IC 02

PRACTICE OF LIFE INSURANCE

Acknowledgement
This course is based on the revised syllabus has been prepared with the assistance of

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We also acknowledge GTG, Pune for their contribution in preparing the study material.

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There has been a steady increase in the awareness of life insurance over the last few years. It is extremely important that life insurance is given top priority and not seen as an instrument of investment alone but an important tool for building protection for the family. Experience shows that due to the inherent lack of knowledge of life insurance and its features, it has often been dismissed from being discussed and its importance undermined.

In an attempt to spread knowledge and awareness of life insurance early on, this book on Practice of Life Insurance has been revised and which we believe, would come in very handy to those associated in various fields in life insurance. It has been written specifically for the benefit of students appearing for the Licentiate examination. The topics are covered in a lucid style to provide a framework for understanding the concepts of practice of life assurance, in a simplified manner and to make the learning experience, an enjoyable one. In order to make the subject easy to assimilate, this book also uses realistic examples, diagrams, tables and case-studies to help students get a better and complete understanding on each of the topics therein.

This book aims at giving a clear emphasis on the key points in the field of life insurance, and to facilitate learning and ensuring a thorough understanding of the subject and is based on rigorous and current research.
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CHAPTER 1

LIFE INSURANCE ORGANISATION

Chapter Introduction

This chapter discusses how life insurance evolved; its organisational structure and functions. You will also learn about the appointment of life insurance agents, their duties and their remuneration. The chapter also takes you through the corridors of insurance history and acquaints you with the fascinating growth of this industry in India.

Learning Outcomes

- Overview of the Indian insurance market.
- Discuss about the activities and organisational structure of a life insurance company.
- Learn about the appointment of life insurance agents and their functions.
- Know about the remuneration to agents and continuation of agency.
- Discuss the trends in life insurance distribution channel.
1. Overview of the Indian insurance market.

[Learning Outcome a]

Life insurance is commonly referred to as life assurance.

**Definition**

Section 2(11) of the Insurance Act, 1938 defines life insurance business as follows: “Life Insurance Business” is the business of effecting contracts of insurance upon human life, including any contract whereby the payment of money is assured on death (except death by accident only) or the happening of any contingency dependant on human life and any contract which is subject to the payment of premiums for a term dependant on human life.

1.1 Growth of Insurance business in India

The growth of insurance business in India started with the enactment of the Insurance Act, 1938.

**Postal Life Insurance (PLI)**

The PLI came into being on 1st February 1884, exclusively for the benefit of the employees of the postal department. It was extended to the employees of the telegraph department in 1988. After independence, the scheme was extended to cover the employees of the Central and State governments, local bodies, municipalities, the Reserve Bank of India, nationalised banks, public sector undertakings, port trusts, universities and government aided educational institutions, councils of scientific and industrial research, railways and defence services. The scheme was made available to the general public in rural areas with effect from 24 March 1995 and was called Rural PLI.

**Life Insurance Corporation of India (LIC)**

In 1956, the life insurance business in India was nationalised and the Life Insurance Corporation of India (LIC) was formed on 1st September 1956. The entire life insurance business, which was in the hands of Indian companies, branches of foreign companies and some provident societies were transferred to LIC. The Postal Life Insurance (PLI) and the insurance departments of some States were not merged with the LIC.
Further Changes

Until 1999, LIC had the exclusive right over life insurance business in India. In 1999, relevant laws were amended and the life insurance sector was opened up for business to private players.

In 2010, there are 23 life insurance companies transacting life insurance business in India

1.2 Liberalisation of the Indian insurance sector

Insurance in India is governed by the Insurance Act, 1938 as amended from time to time. It lays down the rules and regulations for the insurance industry. The Insurance Regulatory and Development Authority (IRDA) Act was enacted in 1999. IRDA is the regulator for insurance business in India.

In the year 2000, the insurance sector was liberalised and opened up for business to the private sector. Foreign Direct Investment (FDI) was allowed in insurance up to 26%, wherein the foreign players were allowed to enter into joint ventures with domestic players.

Lot of domestic players joined hands with foreign partners who brought in valuable expertise and capital.

Opening up of the insurance sector has led to emergence of innovative insurance products and has also helped in deeper penetration of insurance.

