancellation of a nomination. Insurer may charge a fee from the policyholder, as specified by the regulations for affecting such changes".

8.2.2 Assignment

Assignment is the transfer of the benefits or proceeds of the policy by the holder of a life insurance policy (Assignor) to a lender (Assignee), as collateral for a loan. The assignee is paid first and any remaining funds, if any, are given to the insurance beneficiaries in the event of the death of the assignor or insured.

On assignment, nomination is cancelled, except when assignment is made to insurance company for a policy loan. This simply means that when the benefits or proceeds of the policy are transferred to the insurance company for taking a policy loan, then nomination will not be cancelled.

Except when an assignment is made to an insurance company for a policy loan, the nomination is revoked upon assignment. This only implies that the nomination will not be revoked when the benefits or revenues of the policy are transferred to the insurance company for the purpose of accepting a policy loan.

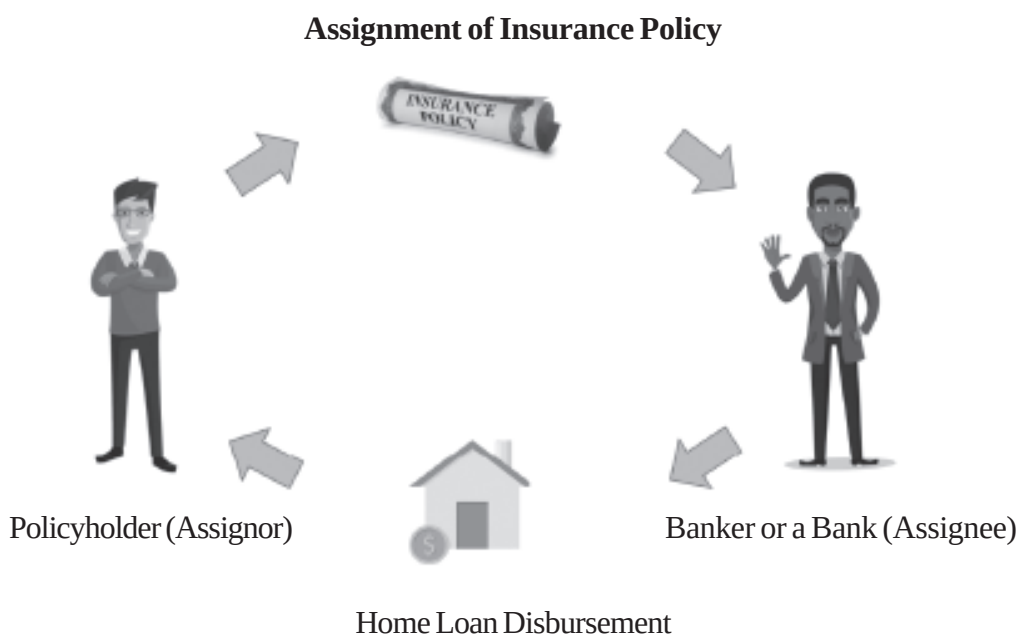


Figure 8.2: Assignment of Insurance Policy

"The assignment of a life insurance policy implies the act of transferring the rights, title and interest of the policy from one person to another". The person who transfers the rights of the policy is called assignor and the person to whom the policy's rights are transferred is known as the assignee.

The Insurance Act's Section 38 governs assignment in India. The assignee acquires ownership of the policy upon execution of the assignment and receives all rights, title,



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and interest therein, subject to the restriction that the assignee may not have a greater title than the assignor.

As per the Insurance Laws Amendments Act 2005, "An insurer may, accept the transfer or assignment, or decline to act upon any endorsement, where it has sufficient reason to believe that such transfer or assignment is not bonafide or is not in the interest of the policyholder or in public interest or is for the purpose of trading of insurance policy."

The parties must be competent to enter into contracts and must not be legally ineligible to assign.

There are two types of assignments:

1. Conditional Assignment and
2. Absolute Assignment

Conditional Assignment	Absolute Assignment
Conditional assignment provides that the policy shall return back to the life assured on his or her surviving the date of maturity of the conditional assignment or on the death of assignee.	Absolute assignment provides that all rights, title and interest which the assignor has in the policy are transferred to the assignee without reversion to the former or his/her estate in any event. As a result, the assignee has complete ownership of the policy. Without the assignor's permission, the assignee is free to handle the policy anyway they consider right.
This is done when the insured wishes to pass benefits of the policy to a relative in case of early death or certain conditions. The rights of the policyholder are restored once the conditions are fulfilled.	This is done as a part of consideration for a loan in favour of the lender/bank/lending institution. In such an assignment, the insured loses his rights in the policy and the absolute assignee can deal with it independently.
Example:	Example:
You own a life insurance policy of Rs. 20 lakhs and wants to take a loan of Rs 20 lakh from the bank. So, can go	You own a life insurance policy of Rs.20 lakhs and wants to gift your life insurance policy to your mother. So you



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for a conditional assignment of the policy. You (Assigner) will assign the policy to the bank with a condition that all the rights, benefits of the policy will stay with the bank (assignee) till the time you have an outstanding loan amount. In case you fail to pay the loan, the bank can recover the outstanding amount by surrendering the life insurance policy. If You are able to pay back the loan amount to the bank, then the bank will reassign the life insurance policy back to you. In case if you die before paying the loan to the bank, then the bank will get the death benefit and no family member will have any right over the policy. In case benefit received under the policy is Rs 20 lakh and outstanding loan is for Rs 10 lakh, the insurance company will give Rs 10 lakh to the Bank and the remaining amount to the your legal heirs.

will have to go for an absolute assignment of the policy. After the assignment, rights, title and interest of the policy will be transferred to your mother. After the assignment of the policy, your mother will have a full control on the policy. She can gift it to some other person if she wishes to, subject to the clauses and acceptance of assignment request by the insurance company.

8.2.3 Nomination vs. Assignment

Basis of Difference	Nomination	Assignment
Meaning	The policy holder suggests the name (s) of the person (s) to whom the insurer should pay the money promised following his or her death through the nomination process.	Assignment is the process of transferring the title of the insurance policy to another person or institution.
When can the nomination or assignment be done?	Nomination can be done either at the time of proposal or after the commencement of the policy.	Assignment can be done only after commencement of the policy.

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Who can make the nomination or assignment?	Nomination can be made only by the life assured on the policy of his own life.	only by the life assured on owner of the policy either by the life assured if he is the policy holder.
Where does it apply?	It only applies in situations where the Insurance Act of 1938 is in effect	This is applied across the world as per the country's law governing property transfer.
Does the policy holder retain control over the policy?	The policy holder retains title and control over the policy.	The policy holder loses the right, title and interest under the policy until a re-assignment is executed.
Is a witness required?	Witness is not required.	Witness is required.
Do the Nominee or Assignee get any rights?	Nominee has no rights over the policy.	Assignee gets full rights over the policy, and can even sue under the policy.
Can it be revoked?	Nomination can be revoked or cancelled at any time during the term of the policy.	The assignment once done cannot be cancelled, but can be re-assigned.
Minor Case	Appointee has to be appointed if nominee is a minor	Guardian must be appointed if assignee is a minor
In event of nominee or assignee passes away	In event of nominee's death, the insurance policy rights revert to the policy holder or to his legal heirs	According to the provisions of the assignment, the rights under the policy revert back to the life assured in the event of the conditional assignee's death. The policy belongs to the absolute assignee's lawful heirs in the event of his passing



What happens if the nominee or assignee passes away after the life insurance policy holder has passed away but before the death claim is paid	In case of nominee's death, the rights of the policy revert to the policy holder or to his legal heirs.	In case of conditional assignee's death, the rights on the policy revert back to the life assured, based on the terms of assignment. In case of the absolute assignee's death, his legal heirs are entitled to the policy.
Can creditors attach the policy?	Creditors can attach the insurance policy which has an nomination in it.	Creditors cannot attach the policy unless the assignment is shown to have been made to defraud the creditors.



INTEXT QUESTIONS 8.1

- When a policyholder or insured suggests a name for the person or people to whom the insurer should pay the sum insured following their death, this is known as _____
 - Contract of Adhesion
 - Nomination
 - Assignment
 - Indemnity
- The policy holder needs to appoint _____ in case the nominee is a minor.
 - An Assignor
 - An Assignee
 - An Appointee
 - None of the above

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3. If the nominee is minor and appointee was not assigned in the policy, then the Death claim is paid to the
 - a) An Assignor
 - b) An Assignee
 - c) Legal heirs of the policyholder
 - d) An Agent
4. _____ implies the act of transferring the rights, title and interest of the policy from one person to another
 - a) Contract of Adhesion
 - b) Nomination
 - c) Assignment
 - d) Indemnity
5. On assignment, nomination is not cancelled, when assignment is made to a _____
 - a) Bank for a loan
 - b) NBFC for a loan
 - c) Insurance company for a policy loan
 - d) All of the above

8.3 FREE-LOOK PERIOD

When a policyholder receives and reads the terms and conditions of a new life insurance policy, he may realise that they are not what he wanted. Within 15 days after receiving the insurance policy, the policyholder may return it.

IRDAI has addressed this issue by incorporating a consumer-friendly clause into its regulations. It has devised a "free look period" or "cooling off period,"

The following criteria must be fulfilled for the insured to return an insurance policy they have purchased during this period and receive a refund:

1. Within 15 days of obtaining the policy document, he or she has the choice to execute it.

2. He or she must intimate the insurance company in writing.
3. The insurance premium refund will be adjusted to account for the proportionate risk premium for the duration of coverage, the insurer's expenses for the medical exam, and the costs of stamp duty.

As a benefit, owners of life insurance policies have access to this free look period. They have fifteen days from the date the insured received the policy document to exercise this option.



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8.4 ALTERATION

The contract's terms are stated in the policy document, and they apply for the duration of the policy. No changes can be made unless they are agreed to by both the policyholder and the insurer. There may be situations where the policyholder requests a change in the terms of the contract if their circumstances change. Such adjustments may be made provided they are approved by both the insurer and the assured. An example of this may be where a policyholder requests a reduction in the sum assured as they are finding it difficult to pay the premium for the original sum assured, or they may ask to change the mode of payment.

Typically, changes to the insurance policy cannot be made within the first year of the policy, with the exception of changes to the premium payment method or changes that are mandatory, such as

- Name or address change,
- Readmission of age in case it is proved higher or lower.
- Request for grant of double accident benefit or permanent disability benefit etc.

Alterations might be allowed in later years. Some of these changes may be made by adding an appropriate endorsement to the policy or in separate papers. Some changes may necessitate the cancellation of current policies and the issuance of new ones because they call for a significant change to the policy terms and conditions.

The following are some examples of the major kinds of modifications allowed:

1. Modifications to specific insurance types or policy duration. (Where enhancement of risk doesn't take place)
2. A decrease in the sum insured.
3. Premium payment mode alteration

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4. Modifications in the commencement of the insurance policy date
5. Separation of the insurance policy into two or more insurance policies
6. Removal of restrictive clause or an additional insurance premium
7. Conversion from without profits to with profits insurance plan
8. Name Correction
9. Option for settling claim and awarding double accident benefit.