Liberalisation brought in the much needed competition and better customer service.
1.3 List of private life insurance companies operating in India

The following are the existing life insurance companies (other than LIC) that are currently operating in India:

<table>
<thead>
<tr>
<th>Company Name</th>
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<tbody>
<tr>
<td>Bajaj Allianz Life Insurance Co. Ltd</td>
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<tr>
<td>Birla Sun Life Insurance Co. Ltd</td>
</tr>
<tr>
<td>HDFC Life Insurance Co. Ltd</td>
</tr>
<tr>
<td>ICICI Prudential Life Insurance Co. Ltd</td>
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<tr>
<td>ING Vysya Life Insurance Co. Ltd</td>
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<tr>
<td>Max New York Life insurance Co Ltd</td>
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<tr>
<td>Met Life India Insurance Co Ltd</td>
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<tr>
<td>Kotak Mahindra Old Mutual Life Insurance Co. Ltd</td>
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<tr>
<td>SBI Life Insurance Co. Ltd</td>
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<td>Tata AIG Life Insurance Co. Ltd</td>
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<tr>
<td>Reliance Life Insurance Co. Ltd</td>
</tr>
<tr>
<td>Aviva Life Insurance Co Ltd</td>
</tr>
<tr>
<td>Sahara India Life Insurance Co. Ltd</td>
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<tr>
<td>Shriram Life Insurance Co. Ltd</td>
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<tr>
<td>Bharti AXA Life Insurance Co. Ltd</td>
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<tr>
<td>Future Generali Life Insurance Co Ltd</td>
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<tr>
<td>IDBI Federal Life insurance Co. Ltd</td>
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<tr>
<td>AEGON Religare Life Insurance Co. Ltd</td>
</tr>
<tr>
<td>D.L.F. Pramerica Life insurance Co. Ltd</td>
</tr>
<tr>
<td>Star Union Dai-ichi Life Insurance Co.Ltd</td>
</tr>
<tr>
<td>India First Life Insurance Co. Ltd</td>
</tr>
</tbody>
</table>

Learn about the activities and organisational structure of a life insurance company.

[Learning Outcome b]

The two primary objectives of life insurance companies are:

To spread life insurance widely with a view to reaching all insurable persons in the country and providing them adequate financial cover against death, at a reasonable cost.
In order to clear the road blocks in the expansion of insurance coverage among low-income segments, the IRDA has issued Micro-Insurance Regulations 2005. The aim of these regulations is to spread life insurance widely among the poor and the lower-segment people in the country.

To maximize mobilisation of people’s savings by making insurance-linked savings adequately attractive.

Rajiv has taken a life insurance policy of Rs. 12 lakhs for 20 years at a premium of Rs. 50,000 per year. He can easily save Rs. 50,000 each year to pay as premium and get Rs. 12 lakhs after 20 years or his heirs can get the money after his death during the term of policy. It is certainly easier for him to save a small amount every year and get a lump sum at the end of 20 years, than saving Rs. 12 lakhs himself. Hence, life insurance helps to mobilise his savings so that he can get the maximum amount at a later date.

2.1 Activities of the life insurance company
The essential activities of a life insurance company are:

a) Obtaining applications or proposals from prospective buyers

Example
Arun is a government officer. He is going to retire after 10 years. The greatest risk he faces after retirement is the lack of income or reduced earning capacity. MNO Life Insurance Company approached Arun with different insurance plans. Arun applied for Annuity (Pension) Plan and chose the option of getting pension during his lifetime. Arun filled up the proposal form and furnished all material information required by MNO Company.

Examining and making decisions on the proposals for insurance is called underwriting. Underwriting means analysing selection and classifying of risk by assessing the economic, physical, medical and social status of a person while accepting the risk for their life.
Vishal was appointed as the underwriting officer of MNO Life Insurance Co. Ltd. His duty was to give the proposal a detailed consideration from all angles and decide whether the risk is to be accepted at the standard rate or a higher rate of premium and the overall terms of acceptance of risk depending upon the risk involved.

Issuing the insurance **policy document**, incorporating the terms and conditions of the insurance cover (insurance policy is a document that serves as an evidence of the insurance contract between the insurance company and the policy-holder.It conveys the details of the risk coverage of the company).

In Arun’s example above, MNO Insurance Company assessed and reviewed Arun’s economic, physical and medical and social status. After being satisfied, the company issued the policy document that set out the terms and conditions of the contract.

Keeping sight of conditions of the insurance contract by either party e.g. timely payment of premium by the policy-holder and timely payment of benefits as per the policy conditions by the insurance company.

Continuing with the same example, MNO Insurance Company kept sight of the terms of the contract and made timely survival benefit payment to Arun in return for the timely payment of premium made by him.