In most cases, there is no risk increase associated with these changes. There are other policy changes that are prohibited. The insurer must try to ensure that there will be no adverse selection against them when they consider a request for alteration. Adverse selection means the change should not increase the risk.

Alterations which increase the risk are:

- increasing the sum assured
- increasing the term
- change of insurance plan e.g. conversion of term plan to whole life plan

Alterations are generally not allowed if they involve:

- change to a longer term
- extending the premium paying period
- changing from one plan of insurance to another that represents increased risk

Some alterations are made by having a suitable endorsement on the policy itself. If the alterations are substantial, a new policy may be issued. This will happen if a policy is being split into two or more policies, incorporating the desired alterations. Unless an alteration is to correct a mistake, a fee is usually charged to effect the alteration. Alterations in frequency of payment from quarterly to half yearly or yearly reduces the administrative work in servicing the policy so no fee is charged.

Charging a fee has two purposes:

- to cover expenses
- is an attempt to discourage frequency of alterations

8.5 CLAIM CONCESSION

Strictly, if premium is not paid, the policy lapses and no further payments would be due under the policy. Therefore, no claim can be entertained on a lapsed policy.

However, insurers do take liberal and humane view in these matters. Eg: The LIC of India allows the following privileges or concessions:

- **Claim Concession:** If under a policy at least three full years' premium is paid and if subsequent premium remains unpaid and the death claim arises within six months of the first unpaid premium, the claim is settled in full, as if the policy had remained in full force
- **Extended Claim Concession:** Similarly, if under a policy at least five full years' premium is paid and if the subsequent premium remains unpaid and the death claim arises within twelve months of the first unpaid premium, the claim is settled in full, as if the policy had remained in full force.

Note: In both the above cases, the policy money will be paid after deducting the outstanding premiums with interest thereon and the premiums falling due till the next anniversary of the policy.



INTEXT QUESTIONS 8.2

1. The insured may return the insurance policy during the free-look period, which is within _____ of receiving the insurance policy document if they are not happy with it.
 - a) 60 days
 - b) 45 days
 - c) 30 days
 - d) 15 days
2. Which of the following statements about a policy that a policyholder returned during the free look period is true?
 - a) Full refund of insurance premium is given by insurer
 - b) Half refund of insurance premium is given by insurer
 - c) The insurance premium refund will be adjusted to account for the proportionate risk premium for the duration of coverage, the insurer's expenses for the medical exam, and the costs of stamp duty.
 - d) No refund of insurance premium is given by insurer



Notes

Life Insurance



Notes

3. If an insured purchases an insurance policy during the _____ period and decides they do not want it, they may return it and receive a refund.
 - a) Survival
 - b) Free look
 - c) Termination
 - d) Free up
4. Which of the following are the conditions that are designed to eliminate certain risks?
 - a) Explanatory
 - b) Extended
 - c) Supplementary
 - d) Restrictive
5. What conditions would require the policy holder to designate an appointee?
 - a) Insured is minor
 - b) Nominee is a minor
 - c) Insured is not of sound mind
 - d) Insured is unmarried
6. Under the _____ Insurance Act of 1938, a nomination for an insurance policy is permissible.
 - a) Section 10
 - b) Section 38
 - c) Section 39
 - d) Section 45
7. Which of the following changes will an insurance company accept?
 - a) Separation of the insurance policy into two or more insurance policies
 - b) Extension of the premium paying term
 - c) Conversion from with profit to without profit insurance plan
 - d) Increase in the sum assured



WHAT YOU HAVE LEARNT

Assignment is the transfer of the benefits or proceeds of the policy by the holder of a life insurance policy (Assignor) to a lender (Assignee), as collateral for a loan. In the event of the death of the assignor or insured, the assignee is paid first and the balance if left is paid to the beneficiaries of the policy. There are two types of Assignment: Conditional Assignment and Absolute Assignment.

During this free look of 15 days, if a policy holder who has purchased a new life insurance policy and after receiving and examining the policy document comes to know that the terms and conditions are not what he wanted. The policy holder may return the policy to the insurer within 15 days of receiving the insurance policy, if he is not satisfied. The policy document embodies the terms of the contract, and these terms continue throughout the period of the policy. No changes can be made unless they are agreed to by both the policyholder and the insurer. There may be situations where the policyholder requests a change in the terms of the contract if their circumstances change. Such adjustments may be made provided they are approved by both the insurer and the assured. Alteration which increases the risk are not allowed.



TERMINAL QUESTIONS

1. What do you understand by 'Nomination'? What are the different provisions related to Nomination?
2. What do you understand by 'Assignment'? What are the conditions for valid assignment?
3. What do you understand by 'Assignment'? What are the different provisions related to Assignment of insurance policies?
4. What are the differences between Nomination and Assignment?
5. Write a short note on:
 - a) Free Look Period
 - b) Alterations
 - c) Claim concession



Notes



Notes



ANSWERS TO INTEXT QUESTIONS

8.1

1. (b) Nomination
2. (c) An Appointee
3. (c) Legal heirs of the policyholder
4. (c) Assignment
5. (c) Insurance Company for a policy loan

8.2

1. (d) 15 days
2. (c) The insurance premium refund will be adjusted to account for the proportionate risk premium for the duration of coverage, the insurer's expenses for the medical exam, and the costs of stamp duty.
3. (b) Free look
4. (d) Restrictive
5. (b) Nominee is a minor
6. (c) Section 39
7. (a) Separation of the insurance policy into two or more insurance policies



LEARNING OUTCOMES

After studying this chapter, you are able :

- To assist the client while dealing with the provisions of nomination, assignment, free look period, and alterations.

9

LIFE INSURANCE UNDERWRITING PART- I

**Notes**

9.0 INTRODUCTION

The work of life insurance advisor is not only submitting the proposal form from the proposer to the insurance company. The proposal form should be accepted by the underwriter of the life insurance company resulting in issuance of policy. Every proposal form goes through a gateway where the life insurance company decides whether to accept or reject the insurance proposal. If it is accepted what should be terms and conditions attached to acceptance. In this chapter you will come to know about the process involved in life insurance underwriting and what are the elements involved in its process.



9.1 OBJECTIVES

After reading this lesson, you will be able to:

- Explain the concept and process of Underwriting
- Explain the classification of the risk
- Explain the role of an agent as a primary underwriter and in the process of Fraud monitoring
- Discuss and apply the methods of underwriting while assessing risk
- Explain the concept of Medical and Non-medical underwriting
- Explain the factors affecting medical and non-medical underwriting
- Describe the sources of life insurance underwriting



9.2 UNDERWRITING - BASIC CONCEPTS

Life insurance underwriting is the process of:

Assessing



Selecting



Classifying



Evaluating



Measuring and



Rating the level of risk with an individual.

Figure 9.1: Underwriting Process

The underwriting process is an important process as it assesses the risk proposed to be insured and is the basis of the decision to accept the offer for insurance and on what terms insurance or decline the offer for insurance. It would be unfair if the premium is not charged according to the risk assessment (charged premium may be more or less than necessary).

9.2.1 Underwriting Concept

In life insurance, the underwriter will review all the information disclosed on the proposal form, personal statement, the report of the agent and officials and the medical reports to arrive at their decision.

Life insurance underwriting is mainly concerned with two aspects:

1. Evaluation of risk associated with an individual for providing life insurance cover.
2. Pricing the risk



Notes

9.2.2 Purpose of Underwriting

The purposes of underwriting are as follows:

1. Anti-selection prevention or selection against the insurance company
2. Risk classification and ensuring risk equity

Definition

Risk Selection

The process of selecting risks involves assessing each life insurance proposal for the level of risk it entails, deciding whether to issue life insurance or not, and if so, on what terms and conditions. One of the methods used by insurance companies to screen insurance applicants is risk selection. It entails categorizing candidates using underwriting rules and figuring out how much premium to offer a specific applicant.

Anti-selection is the propensity for people to enthusiastically seek for insurance and profit in the process when they suspect or know that their likelihood of suffering a loss is high. For example- Anti-selection happens when a lack of underwriting data makes it possible for smokers or other higher-risk individuals to pay the same premium for life or health insurance as non-smokers.

Example- If Life Insurance Company is not selective in offering insurance then there is high chance that the person with medical hazards like cancer, diabetes, hyper tension, heart disease etc who are not expected to live long they would like to purchase life insurance. In other words we can say that if insurer is not selective in accepting lives it would incur losses.

9.3 EQUITY AMONG RISKS

The term "Equity" denotes the need that proposers who face similar levels of risk be assigned to the same premium class. We've already seen how life insurers figure out the rates to charge using a mortality table. The mortality experience of typical lives or typical risks is shown in the table. They primarily consist of those who propose purchasing life insurance.

9.3.1 Risk classification

Based on the information collected by the underwriter from different sources, he can classify the risk related to an individual. The various sources from where the underwriter can gather information for assessing the risk are:

Life Insurance



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- Proposal form
- Insurance agent's confidential report
- Medical history and medical examinations reports of the life proposed
- Income statements (for eg. Balance sheet, ITR, Form 16 etc.)

In order to maintain equity, life insurance underwriter follow risk classification process in which depending upon the kind of risk individual lives possess they are categorised and different classes of risk are assigned. There are four classes of risk.

1. Standard Lives

Definition- If the risk with an individual is considered to be low and insurable at the standard premium rates by insurance companies, and then it is known as standard risk.



Figure 9.2: Risk Classification

2. Preferred Risks

Because the risk-anticipated mortality is much less than that of standard lives, a lesser premium could be charged.

Policy holder under preferred risk category is less likely to file insurance claims. The insurer would prefer preferred risks over higher or standard risk because preferred risk represents a good risk for their company and there is high chance to make the profit out of it. The less number of claims for insurance company equates to more money received and less money paid out in form of claims. The insurance companies generally give discount to the preferred risks. For example- Life insurers give discount to non-smoker.



3. Substandard Lives

The lives in which anticipated mortality is higher than standard or average lives, but still can be insurable. Standard lives are accepted for insurance with extra or higher premium or with certain restrictions.

Sub-standard risk is a term used to describe when an individual's risk is deemed to be high and cannot be insured by insurer at regular premium rates. The range of sub-standard, too, may vary from being slightly sub-standard to substantially sub-standard.

If the insurer has to assess the information on individuals for risks, there will be a case of adverse selection, where more individuals with standard risks will get insured, as a result of which insurance companies would have to suffer losses. The Underwriter also have to ensure that the terms offered to the substandard lives are reasonable and fair, not only to the proposer but also to the other policy holders and the insurer.

Sub Standard risk can be further classified as:

- a) Increasing extra risk
- b) Decreasing extra risk
- c) Constant extra risk

1. **Increasing extra risk-** It is characterized as rising extra risk when the danger attached to a particular person is initially thought to be minimal but there is a probability that risk could increase in the future.