Attending to various requirements such as nominations, assignments, surrenders, payment of claims, alteration of terms and conditions during the term of policy.

Neeraj is married to Kalyani and has two kids. He holds an insurance policy. He nominated his wife in his insurance policy. This is essential to avoid any dispute over the claim of insurance policy money after his death. By nominating his wife, he made it clear that he wanted his wife to get the insurance policy moneys in case of his death.
Other important activities such as compliance with laws and regulations investment of funds, maintenance of accounts, management of personnel etc.

### Example

The Head Office of LIC is responsible for looking after extraordinary activities such as judicious option of investment of funds, maintenance of accounts etc.

#### 2.2 Organisational structure of the Life Insurance Corporation of India (LIC)

**Meaning of Organisation and organising**

**a) Organisation**

### Definition

An organisation is a legal entity which is created for some activity or to achieve some purpose.

It is the foundation upon which the whole structure of management is built.
In other words, it is a structure controlled by a group of individuals who are working towards a common goal.

### Example

A company is the most common form of organisation as it is owned by a group of shareholders, who have contributed to the capital of the company. These shareholders have come together for the purpose of achieving maximum profit. The total capital is divided into small units called shares which are paid for by the shareholders.

An organisation is called a legal entity as it is lawfully authorised to enter into contracts, sue and be sued in courts. An organisation has a separate status and identity, and is considered to be a person in the eyes of the law. As a person, it can collect wealth and do business. Like a person, it can think, grow and occupy space. An organisation’s learning is the learning of its employees. When this learning is recorded in the files of the organisation, and becomes available to the other employees, the organisation is said to have learnt.
There are various forms of organisation. Companies, partnership firms, proprietorship concerns, cooperative societies and trusts are the forms of organisations that are registered under special laws. Life Insurance Corporation of India is an organization created by a special Act, namely the Insurance Act.

b) Organising

The word ‘organising’ refers to the arrangements made to enable the organisation to carry out its activities, which are necessary in the course of business. The main purpose behind organising is to ensure smooth functioning of the activities of an organisation. Organising is to set up different levels of offices or departments and sections, with distinct levels of responsibilities for supervision and to staff them with people having competence and authority to carry out the responsibilities.

Example

The different activities carried out in a house would be cooking, sleeping, bathing and cleaning. There are separate rooms for each of these activities. There are separate equipments in the rooms for the performance of these tasks. This is how a house is organised for it to function smoothly.

In the same way, in an organisation, decisions are made as to what activities have to be done, where and how. The way these activities are grouped leads to formation of offices, departments and sections. People have to be earmarked to do these activities. Responsibilities for results have to be assigned and the authority to take decisions has to be defined. When all these are clarified, there will be people occupying places in offices with clear authority and responsibility. An organisation is then said to be in order.

The structure of an organisation refers to this arrangement of departments and sections and the authorities and responsibilities vested in the various positions. The structure helps in stabilising processes and avoiding wasteful conflicts.

Organisational structure of the Life Insurance Corporation of India

The Life Insurance Corporation of India transacts business throughout India with a four tier structure. The chart below shows the organisational structure of the Life Insurance Corporation of India.
Diagram 1: Organisation of LIC of India

The following departments are likely to exist in an insurance office. These may be located in the branch office or in the Divisional / Head Offices and are determined by the activities they carry out, though they may be called by different names:

- **Business development or Agency or Marketing**, concerned with the development of agency force, market development and business growth
- **New business**, concerned with receiving, scrutinising and taking underwriting decisions on new proposals and also issuing policies
- **Policyholders’ servicing**, which would be concerned with administration of the policy, monitoring premium payments, lapses and revivals, attending to alterations, nominations, assignments, surrenders, loans and claims
- **Accounts**, that handles the financial aspects

The following departments are likely to be centralised in the Head Offices, as they require specialised skill and impact the whole organisation.

- **Actuarial**, studying the claims experience, doing valuations, declaring bonuses, monitoring the adequacy of premiums, developing new products, settling underwriting standards, studying mortality rates, etc.
Shirin was appointed as actuary in the Head Office of LIC in Mumbai. Her duty was to compile and analyse statistics in order to calculate insurance risks and premium.

- Investment of funds, studying and using the opportunities for maximising returns
- Planning, including marketing strategies and net distribution channels
- Legal, including compliances with IRDA requirements
- Advertisement, publicity and public relations

Departments such as personnel, HRD, training, purchases, administration for office upkeep etc. will be found in all offices.

Almost 90% of the activities relating to policyholders, from receipt of proposal to settlement of claims are handled at the branch offices in the Life Insurance Corporation. The other offices have supervisory and advisory functions.

### 2.3 Organisational structure of Postal Life Insurance

<table>
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<th>Description</th>
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<td>Chief General Manager</td>
<td>The person is the head of the Directorate and functions under the supervision and control of the Postal Services Board. The Postal Services Board is constituted by the Central Government to look after the activities of the Post and telegraphs department.</td>
</tr>
<tr>
<td>District Postal Head Officer</td>
<td>The person looks after all PLI operations in the district, including sales and payment of claims.</td>
</tr>
</tbody>
</table>

Premiums are collected by all post offices but final accounting is centralised at the office of the Director of Accounts in Calcutta.

### 2.4 Organisation Structure of Private Life Insurance Companies

The 23 private life insurance companies have started operations on various dates between 2001 and 2009. All of them operate only in India. In the initial stages, most of them started with a two-tier structure: head office and branch offices reporting to head office. As the business expanded, many of them have increased not only the number of offices, but also the tiers. Many of them have zonal and regional offices between the Head Office or Corporate Office and the branches. This has become necessary as the new companies have been expanding their network, opening more branch offices.
Test Yourself 1

Question 1
Which office of the LIC handles actuarial and investment functions?

- Central Office
- Zonal Office
- Divisional Office
- Branch Office

Learn about the appointment of life insurance agents and their functions.

[Learning Outcome c]

3.1 Introduction
Life Insurance in India today, is sold in more than one ways viz: Agents, Telemarketing, Internet sales, Brokers, Corporate agents etc. For some years now, there has been a rise in insurance telemarketing. Numerous insurance companies are engaged in providing insurance. They are very well trained in the art of ethical selling and customer service.

In simple language, an agent is one who acts on behalf of another. The person on whose behalf the agent acts is called the principal.

Example
The lawyer is the agent of the client when they argue a case in court.

Example
An ambassador is an agent of their country.

The persons who do the job of meeting, explaining and persuading potential customers are called insurance agents. They are the salesmen or intermediaries between the insurer and the public. Agents have to be licensed from the IRDA under the Insurance Act. A licensed agent can work with only one life insurer of their choice. Agents may be individuals or corporate bodies.
There is also a system of insurance brokers. They are independent and not attached with any particular insurer. A broker usually does business with more than one insurance company. An insurance broker is someone who represents more than one insurance company, unlike an insurance agent who represents only one insurance company. A broker is a mediator between the customer and the insurance companies, charging commission only from the insurer.

**Example**

Ram is a life insurance agent with XYZ Life Insurance Company. He met his client, Mrs Roy, and offered her various policies of XYZ Company, to suit her needs. Mrs Roy bought the endowment plan for 20 years from Ram. Later, she got her address changed through Ram on her policy records, as she had moved to a new home. This is how an agent brings in new business and provides services throughout the term.

Ajay, an insurance broker, offered his client, Mr Shaikh, term insurance policies of 10 different companies to choose the most suitable one. Mr Shaikh bought a 25 lakhs term plan of AAA Life Insurance Company. Ajay would get his commission from Company. He would also be able to provide service for Mr Shaikh’s policy with AAA Company as and when needed.

In this chapter, the word ‘agent’ is used to refer to all salesmen, whether called an agent, corporate agent, bank, broker, insurance advisor, consultant or by any other name.

### 3.2 Need of an agent in insurance selling

Agents are essential for selling life insurance due to the following reasons:

- **Insurance is a concept that needs to be explained face to face.**
  - Personalised guidance can be given only when there is personal interaction between the agent and the customer.
  - The agent gets to meet the proposer personally. Therefore, the agent is in a position to provide valuable information such as details on personal styles, habits, family etc. which is important for risk evaluation and also helps to understand the special needs of the prospective customer.
  - The agent can explain to the customer how insurance is not just another investment avenue, but provides timely financial security as well.

- Each prospective buyer has special needs and requires specialised solutions.
  - Personalised guidance can be given only when there is a live interaction with the agent.
Example

Atul wishes to buy a life insurance policy. He doesn’t know whom to approach. He logs on to the website of an insurance company, but still cannot understand which product (policy) would be suitable for him. So, he goes to his friend for help. His friend sends an insurance agent, Lalit to him. Lalit tells Atul about the different insurance products available, along with a recommendation of which one would be good for him and also clears all his doubts. This is how Lalit, an insurance agent, acts as an intermediary between Atul, the proposer and the insurer.