For example- An obese person may not be having any disease at the time of underwriting and may be assumed low risk at the time of taking a policy. But if weight is not managed properly then in near future with the advancement of age, he is more prone to hypertension, diabetes or heart disease.

2. **Decreasing extra risk-** Decreasing extra risk is the opposite of increasing extra risk. The risk associated with an individual is high at the time of initial underwriting but decreases over a passage of time.

For example- If a person is diagnosed with TB at the time of taking a policy while underwriting, there is the chance that person can be completely cured in future with proper medication and supervision.

3. **Constant extra risk-** Constant extra risk is what is known as the case where an individual's risk is thought to be constant over time.

Life Insurance



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For example- If an individual looking for life insurance policy is a pilot then the risk associated with him will remain constant in future also because his occupation is pilot and there is always chance of accident death related to flying plane. If he leave flying he will be categorised as standard risk.

4. Declined Lives

If the risk associated with an individual is considered to be substantially high and no amount of extra premium or specified exclusions can help the company in diminishing that risk for the company, then the proposal is declined by the insurance company.

This is also called uninsurable risk. In this type the medical or financial risk exposure is high and according to the underwriting consideration of Life Insurance Company the individual proposal is declined citing the reason for the same.

For example- The proposal form of the person with serious ailment like cancer of specific gravity, highly diabetic, heart disease etc is declined for term insurance policy.



INTEXT QUESTIONS 9.1

1. Life insurance underwriting is the process of _____
 - a) Assessing and Selecting risk
 - b) Classifying, Evaluating and Measuring Risk
 - c) Rating the level of risk with an individual
 - d) All of the above
2. Which of the following risks associated with an individual is high at the time of initial underwriting but decreases over a period?
 - a) Increasing extra risk
 - b) Constant extra risk
 - c) Decreasing extra risk
 - d) Falling extra risk



Notes

9.5 UNDERWRITING/SELECTION PROCESS

Underwriting or the selection process may be said to take place at two levels: There are two levels of underwriting, or the selection process. They are:

- At field level
- At the department level of underwriting division

Underwriting or the selection process

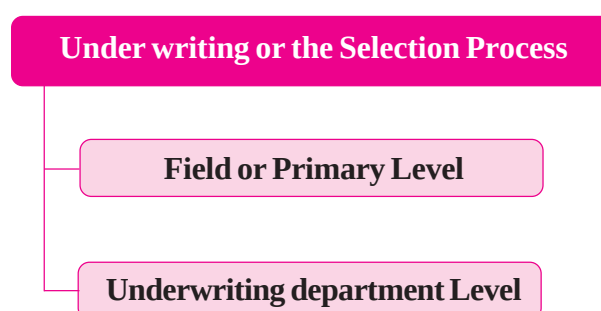


Figure 9.3: Underwriting or the Selection Process

1. Field or Primary level

It is also known as primary underwriting. The information about the proposer and subject matter of insurance is gathered by life insurance agent or insurance company representative and on this basis insurer decide whether an insurance coverage be granted to applicant or not. The agent as the primary underwriter plays a vital role because he knows the proposer very well.

There is a column in the proposal form named agent confidential report where agent or primary underwriter complete or fill this report regarding specific information, opinion and give recommendation about proposer.

A moral hazard report may be sought from life insurer official regarding income and financial status, occupation and reputation of proposer.

Role of agent as primary underwriter and Fraud monitoring

The facts that the proposer discloses in the proposal form will determine whether or not the risk will be accepted. It's quite challenging for the insurance underwriter who sits in insurance underwriting department to know about the truthfulness of



Notes

facts disclosed by the proposer. It's a challenge for them to detect the fraud and misrepresentation by the applicant.

The insurance agent plays a vital role as a primary underwriter. The insurance agent knows very well about the proposed life. He or she is the best person to know about true facts about applicant. Agent confidential report helps the underwriter to assess the risk related to proposer's life.

2. Underwriting Department Level

Underwriting department or office level is the second level of life insurance underwriting. The insurance underwriters are the specialized person who assess the risk and take decision to accept or reject the proposal on the basis of relevant data.

9.5 METHODS OF UNDERWRITING

For decision making underwriters follows two methods:

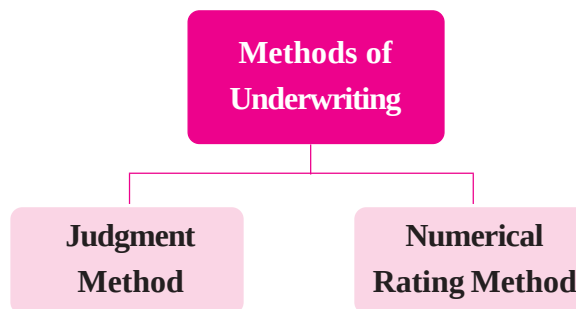


Figure 9.4: Methods of Underwriting

- Judgment Method-** In this method, the underwriter's personal assessment based on his experience determines whether to accept or deny the risk. This method is rarely used in underwriting in present times. The individual is assigned ratings on the basis of subjective judgment of the underwriter.

When professional assistance is required in a situation with just one or two unfavourable events, this technique can be quite helpful. But when more number of factors needs to be evaluated, there is no standard process for underwriting.

Limitation: - It was found to be very inconsistent and very subjective.

The method of classification is not scientific.



2. Numerical Rating Method-Decision to accept or decline the risk depends upon numerical rating employed by underwriters.
- It was originally devised in USA in 1960s and has gained popularity around the world.
 - The biggest advantage is it ensures consistency in risk classification.
 - It is employed by underwriters for taking decisions to accept or decline the risk.
 - This method uses mortality ratings as the basis of selection and classification of lives.

Advantages of Numerical Rating Method-

- Establishes a standard method of underwriting.
- The factors are rated on the basis of documented manuals.
- It eliminates personal judgement of the underwriters to a large extent.
- It helps in assessing the combined effects of multiple adverse factors together.
- It increases speed and efficiency in handling large volumes of business and also maintaining consistency in decision making in the underwriting process.

Disadvantages of Numerical Rating Methods- This method involve charging a level extra premium for the sub- standard lives throughout the term of the policy contract. This would be unfair for the persons whose category of extra risk is of decreasing type that is where the extra risk diminishes over a period of time. Hence charging of level extra premium for the entire term to these individuals is not justifiable.

Judgment Method	Numerical Method
Under this method subjective judgment is used, especially when deciding on a case that is complex. Example: Deciding whether to give insurance to give insurance to someone who has acute diabetes and on what terms	Under this method underwriters assign positive rating points for all negative or adverse factors (negative points for any positive or favourable factors).



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In such situations, the department may get the expert opinion of a medical doctor who is also called a medical referee.

The total number of points so assigned will decide how much Extra Mortality Rating (also called EMR) it has been given. Higher the EMR, more substandard the life is. If the EMR is very high, insurance may even be declined.

9.6 UNDERWRITING DECISIONS

Life insurance underwriter takes various kinds of decisions regarding underwriting of proposer. They are as follows:

1. **Acceptance with standard risk-** the proposer is charged with the same premium as mentioned in premium table and is assumed as standard or ordinary life. This is the most common decision taken by insurance underwriter. The standard premium will be charged from the proposer.
2. **Acceptance with an extra premium:** This is generally in majority of sub-standard risks. In this method an insurance company charges extra premium over the standard rate for accepting the risk. The loading is charged from the proposer in this case which means extra premium with extra risk. For example a proposer has elevated lipid profile and high blood pressure, in this case he will be charged extra premium and will be assumed sub standard risk.
3. **Acceptance with a lien on the sum assured:** This is a type of full or partial restriction on benefit amount at the time of claim which is imposed by life insurance company

Example: If the insured person dies due to relapsed tuberculosis within specified time period then life insurer will pay decreased sum insured. This is an example of Lien imposed by life insurer for a TB recovered person.

4. **Acceptance with a restrictive clause:** In certain circumstances, a restrictive condition is in place that limits the death benefit that would otherwise be paid out in the event of a death.

Example Pregnant women are subject to a pregnancy clause that restricts the amount of insurance that will be paid out in the event that a pregnancy-related death occurs within, say, 3 months of delivery.



5. **Denying or delay the proposal:** If the risk associated with an individual is considered to be substantially high and no amount of extra premium or specified exclusions can help the insurer in diminishing that risk for the company, then the proposal is declined by the insurance company. Finally underwriter of Life Insurance Company may decline or reject the life insurance proposal.

Example: An individual who is suffering from cirrhosis of liver and having little chance of remission, would be a reason for rejection

Example- An insurance company may ask proposer to wait for few months in case of a recently diagnosed TB person before accepting his life insurance proposal. The underwriter delay or postpone the decision to review the situation of proper's health after proper medication and supervision.

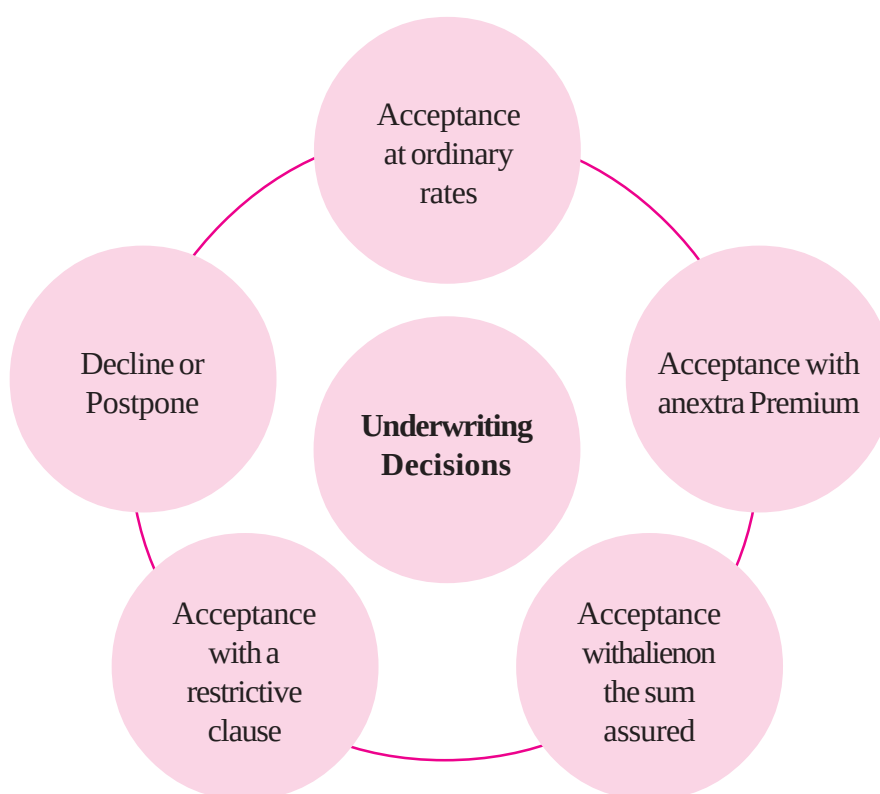


Figure 9.5: Underwriting decisions



Notes



INTEXT QUESTIONS 9.2

1. In which case the life insurer underwriter will decline the proposal form-
 - a) Illiterate women
 - b) An overweight person
 - c) AIDS Patient
 - d) Person operated for gall bladder stone
2. What is the role or function of insurance underwriter?
 - a) Claim Management
 - b) Acceptance or declining the risk
 - c) Insurance policy sales
 - d) Pricing of insurance policy

9.7 SOURCES FOR LIFE INSURANCE UNDERWRITING

- a) **Application form (Proposal form)**- This is the major source of life insurance underwriting because lot of information regarding proposer is extracted from this form and this help in assessing and classification of proposer risk.
- b) **Occupational/avocation/residential-supplementary questionnaire regarding this are asked in proposal form.** The information help in identifying occupational or residential or avocation risk. These also help in identifying the type of risk and taking appropriate underwriting decision to accept or reject the proposal form.
- c) **Underwriting manuals**- Underwriting manual are written manuals which help the underwriter to rate the different factors of underwriting. The favorable and unfavorable factors are identified and appropriate rating is done on the basis of manuals. And at last the decision is taken by the underwriters on the basis of final rating value.
- d) **Internet, government data base, other relevant data**- These days underwriters also use internet and social media to identify the kind of risk the proposer carries. For example if a particular life insurance is taking a term cover of a celebrity then underwriter will also take some clue regarding lifestyle and habits of that celebrity before accepting the proposal.



Notes

- e) **Medical examiner report-** This helps in the medical underwriting. If some adverse medical report comes, the underwriter will take the decision on the basis of these medical reports and finally take decision to accept the proposer on same premium or charge loading or reject the proposal form.
- f) **Standard income documents for salaried applicants-** Salary slips, last six month bank statement of salary account, form no 16, individual income tax returns. This helps in non- medical underwriting.
- g) **Agent s confidential report-** This is the special column in the proposal form where underwriter expects something significant information which insurance agent will share regarding the proposer. The insurance agent is also called primary underwriter as he/she knows more about the proposer risk as compared to the insurer's underwriter sitting in the office. If any adverse information is found out the agent should share that with the insurer through this report. This report is kept confidential.



INTEXT QUESTIONS 9.3

1. Which of the following are the sources from where the underwriter can gather information for assessing the risk?
 - a) Proposal form and Insurance agent's confidential report
 - b) Medical history and medical examinations reports of the life proposed
 - c) Income statements (for eg. Balance sheet, ITR, Form 16 etc.)
 - d) All of the above
2. Which of the following is not an underwriting decision?
 - a) Delaying the risk
 - b) Declinature of risk Rejection of risk
 - c) Accepting the standard risk
 - d) Rejection of Insurance claim

Life Insurance



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3. A pregnant lady named Pallavi would like to purchase term insurance policy. What would be the best decision an underwriter can take according to you. Choose the most appropriate decision-
 - a) Acceptance at ordinary rates
 - b) Acceptance with extra premium
 - c) Decline the proposal
 - d) Postponement of the acceptance of risk
4. Ramesh may be charged less insurance premium because his expected mortality is substantially lower than standard life. He has submitted a term insurance proposal form. Risk category classification for Mr Ramesh would be _____.
 - a) Standard lives
 - b) Preferred risks
 - c) Sub-standard lives
 - d) Declined lives



WHAT YOU HAVE LEARNT

The underwriting process is an important process as it assesses the risk proposed to be insured and is the basis of the decision to accept the offer for insurance and on what terms insurance or decline the offer for insurance. It would be unfair if the premium is not charged according to the risk assessment. Life insurance underwriting is mainly concerned with two aspects. It consists of evaluation of risk associated with an individual for providing life insurance cover and pricing the risk. The purpose of underwriting is anti-selection prevention or selection against the insurance company and risk classification and ensuring risk equity.

Underwriting or the selection process may be said to take place at field and underwriting department levels. There are two methods of life insurance underwriting named judgement and Numerical Rating Method (NRM). The underwriters proceed to collect the premium and issue the insurance if they are convinced that all the requirements have been met.



TERMINAL QUESTIONS

1. What is the purpose of underwriting in Insurance? Explain with examples.
2. What do you understand by 'equity among risks'? Give examples to support your answer.
3. Write a note on the various sources from where the underwriter can gather information for assessing the risk.
4. Classify different risk classes depending on the degree of risks associated with it.
5. Explain the process of underwriting in detail.
6. Explain the role of agent as primary underwriter and in Fraud monitoring.
7. Explain the Judgment and Numerical rating method of underwriting.
8. Write the advantages and disadvantages of Judgment method of underwriting.
9. Write the advantages and disadvantages of Numerical Rating Method of underwriting.
10. Discuss the various Life Insurance underwriting decisions an underwriter can take?



ANSWERS TO INTEXT QUESTIONS

9.1

1. (d) all of the above
2. (c) Decreasing extra risk

9.2

1. (c) AIDS Patient
2. (b) acceptance or declining the risk

9.3

1. (d) All of the above
2. (d) Rejection of Insurance claim



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Notes

3. (d) Postponement of the acceptance of risk
4. (b) Preferred risks



LEARNING OUTCOMES

After studying this chapter, you are able :

- To explain the process and concept of the underwriting and apply the methods of underwriting while assessing risk.

**10**

LIFE INSURANCE UNDERWRITING PART- II

10.0 INTRODUCTION

The previous lesson provided an understanding of the importance of the role of underwriting and the process insurers use to assess risk and underwrite a proposal. This lesson you will learn about the concept of Medical and Non-medical underwriting along with the factors affecting medical and non-medical underwriting.



10.1 OBJECTIVES

After reading this lesson, you will be able to:

- Explain the concept of Medical and Non-medical underwriting
- Explain the factors affecting medical and non-medical underwriting
- Describe the sources of life insurance underwriting

10.2 TYPES OF UNDERWRITING: MEDICAL AND NON-MEDICAL UNDERWRITING

There are two types of underwriting:

1. Medical Underwriting
2. Non-Medical Underwriting



Notes

10.3 MEDICAL UNDERWRITING

10.3.1 Meaning of Medical Underwriting

Definition- Medical Underwriting refers to the underwriting process where underwriters use health related information through a pre insurance medical screening of a prospect to take a decision regarding acceptance or rejection of the application, or the amount of insurance cover to be provided to the insured.

To determine the health status of applicant the medical reports are asked by the underwriter of the life insurance company. The insurance company then assesses these medical findings to decide whether to accept or reject the proposal. Therefore, the use of medical reports to accept or decline a risk is made possible.

High costs are involved in conducting and examining medical underwriting. When strict underwriting considerations are done by the insurance company underwriter, it is called cream skinning. It means they are choosing the best life or risk and rejecting other proposal forms. This decision can disappoint the proposer.

For life insurance underwriting considerations age and health status of the individual is important. The underwriter can identify any preexisting diseases or medical conditions by consulting personal and family medical histories.

Example: Medical conditions like high blood pressure, obesity and high glucose levels have a high mortality. The medical underwriter needs to be very careful while assessing proposers with these medical conditions.

10.3.2 Factors Affecting Medical Underwriting

The life insurance underwriting decisions are influenced by some medical factors through medical underwriting. Generally they call for medical reports.

Some of the factors are as follows:

a) Family History

There are three considerations while assessing the family history impact on mortality risk. They are as follows-

- i. **Heredity:** There are some ailments which can be transferred from parents to children. Medical insurance rates are influenced by family medical history since genetic disorders increase the likelihood that the applicant may contract them as well. The insurance writer will compute the applicant's life



Notes

expectancy while setting insurance rate premiums. For instance, it is necessary to determine hereditary risk factors by looking at the applicant's family members' medical histories with reference to diabetes, hypertension, etc.

- ii. **Average longevity of the family:** The questions related to parents' longevity are asked in proposal form where underwriter wants to ascertain longevity of the family members. This also provides a clue to underwriter to ascertain the type of risk a proposer is. For example: if both the parents died early due to cancer the underwriters need to be very cautious in accepting the proposal. He needs to rule out the possibility of cancer in the proposed before accepting the proposal form.
- iii. **Family Environment:** The family may be susceptible to infection or other ailments as per the environment in which they reside. These includes the occupation (whether hazardous or not), place of residence and occupation. The place where the family is residing also affects the underwriting. The factors like polluted area, densely populated, narrow lanes, less medical facilities, place where every year some communicable disease spreads etc. will affect the underwriting decision.

Life insurance companies need to more cautious in dealing with applicant with adverse medical history. Insurer may impose extra mortality rating or loading and can call for additional medical reports in these types of cases.

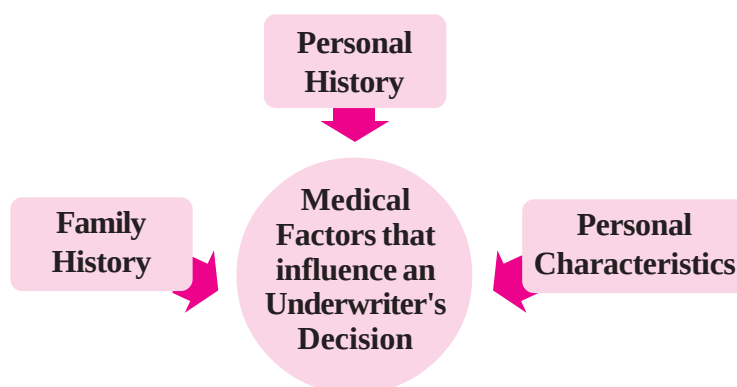


Figure 10.1 Medical Factors that influence an Underwriter's decision.

b) Personal History

The life insurance proposal form consists of some specific questions related to treatment, surgeries done, any past impairment, disease which life to be insured has suffered from. The proposer is supposed to answer these questions.

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A person's prognosis may be impacted by their medical background. Some illnesses leave marks and can recur or reduce resistance. The proposer is questioned about any current or previous illnesses related to different body systems. The proposer should not hide any information related to present and past illness because it helps the underwriter to take prudent decision regarding the risk. If proposer accepts any past and present disease it will not means denial of proposal. There are specific diseases of less severity where standard premium is charged, or extra premium would be charged for substandard risk. The proposer should disclose the name of disease, duration and treatment taken in proposal form. Some questions related to alcohol, drug and habits are asked. The applicant should also disclose these facts accurately.

The medical examiner's reports or any necessary special reports may also reveal the issues. The most common illnesses that are fatal diseases include.

- i. Cardiovascular diseases like heart attack, coronary artery disease, myocardial infarction
- ii. Diseases related to respiratory system like TB, bronchitis, Asthma
- iii. Malignant tumours, (also known as cancer)
- iv. Diseases related to renal system like kidney failure which may lead death
- v. Impairments of the endocrine system like Diabetes.
- vi. Diseases related to digestive system like gastric ulcers, hepatitis, ulcerative colitis and cirrhosis of the liver
- vii. Diseases related to nervous system like Parkinson disease, meningitis, Alzheimer disease
- viii. Blood diseases like anaemia, thalassemia

c) Personal Characteristics

These can also give some major indications for some disease.

- i. **Build:** To ascertain that a person is overweight or underweight, height and weight is required to calculate Body Mass Index (BMI). On the basis of BMI underwriter comes to know about weight category. This help in risk assessment. The proposer's height, weight, chest measurement and girth of abdomen is required as part of built.

The way a person is built reveals whether or not they are healthy. The person's height, weight, and chest measurement can be used to determine



Notes

height and weight must be provided. This illustrates how the body is built. In fact, the majority of insurers publish a chart of ideal height and weight, which even doctors abide by. While writing the height and weight, the actual measurement should be quoted instead of taking from the build- chart.

Generally it is expected that there should be minimum four centimeters chest expansion in normal person and individual's expanded chest should be more than abdominal girth.

ii. Blood Pressure: Individual blood pressure is the next indicator. Blood pressure consists of two measurements. They are:

- **Systolic:** Systolic blood pressure measures the pressure in your blood vessels when your heart beats.
- **Diastolic:** Diastolic blood pressure measures the pressure in your blood vessels when your heart rests between beats.

A person is said to be have high blood pressure or hypertension if his/her actual reading are much higher than above mentioned values. If an individual have low blood pressure, it is known as hypotension.

Normal blood pressure range is less than 120/ less than 80. Anything between 120-139 /80-89 is considered pre-hypertension. Numbers above 140-159 / 90-99 is considered high (hypertension). High blood pressure increases the risk of heart attack, heart disease & stroke and can also cause kidney disease.

The pulse rate indicates the blood pressure flow in the system. It can vary from 50 - 90 per minute with an average of 72 per minute.

iii. Urine - Specific gravity: The various salt balances in the urinary system of the body is indicated by specific gravity of urine. Any malfunctioning in the system is indicated by specific gravity of urine. The presence of sugar in urine indicates towards diabetes disease.



INTEXT QUESTIONS 10.1

1. Which of the following Factoris not related with medical underwriting?
 - a) Family Medical History
 - b) Personal Characteristics like build, blood pressure, etc.
 - c) Place of Residence
 - d) Personal Medical History

Life Insurance



Notes

2. Why does hereditary history matter in the underwriting of medical claims?
 - a) To ascertain the wealth of proposer
 - b) Some ailments may be transferred from parents to their children.
 - c) Wealthy parents have healthy children.
 - d) All of the above
3. Which of the following personal characteristics are studied for the purpose of medical underwriting?
 - a) Build
 - b) Blood Pressure
 - c) Specific gravity of one's urine
 - d) All of the above

10.4 NON-MEDICAL UNDERWRITING

10.4.1 Meaning of Non-Medical Underwriting

Definition- The underwriting procedure wherein the insurance companies offer insurance coverage to the prospects on a non-medical basis is referred to as non-medical underwriting.

Many life insurance proposals are accepted by the underwriters of the insurance companies without conducting medical tests. These cases are known as **non-medical proposals**.

The logic behind conducting non-medical underwriting is due to the finding which says medical examinations bring out adverse features only in a small proportion (say one tenth) of the cases. Rest can be found out from the proposal form filled by proposer or leave records of proposer and various other documents.

The cost involved in conducting medical test and doctor's fees can be saved by not conducting medical test. Life insurers have hence adopted the practice of granting insurance without insisting on a medical examination. An insurance cover is provided to the insured without any medical tests, non- medical underwriting is considered to be riskier and so the insurance cover is priced higher than medically underwritten products.

10.4.2 Non-Medical Underwriting conditions

Certain conditions for Non-medical underwriting are as follows:

- i. Imposition of some maximum limit on sum insured: For example, any proposal above five lakh sum insured will be subject to medical examination.
- ii. Entry age barrier may be imposed: for example the proposer below the age of 55 need not to undergo medical test.
- iii. Limitations for certain insurance plans: for example, anyone above 55 years of age has to undergo medical tests.
- iv. Restriction for certain insurance plans: for example the term insurance plan will not be given without medicals.
- v. Limitation in form of duration of cover like insurance maximum term may be limited to twenty five years /up to age 60 years of age.
- vi. Class of lives: Non-medical insurance may also be allowed to certain specific categories of individuals, for instance, non-medical special is provided to employees of reputed firms - having one year service. These companies have proper leave records and may also have periodic medical examinations so that the employee's medical status can be easily verified.



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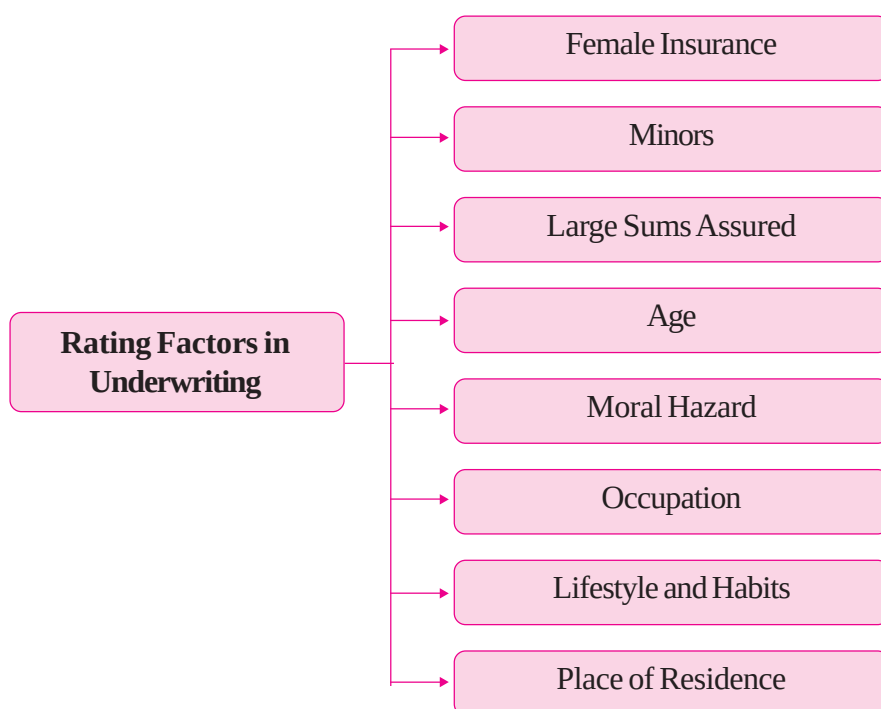
10.4.3 Rating Factors in Underwriting

Figure 10.2 Rating factors in Underwriting

Life Insurance



Notes

- a) **Female Insurance:** Although the longevity of women is greater than men but they may have some problem related to moral hazard. The other factor affecting longevity of women is pregnancy. The insurer may provide full insurance to women who are earning and can restrict the coverage on other categories of women. The insurability of women depends upon need for insurance and premium paying capacity. Likewise some restrictions or conditions may be imposed on pregnant women.

This presents a special challenge to the underwriter. When the services of housewives are not compensated financially its very difficult to arrive at the cover. If due care is not taken while giving life cover to non- working women then it can led to huge adverse claim experience. Generally small sums are granted if there is an equal cover on the husband's life.

The special consideration need requires for giving moderate or large covers to women are as follows:

- i) **Educational Background-** If the woman is educated then there is a good possibility of her being aware of the cover and the risk on her life.
- ii) **Insurance on other family members-** There can be higher chances of moral hazard if she is the only one insured in her family.
- iii) **Nature of Plan-** Whether the insurance policy requested by woman is Term Insurance or Investment type of plan it is important to look into reasons and needs for purchasing the policy. If reason for purchasing is saving then why she is taking cheapest form of insurance (term plan).

Generally an illiterate woman with very little or no earned income asking for high sum insured term plan is a high risk. An underwriter needs to understand the trends related to social or cultural aspects and trends related to the claim experience while granting insurance to women with no earned income.

- b) **Minors:** According to insurance contract a minor (a person less than 18 years of age) cannot enter into contract. A parent or legal guardian is required if minor enter into contract. As minor usually have no earned income, it is important to ascertain the need of insurance. From the point of risk perspective insurance taken on child's life does not make any sense. But in our country there is a huge demand for this segment.

The parents take moderate or large covers on their children life due to following reasons:

- ◆ As a targeted saving instrument



- ❖ To get insurance at low cost when the children enjoy good health and insurability
- ❖ In anticipation of their insurance needs as adults
- ❖ To pass on the wealth to the future generation

Three conditions would generally be sought when considering insurance for minors:

i. Whether they have a properly developed physique

Poor growth of physique can arise as 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

The underwriter has to be very vigilant while getting the proposal form on minor's life if child's parents are not insured. The underwriter will try to ascertain why insurance is not taken on parents' life.

- c) **Large Sums Assured:** The underwriter of an insurance company need to be very cautious if proposer is asking for higher sum insured policy relative to his/her annual income. Generally insurance company can put restriction to it like allowing sum insured 10-12 times of annual income of proposer. It can be adverse selection for the company if he/she ask very high sum insured.

Example : If the proposer annual income is Rs 10 lakhs per annum and he is asking for Rs 2 crore sum insured term insurance policy, the insurance underwriter need to be very vigilant as this proposal may be risky for insurance company. As this may indicate that proposer may be suffering from serious ailment or anticipation of suicide. Other reason may be ignorance or miss selling by insurance agent.

There would be higher premium if proposer opts for high sum insured policy. There can be question in the mind of underwriter regarding policy continuity by paying renewal payment regularly. Therefore it is advisable to limit the sum insured. For example premium payable is a maximum of say one third of an individual's annual income.

- d) **Age:** Mortality refers to a fatal outcome or death. The number of deaths in a given population is the mortality or death rate. Age is closely related to mortality risk. As the age advances the mortality risk also increases. When looking at insurance for persons who are of senior ages, the underwriter must be cautious.

Life Insurance



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For example- If a person is taking insurance at the age of 55 years for the first time the underwriter will definitely enquire about the need for taking insurance at higher age for the first time and this is suspected to have moral hazard for the first instance.

Generally, as the age advances there is more chances of occurrence of some specific disease like heart disease, kidney disease etc. The insurer may ask some special medical reports like Chest X Ray, HbA1c, ECG etc, if a person of advance age is opting for higher sum insured. These medical tests will tell more about the health of the life proposed as compared to the ordinary medical test conducted or answers given by proposer in proposal form.

Age is very important aspect for underwriting. Valid age proofs may be standard or non-standard.

Standard Age Proofs

Some documents considered as standard and non- standard age proofs are:

Valid age proofs

Standard age proof

- School or college certificate
- passport
- PAN card
- Service register
- Certificate of baptism
- Certified extract from a family bible if it contains the date of birth
- Identity card in case of defence personnel
- marriage certificate issued by a Roman Catholic church

Non-standard age proof

- Horoscope Ration card
- Ration card
- An affidavit by way of self-declaration
- Certificate from village panchayat

Figure 10.3 Valid age proof (Standard and non- standard age proof)

If the proposer has no standard age proofs, then insurer may consider non- standard age proof. The insurers may impose some restrictions on submission of non- standard age proofs like restriction of sum insured, insurance plan etc.

e) Moral Hazard

Dishonesty or character defects in an individual that increase the frequency or severity of loss. For example- a dishonest person would like to do fraud with insurance company to get insurance claim which he is not entitled to.

Moral hazard cannot be assessed or measured, it is judged entirely on circumstantial evidence such as lifestyle and reputation for integrity etc. This is a risk for which premium cannot be calculated for. The underwriter would not, under any circumstances, approve the proposal if moral hazard was suspected.

The insurer needs the agent's confidential report in order to evaluate the risk and viability of the insurance proposal. The report includes details about the proposer's financial situation and way of living. The report's objective is to give the underwriter additional details to help them evaluate the risk, particularly in light of any potential moral hazard.

f) Occupation

The factors evaluated for underwriting is nature of occupation. There are hazards related to nature of occupation called occupational hazard. These hazards are those that are attached to the job the person does. People working at great height or with high electric voltage equipment are more likely than those who don't to be victims of accidents. Many of the jobs at municipal and other local bodies are hazardous in the sense that the incumbents are susceptible to serious respiratory and other illnesses. Although these risks justify extra premium, the insurers may decide to waive the extra premium.

For example- Rajesh is suffering from asthma and is employed in cement factory. He would be assumed higher risk by underwriting team as compared to the person suffering from same disease but working as a faculty (teaching job) in university.

Sources of Occupational Hazards- It may arise due to three sources. They are as above:



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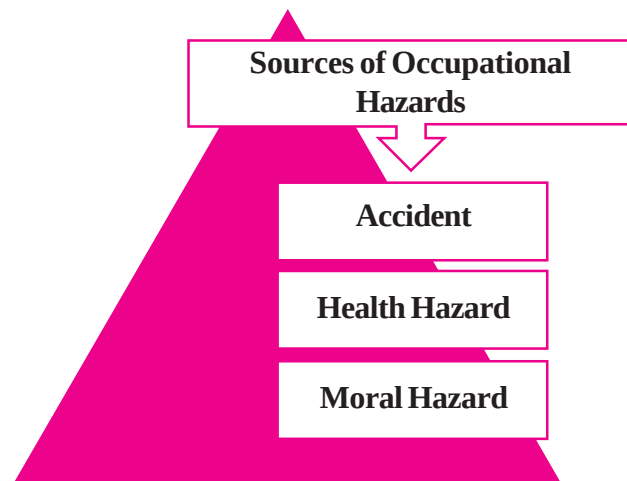


Figure 10.4 Sources of Occupational hazards

- i. **Accidental Hazards:** There are some specific jobs which are more prone for occurrence of accidents like people working in chemical and fire cracker factories, artists in film stunts etc.
- ii. **Health Hazards** there are some specific jobs which can raise the occurrence of medical impairment. Various examples of health hazards are as follows:

For example- a person working in chemical industry is exposed to certain chemicals either short or long term due to which he can develop skin related diseases, respiratory diseases, cancer etc.

For example- a person working in mines. The health problems related to physical work undertaken and the inhalation of dust causing pneumoconiosis.

 Lastly, the jobs where person sits on computer screen for long like BPO, KPO can affect certain body parts. A person working in noisy settings have high probability of ear and brain impairment.
- iii. **Moral Hazard** these types of hazard arise when job's proximity is towards drugs and alcohol or criminal elements. For example bodyguard of a businessman with suspected criminal links. Generally the proposer is asked to fill the occupational questionnaire related to job details, risk exposure and job profile whenever the applicant's occupation is listed in hazardous occupation. A flat extra (for example Rupees one per thousand sums insured) or loading (extra risk with extra premium) is charged for such kind of occupational risk. Such extra premium charged can be removed or reduced if insured's changes his occupation from risk to less risky one.



A higher premium is charged to compensate the additional risk that the life insured is exposed to as a result of their work, however restrictions are typically not enforced based on risky occupations. A career in aviation is one such example. In the event that the life insured passes away due to an accident while engaged in aviation, only passengers on commercial airlines are eligible for the double accident and disability payout. Some insurers demand that they be informed of a change in employment.

g) Lifestyle and Habits

This covers a wide range of applicant characteristics. If any lifestyle and habits characteristics are present in applicant then moral hazard report and agent confidential report are expected to mention it which suggest extra exposure to risk. Three important features are as follows:

- i. **Smoking and tobacco use habits:** As we all know that tobacco use in any form is very hazardous to health and life. This is led to many other kinds of medical risks also. The life insurance companies give discount to nonsmokers and on the other side charges extra premium from smokers. In proposal form if the applicant disclose that he/she is a smoker then addition question related to frequency (number of times consumption in a day) is asked.
- ii. **Alcohol:** If the alcohol is consumed in excess regularly for long time it affects the mortality rate. The digestive system and liver functioning is impaired if proposer is habitual of heavy drinking for longer term. This can also cause mental disorders. Small amounts of alcohol used on occasion pose no danger. In many nations, it actually plays a role in social life. It also leads to family abuse, accidents, suicides, violence and suicides.

If the proposer gives affirmative answer regarding alcohol consumption then underwriter ask addition question from her/him. The underwriter decision to accept or reject the proposal depends upon quantity, frequency of alcohol consumption and complications from alcohol drinking.

- iii. **Substance abuse:** The use of drugs or narcotics, sedatives and other similar stimulants comes under the substance abuse. The use of these substances indicates criminal disposition and moral hazard and some of these are illegal. On suspicion, the underwriter can call for addition test to check the substance abuse. Generally the proposal is declined for these type of cases.

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For example: Raj has a high risk hobby as bungee jumping, scuba diving. His proposal form will be accepted by charging higher premium. If the risk factors are too high, the proposal of that individual may be declined or rejected.

h) Place of residence: the factors evaluated for underwriting are

- Risk levels relating to the location where individual resides.
- Risk levels relating to the location to where the individual is travelling.

For example: Ramesh resides in a location where the medical infrastructure is poor, political instability exists, the crime rate in this location is high or this place is disease prone. This will be considered high risk by the underwriter of the insurance company. In this case the risk will be categorised as high risk and the proposal may either be rejected or accepted with modified terms.



INTEXT QUESTIONS 10.2

1. The moral hazard example is/are:
 - a) The person died due to electric shock.
 - b) A dishonest person want to inflate the claim amount due to fraudulent means
 - c) The policy lapses because the insured has not paid timely premium.
 - d) All the above
2. Which of the following circumstances will not impact a person's ability to obtain insurance?
 - a) Daily exercise
 - b) Banned substance abuse.
 - c) Chain Smoking
 - d) Alcohol consumption in large quantity
3. On the basis of non- medical underwriting, which proposal form of applicant is unlikely to be selected?
 - a) Saroj, working as assistant professor in government university, aged 25 years and has applied for money back policy of 15 year duration.
 - b) Mahi, aged 55 years, works in a chemical factory and has applied for a term insurance cover of Rs. 80 lakhs



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- c) Sahu, aged 25 years, working as underwriting manager in private insurance company and wants to take Rs 10 lakh sum insured term insurance plan.
- d) Mohit, who is working as a claim manager in life insurance company, aged 28 and applied for Rs 15 lakhs sum insured endowment policy.
4. Rajnish is an asthma patient who is employed in a cement factory as a supervisor. Which of the following risks he is exposed to?
- | | |
|------------------------------|----------------------|
| a) Physical risk | b) Financial risk |
| c) Lifestyle and habits risk | d) Occupational risk |
5. Which of the following is considered to be the greatest risk in the chemical industry?
- | | |
|------------------------|-------------------------------------|
| a) Combat injury | b) Type of equipment used |
| c) Heavy working hours | d) Contact with dangerous chemicals |
6. Which of the following is an example of a risk factor that is not associated with the residence of an individual?
- | | |
|-----------------------|-------------------------|
| a) Medical facilities | b) Infrastructure |
| c) Occupation | d) Political conditions |



WHAT YOU HAVE LEARNT

Medical Underwriting refers to the underwriting process where underwriters use health related information through a pre insurance medical screening of a prospect to take a decision regarding acceptance or rejection of the application, or the amount of insurance cover to be provided to the insured. There are some medical factors that would influence an Underwriter's decision like family history with respect to Heredity, Average longevity of the family, and Family environment; Personal history with respect to past illness; and Personal characteristics like build, blood pressure etc.

There are different sources of underwriting like Application form (Proposal form), Occupational/Avocation/Residential-supplementary questionnaire regarding this are asked in proposal form, Underwriting manuals, Internet, government data base, other relevant data, Medical examiner report, Standard income documents for salaried applicants, Agent's confidential report, etc.



Notes



TERMINAL QUESTIONS

1. What do you understand by medical underwriting? How is it different from Non-medical underwriting?
2. What are the factors that must be known to the insurer which may affect the decision of a medical underwriter?
3. What do you understand by non-medical underwriting? What are the certain conditions that need to be followed in case of non-medical underwriting?
4. What are the factors that must be known to the insurer which may affect the non-medical underwriting?
5. Study the factors which may affect the non-medical underwriting by collecting the information from 2-3 members of your family and ascertain the level of risk involved which is useful in non-medical underwriting.



ANSWERS TO INTEXT QUESTIONS

10.1

1. (c) Place of residence
2. (b) Some ailments may be transferred from parents to their children.
3. (d) All of the above

10.2

1. (b) A dishonest person wants to inflate the claim amount due to fraudulent means
2. (a) Daily exercise
3. (b) Mahi, aged 55 years, works in a chemical factory and has applied for a term insurance cover of Rs. 80 lakhs
5. (d) Occupational risk
6. (d) Contact with dangerous chemicals
7. (c) Occupation



LEARNING OUTCOMES

After studying this chapter, you are able :

- To understand the medical and non - medical underwriting process.

11

CLAIMS MANAGEMENT IN LIFE INSURANCE

**Notes**

11.0 INTRODUCTION

The purpose of any Life Insurance policy is to support the family in case of any loss due to any unfortunate event with the life of the insured. It is not easy for the family to bear the loss. In such a situation it is important that the members of the family should have the knowledge of the claim settlement process and the documents involved so to ensure the timely settlement of claims. You as an insurance agent or manager need to make them aware about the procedure for claim settlement at the time of buying the policy as well as at the time of claims. In this chapter you will study about the claim settlement procedure in life insurance as well as about the documents involved at the time of claims.

11.1 OBJECTIVES

After reading this lesson, you will be able to:

- Understand the meaning of a 'Life Insurance Claim'
- Classify the different types of 'Life Insurance Claim'
- Describe the Claim Settlement procedure in Life Insurance.
- Summarize the documents required in Life Insurance Claim.
- Explain the role of agent in the Claim Settlement procedure in Life Insurance.



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11.2 CONCEPT OF CLAIMS

The claim event is significant in insurance because the insurer have made promise at the proposal stage to cover the perils according to terms and condition of the policy. This is the right time or opportunity for insurer to fulfill their promises by paying claim.

Definition

An insurance claim is a request made to the insurer to execute its commitment in accordance with the terms and conditions of the policy.

A claim is the payment given by the insurer to the insured or claimant upon the occurrence of the event stated in the contract in exchange for the premiums paid by the insured, according to the definition provided by the insurance industry.

An insurer's crucial role is to pay a legitimate claim quickly and easily.

After checking the validity of life insurance claim as per the terms and condition of the policy the insurer approved it and pay to life assured in case of survival or maturity claims or pay to nominee or legal heir in case of insured death.

Example:

Rajesh buys a life insurance policy of Rs 25 lakhs to protect his family in case of his unfortunate death. He dies due to serious car accident leaving the family behind. His wife, who is the nominee under the policy, can claim the insurance amount from the insurance company.

An insurer is the insurance company selling the insurance policy.

An insured is a person or company purchasing the insurance company.

Premium is the amount paid by the policy holder to insurance company for assuming the risk.

11.3 TYPES OF CLAIM

Basically there are two main types of life insurance claims which comes to life insurer.

Claims can be of two types:

- a) Maturity claims
- b) 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.

The life insurance claim settlement depends upon various factors like evidence of insured event, nomination, nature of claim, etc.

11.3.1 Maturity Claim

The amount paid by the insurer at the completion of the plan's duration, assuming the life insured survives, is known as the maturity benefit or the maturity claim amount.

Maturity Claim = Sum Insured + Accumulated bonuses - any unpaid Premium (s) - any due interest

Example:

Ramesh paid a premium of Rs. 60,000 to get an endowment insurance policy worth Rs. 2,000,000 for 15 years. He might request a maturity claim in accordance with the policy's conditions if he survived to the maturity of the policy's term, which is 15 years.

The payout in maturity claim is easy because:

- i) No need to prove the occurrence of the event by policy holder.
- ii) Since the insured is still alive, proving title is not problematic; and
- iii) The insurer need not wait for the policyholder to submit a claim; instead, they can take the initiative to quickly resolve the issue.

Survival benefits: Benefits from the insured's survival up to a predetermined time throughout the policy term may give rise to claims. Money-back policies frequently provide such periodic payouts.

Benefits paid during the assurance period known as "Survival Benefits" under some types of insurance, such as money back plans, are included in maturity claims.

The insurance company servicing offices make the payments of the maturity and survival benefit claims. The servicing office initiates action in respect of both types of payments in advance of their due dates.

The below section will explain how maturity claims are handled for different types of policies.

- i. **Participating Plan:** If a person chooses this participating plan, the amount payable under a maturity claim is the sum insured plus accrued bonuses, less any obligations such as unpaid premiums and interest on policy loans.
- ii. **Return of Premium (RoP) Plan:** In case of some term plans, insurance companies return back the premiums to the life assured at the end of the tenure



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of the plan. In case of some RoP plans the insurance companies also pay some interest on the premium paid.

- iii. **Unit Linked Insurance Plan (ULIP):** The fund value is paid to the insured as maturity claim on the maturity of this plan. Some companies even pay the fund value and the sum assured on maturity.
- iv. **Money-back Plan:** Throughout the policy duration, periodic payments are given to the policy holder by the life insurer at predetermined time period. With each survival benefit instalment, the insurance policy is delivered back to the policyholder with an endorsement of the payments made.

If a person chooses this participating plan, the amount payable under a maturity claim is the sum insured plus accrued bonuses, less any obligations such as unpaid premiums and interest on policy loans.

Claim settlement requirements

The requirements for settling these claims are quite simple. Those are.

- i) Age proof documentary evidence, if age proof is not already admitted.
- ii) Original policy or duplicate, if issued, in lieu thereof along with deed or deed of assignment (if any)
- iii) A form of discharge for the maturity proceeds by the person entitled to receive the moneys. Discharge form should be duly stamped, signed and witnessed.
- iv) Document of assignment, in case of any assignment

The gross amount of the claim, any applicable deductions, and the net amount due are all listed on the discharge voucher. The basic sum assured or paid-up value, the bonus due, any surplus deposits present in the relevant policy account, and any returned excess premiums, if any, make up the gross amount in most cases.

There are various reasons to take proactive action in this area of operations:

- i) For ensuring good image of insurer speed of insurance claim settlement is important.
- ii) The main aim of insurer is to pay the maturity and survival claim timely on due dates to policy holder.
- iii) The insurer would have kept its promises if the policyholder received such payments on time, and he or she would be extremely grateful and satisfied.



- iv) By turning a portion or the entire amount of the claim into premium, this enables the field force to approach current policyholders about purchasing a new policy and to identify new prospects through happy policyholders.

If the policy document is misplaced then usually insurance company may settle policy holder claim on the basis of indemnity bond to be executed on a non-judicial stamp paper by insured. In case of survival benefit claim settlement the insurer issue duplicate insurance policy because the contract continues even after the payment of the survival benefits.

11.3.2 Death Claims

Death claims are payments made by insurer in the event that the insured passes away.

In this type of claim the sum insured or claim amount is paid to nominee (if registered) or assignee (if assignment is exercised by life assured) or legal heir depending on the situation at time of death claim. The life insurance contract ends after death claim due to death of life assured. The insurer pays the amount payable under a maturity claim is the sum insured plus accrued bonuses (if participating), less any obligations such as unpaid premiums and interest on policy loans.

There are two types of death claim:

- a) Early death claim (if death claim comes within 3 years of policy tenure)
- b) Non-early death claim (if death claim occurs after 3 years of policy tenure)

If death claim comes within 3 years of policy tenure (commencement or revival of life insurance policy), it is known as early death claim. They are also known as premature death claims.

Example

Raj had taken life insurance on 30th August 2016. He died of sickness on 28th March 2018. If Raj's heirs lodged a death claim with the insurance company on 2nd April 2018, it would be considered an early claim as the claim had arisen within two years of the date of commencement of the policy.

Example

On August 30, 2014, Ranjan purchased life insurance. He passed away on September 28, 2019, due to illness. If the Ranjan heirs filed a death claim with the life insurer on October 2, 2019, it would be regarded as a non-early claim because the claim had materialised more than two years after the policy's start date.

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Examining each document that the deceased person's heirs submit is necessary. By filing the required claim paperwork, the life insurance agent assists the deceased person's family nominee in receiving the policy payout.

The insurer must be intimated of the cause, date, and location of death by the nominee, assignee, or legal heir.

Throughout the policy duration, periodic payments are given to the policy holder by the life insurer at a predetermined time period. With each survival benefit instalment, the insurance policy is delivered back to the policyholder with an endorsement of the payments made.



INTEXT QUESTIONS 11.1

1. Identify which type of life insurance policy where periodic payments are given to the policy holder by the life insurer at predetermined time period
 - a) Term Insurance plan
 - b) ULIP
 - c) None of the above
 - d) Money back insurance plan
2. An early death claim means?
 - a) If insured, death claim comes within 3 years of policy tenure.
 - b) If insured, death claim comes within 8 years of policy tenure.
 - c) If insured, death claim comes within 5 years of policy tenure.
 - d) If insured, death claim comes within 1 years of policy tenure.
3. Who is entitled to the maturity claim?
 - a) Nominee
 - b) Assignee when there is no assignment registered
 - c) Policy holder himself if there is no assignment under the policy
 - d) Appointee



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11.4 CLAIM PROCEDURE FOR LIFE INSURANCE POLICY

1) Intimation of Death

The first step is to send an intimation of death to the branch office of the insurance company from where the policy was issued.

The intimation should be sent in writing by any of the below mentioned persons:

- ◆ The registered nominee
- ◆ The employer
- ◆ An insurance agent or the Development Officer
- ◆ The relative of the deceased policyholder

Sending a notice of death to the insurance company branch office where the policy was issued is the first step.

Any of the people listed below should send the notification in writing: The following details should be included in the letter of death notification:

- ◆ Name of the life assured
- ◆ A statement that the life assured is dead
- ◆ The date of the death
- ◆ The cause of death
- ◆ The place of death
- ◆ The relationship of the claimant with the assured
- ◆ The policy number
- ◆ Certificate of death issued by the Municipal authorities/ public record office that maintains these records.

The branch office verifies the status of the policy and sends the necessary claim forms along with instructions regarding the procedure to be followed and requirements to be met by the claimant as soon as it receives the notification of death and is satisfied with the authenticity of the notification.

2) Submission of Proof of Death

The proof of death is a certificate issued by the Municipal Death Registry or by a Public Record Office which maintains the records of births and deaths in the locality. Other statements or certificates are also required to be given in the prescribed claim form, such as:

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- ◆ A statement by the doctor who last treated the deceased
- ◆ A certificate by the hospital where the policyholder died
- ◆ A certificate from the employer where the policyholder last worked
- ◆ A certificate of cremation or burial (this is generally called in early claim cases)

3) Submission of Age Proof

If the insured's age was not previously verified, the claimant must do so. Most people see the following documents as being valid age proof:

- ◆ Birth Certificate
- ◆ School Certificate
- ◆ Certificate relating to baptism ceremony among Christians
- ◆ Passport (which is within validity period)

4) Proof of Title of the Claimant

No proof of title is required if the policy has been properly assigned or the nomination is still in effect at the time of death. The claimant must present convincing proof of title to the decedent's estate from the appropriate authority if there is no legitimate nomination or assignment.

The Administrator General or a court may have the authority, and they should be able to:

- ◆ A succession certificate; or
- ◆ Letters of administrator; or
- ◆ Letter of probate; or
- ◆ A registered will

5) Payment of the Policy

The insurer issues a discharge form for completion that needs to be signed by the person who is eligible to collect policy money once all the formalities are finished. Such a person might be.

- ◆ the nominee, if nomination was made under the policy
- ◆ the assignee, if the policy was assigned
- ◆ the legal representative or successor



Notes

According to IRDAI regulations,

- i. "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.
- ii. A claim under a life policy shall be paid or be disputed giving all the relevant reasons, within 30 days from the date of receipt of all relevant papers and clarifications required. However, where the circumstances of a claim warrant an investigation in the opinion of the insurance company, it shall initiate and complete such investigation at the earliest. Where in the opinion of the insurance company the circumstances of a claim warrant an investigation, it shall initiate and complete such investigation at the earliest, in any case not later than 6 months from the time of lodging the claim.
- iii. Subject to the provisions of Section 47 of the Act, where a claim is ready for payment but the payment cannot be made due to any reasons of a proper identification of the payee, the life insurer shall hold the amount for the benefit of the payee and such an amount 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).
- iv. 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."

11.5 FORMS TO BE SUBMITTED FOR DEATH CLAIM

The nominee must submit the following forms to the insurer for life insurance death claims processing:

- Claim form.
- Insurance Policy Document
- Certificate of cremation or burial
- Statement by the doctor who last treated the deceased.
- Statement by the hospital where the policyholder died.
- Statement by the employer about the leave, if any, taken by the life assured on the ground of sickness.

Life Insurance



Notes

- Certified court copies of police report like First Information Report (FIR), Inquest Report, Post-Mortem Report, final Report which are required in case of death by accident.

- Death certificate issued by municipal authorities etc. as proof of death.

Documents required in case of early claims:

- Policy document
- Discharge voucher
- Assignment deed (if any)
- Age proof document (if age is not admitted)
- Proof of title of claimant
- Statement by the doctor who last treated the deceased
- Statement by the hospital where the policyholder died
- Statement by the employer about the leave, if any, taken by the life assured on the ground of sickness.
- Certificate of cremation or burial

Documents required in case of non- early claims:

- Policy document
- Discharge voucher duly completed, signed and witnessed
- Assignment deed (if any)
- Age proof document (if age is not admitted)
- Proof of title of claimant
- Claimant's statement giving details of cause of death, nature of illness suffered, treatment, cremation, etc.
- Original death certificate

Repudiation of death claim:

If the proposer gives incorrect statement and suppression of material facts related to policy, the contract comes to end and becomes void. The death claim can be repudiated if it is found by claims department while processing the death claim and all the benefit under the life insurance policy will be forfeited.



Section 45: Indisputability Clause

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

"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".

Claim Concession:

In the strictest manner, if the premium is not paid, the insurance expires, and no additional payments are required. Therefore, no claim for an insurance that has lapsed can be considered.

However, insurers do adopt a liberal and compassionate stance in certain situations. For instance, the LIC of India offers the following benefits or concessions:

- **Claim Concession:** If a death claim arises under a policy within six months of the first unpaid premium and at least three full years' worth of premiums have been paid, the claim is fully settled as if the policy had been in full force.
- **Extended Claim Concession:** In a similar manner, if a policy's minimum five complete years' worth of premiums are paid, the subsequent premium is left unpaid, and a death claim arises within a year of the first unpaid premium, the claim will be fully settled as if the policy had continued to be in effect.

Note: In the two instances mentioned above, the policy money will be paid after deducting any past-due premiums with interest and any premiums that remain due till the policy's next anniversary.

Presumption of Death:

According to Indian Evidence Act "When someone is reported missing, the claimant should be informed that the life insured will be considered dead after seven years or upon submission of a court order, whichever comes first. In the meanwhile, the policy must be kept in force by making regular premium payments."

Example:

If the insured individual has been reported missing for some time and a maturity claim is made, the claim will remain a maturity claim and not a death claim until the death is established. However, since the insured person holds the title, it will be necessary to provide evidence of death before any other party, such as an heir, can receive the policy income. The process will be the same as when death is assumed.

Life Insurance



Notes

If circumstantial evidence is provided showing that the life assured would not have survived a fatal accident or hazard, the insurance company may take into account paying the claim in the event of supposed death, even within 7 years.

In some instances, the payment is provided in reliance on an indemnity bond to safeguard the insurer's interests in the event that the presumption of death is discovered to be false.

Role of an agent:

An agent must provide the nominee, legal heir, or beneficiary with every assistance in appropriately filling out and submitting claim papers to the insurance company office. In addition to fulfilling duties, this generates goodwill because the agent has a good chance of getting future business or referrals from the deceased's family.

11.6 INSURANCE RIDERS

With a standard insurance policy, riders offer extra insurance protection. A rider is an optional extra benefit that can be added to a standard insurance plan. This is an added benefit that comes with the basic coverage for an additional cost. The sum insured for rider is always less than the sum insured of basic insurance. The several types of riders that insurance companies provide are helpful in boosting insurance coverage by raising the base policy's premium.

The advantage of taking rider is that extra benefit or cover can be taken at less premium with base insurance policy.

The features of Insurance Riders are as follows-

- Riders are optional cover and not compulsory to purchase with base policy.
- To avail this rider benefit insured need to pay extra premium. Extra benefit with extra premium.
- Making them handy for financial advantages should some unpleasant occurrences occur.
- No single rider will have a premium that is greater than the base premium of the chosen policy.

There are many different kinds of riders, but we'll focus on two essential ones here:

- Accident Death Benefit (ADB)
- Permanent Disability Benefit



Notes

Accident Death Benefit (ADB) Rider

Accidents occur randomly, but they are always a possibility. Accidental death is regrettable since it happens without warning. The deceased's family members are in a serious financial difficulty. Accident Death Benefit Rider is helpful in these circumstances. This benefit has a low premium. Accident can refer to any sudden, unexpected incident that has violent outward force and results in bodily injury or death. It need not be a road accident.

For example- Accident include snake bite, death in the swimming pool/ river/ sea, death due to lightening, electric shock etc.

Permanent Disability Benefit

In the event of a handicap, the insured are unable to support themselves financially. The insured person becomes totally dependent or a burden on family members. Benefits for permanent disability are helpful in these circumstances. It is neither a claim for death nor a claim for maturity.

For Example-

Rajan met with a fatal accident which led to the disability and hampered his daily working life. Due to this cover, he received monetary aid in lieu of his disability. Although unable to work, Rajan was nevertheless able to maintain himself and his family thanks to the necessary aid from disability insurance.

11.7 SURRENDER OF INSURANCE POLICY

Before it matures, a life insurance policy can be withdrawn; this is known as surrendering the policy. The term "surrender value" or "cash value" refers to the sum that will be paid to the policyholder after the insurance policy is surrendered. A insured may choose to surrender his policy and withdraw the benefits in times of financial emergency, provided that certain conditions specified in the policy are met. In general, insurers provide thorough information on the surrender value for various years during the policy's duration. For three years, the insured must pay premiums in order to get the surrender value benefit.

Features of Surrender:

- The surrender value is usually given as a percentage of the paid-up value, or the premiums paid.
- The surrender value factor increases with increasing insurance duration. It is independent of the mode of premium or the actual premium.



Notes

Example:

The surrender value of a certain policy after 15 years will be more than of the same policy after 10 years.



INTEXT QUESTIONS 11.2

1. Which claim needs submission of proof of death?
 - a) Maturity Claim
 - b) Survival benefit payment
 - c) Death Claim
 - d) None of the above.
2. In claim settlement cases, in how many months should the investigation be completed?
 - a) 3 months
 - b) 6 months
 - c) 9 months
 - d) None of the above
3. Once all the requirements are completed, how much time should an insurance company take to settle the claim?
 - a) 60 days
 - b) 30 days
 - c) 120 days
 - d) None of the above
4. Praveen died in a car accident. The beneficiary submits documents for death claim. Which of the below document is an additional document required to be submitted in case of accidental death as compared to natural death.
 - a) Certificate of burial or cremation
 - b) Treating physician's certificate
 - c) Employer's certificate
 - d) Inquest Report



5. Based on classification of claims (early or non-early), pick the odd one out?
 - a) Ramya dies after 6 months of buying a term insurance plan
 - b) Manoj dies after one and half years of buying a term insurance plan
 - c) David dies after two and half years of buying a term insurance plan
 - d) Pravin dies after five and half years of buying a term insurance plan
6. Given below is a list of documents to be submitted for a normal death claim by all beneficiaries in the event of death of life insured. Pick the odd one out which is additionally required to be submitted only in case of death by accident.
 - a) Inquest report
 - b) Claim form
 - c) Certificate of burial or cremation
 - d) Hospital's certificate
7. What type of claim is investigated before a pay out?
 - a) Maturity claims
 - b) Early Claims
 - c) Non Early claims
 - d) Survival Benefit payment
8. As per the Evidence Act, after how many years will a missing person be presumed dead?
 - a) Two Years
 - b) Five Years
 - c) Seven Years
 - d) Ten Years
9. The extra benefit with the basic policy by paying extra premium is
 - a) Rider
 - b) Loading
 - c) Excess
 - d) Deductible



Notes



WHAT YOU HAVE LEARNT

A claim is the payment made by the insurance company to the policy holder or claimant on the occurrence of the event specified in the contract, in return for the premiums paid for the insured. Basically, there are two main types of life insurance claims which come to life insurers. a) Maturity claims- The maturity benefit or the maturity claim amount is the amount paid by the insurance company at the end of the tenure of the plan, provided the life assured survives. b) Death claim- The payment of sum assured amount in case the insured dies. There are certain Claim settlement requirements which you have to follow at the time of claims. For the settlement of the claim the first step is to send an intimation of death to the branch office of the insurance company from where the policy was issued. Age Proof, Proof of Death and Proof of Title of the claimant are to be submitted. When all the formalities are completed, the insurance company issues a discharge form for completion which is to be signed by the person entitled to receive policy money. An agent must provide the nominee, legal heir, or beneficiary with every assistance in appropriately filling out and submitting claim papers to the insurance company office. Before it matures, a life insurance policy can be withdrawn; this is known as surrendering the policy. The term "surrender value" or "cash value" refers to the sum that will be paid to the policyholder after the insurance policy is surrendered. The surrender value is usually given as a percentage of the paid-up value, or the premiums paid. The surrender value factor increases with increasing insurance duration.



TERMINAL QUESTIONS

1. Compare the claim settlement ratios of different Life Insurance companies and highlight the top 5 companies on the basis of their claim settlement ratios.
2. Rajesh has bought a life insurance policy with a disability benefit rider. He has made absolute assignment of the policy in favor of Kamran. Rajesh met with an accident resulting in disability and there is a claim of Rs. 50,000 under the accident benefit rider. To whom will the payment be made in this case?
3. Discuss the following: a) Claim concession b) Accident and disability benefit
4. Differentiate between early and non-early claim.
5. Write the documents required for life insurance death claim.

6. Explain the documents required for life insurance maturity claim.
7. What is the role of insurance agent in life claim?
8. Explain the procedure to be followed in case of death claim.
9. Define claim. Explain the classification of life insurance claim.

**ANSWERS TO INTEXT QUESTIONS****Notes****11.1**

1. (d) Money-back insurance policy
2. (a) If insured, death claim comes within 3 years of policy tenure.
3. (c) Policy holder himself if there is no assignment under the policy

11.2

1. (c) Death Claim
2. (b) 6 months
3. (b) 30 days
4. (d) Inquest Report
5. (d) Pravin dies after five and half years of buying a term insurance plan
6. (a) Inquest report
7. (b) Early Claims
8. (c) Seven Years
9. (a) Rider



Notes



LEARNING OUTCOMES

After studying this chapter, you are able :

- To explain the Claim Settlement procedure in Life Insurance to the client and summarize the documents required in Life Insurance Claim.
- To execute the role of agent in the Claim Settlement procedure in Life Insurance.



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