The Life Insurance Corporation of India has more than 13 lakh agents on its rolls. Some of them are full time while some work part time. The other companies are also steadily adding to their agent base. The Postal Life Insurance appoints unemployed youth and extra departmental branch postmasters to procure business under the Rural PLI. Retired employees of the Posts and Telegraphs department and of the Railways are employed as Field Officers, on commission basis to get business.

3.3 Appointment of agents

Diagram 2: To be appointed as an agent, one should fulfil the following conditions:
Deepak aspires to be an insurance agent. He is 20 years old, intelligent and an honest man. He approaches the Development Officer of the LIC. It is the duty of the Development Officer to recruit and train suitable persons as agents. The Development Officer finds Deepak suitable to become an insurance agent because:

- He is not a minor.
- He is not a person of unsound mind.
- He is not guilty of any criminal breach of trust.
- He fulfils all the criteria mentioned in the diagram above.

However, the Development Officer tells Deepak that he needs to undergo practical training for at least 50 hours from an institution approved by the IRDA and also pass the pre-recruitment exams conducted by any examination body recognised by the IRDA.

The prospective candidates would have to give their particulars in a format called the application form and subject themselves to a written test, prescribed by the IRDA and also a personal interview. The prospective candidates can be found through:

- press advertisements
- reference from other agents, staff, clients
- visit to college campuses
- employment agencies
- members of staff

It is not just individuals who can become agents. Companies, firms, banks, cooperative societies etc. can also become agents. These will have to designate one or more persons as ‘Corporate Insurance Executives’, who will be required to obtain licences like individual agents. Other members or employees of the organisation can also work for the corporate agent and they are called ‘specified persons’. They also need to obtain certificates.

In LIC, there are supervisory level employees between the agent and the branch office. They are called Development Officers. They are regular salaried employees and their duty is to recruit and train suitable persons as agents. These intermediaries can also be called Agency Supervisors, Agency Managers etc.

Besides agents appointed by Development Officers, there are Direct Agents and Career Agents. Direct Agents are senior experienced agents, who work independently and report directly to the Branch Manager. Career Agents are selected by the LIC directly on the basis of tests and interviews and are later given extensive training.
3.4 Functions of the agent
The major function of the agent is to solicit and procure life insurance business for
the insurer, who has appointed him as an agent. The regulations framed by the IRDA
lay down a code of conduct, which says that the agent shall:
- Identify himself and the insurance company of which he is an agent.
- Disclose the licence to the prospect on demand.
- Explain all available options to the prospect.
- Recommend a suitable plan taking into account the needs of the prospect.
- Explain the nature and importance of information asked for in the proposal
  form.
- Impress upon the prospect the need to disclose all material information
  truthfully.
- Make all enquiries about the prospect his/her family history, medical history,
special medical reports, admission of age etc.
- Inform the insurer about any material fact, e.g. habits, that could affect the
  underwriting decision.
- Inform the prospect about the acceptance or rejection of the policy.
- Ensure delivery of the policy to the insured.
- Advise policyholders to make nominations.
- Give assistance to policyholders and claimants in complying with the
  requirements.

Test Yourself 2

Question 2
What is the supervisory level between the agent and the Branch Office called?
- Specified Persons
- Development Officers
- Direct Agents
- Career Agents

Know about the remuneration to agents and continuation of agency.

Continuance of Agency
All insurers insist that a minimum amount of business must be done by an agent
in each agency year. The rules may vary from insurer to insurer.
The agency will be terminated in the following circumstances as required by the Regulation:

- Cancellation or non-renewal of license.
- Legal disqualification like permanent incapacity, conviction for criminal misappropriation, criminal breach of trust, cheating or forgery.
- Offering rebate of the whole or part of the commission.

### 4.1 Remuneration to agents

Agents may be remunerated in any of the following ways:

- payment of fixed monthly salary;
- payment of commission related to the business;
- part payment of fixed salary and part payment of commission based on business done

### 4.2 Commission to agents

Commission to agents is specified as a percentage of premiums paid. The percentage may differ from year to year and from product to product. Bonus commission may be payable on the first year premium as an incentive for higher performance. This could be a percentage of the eligible first year commission. The rates of percentage may increase as the amount of first year commission increases. Commission may be paid right through the term of the policy or may be paid only for a fixed number of years. Hence, every time a policyholder pays their instalment premium, the agent receives the commission.

In the Insurance Act, there is a provision whereby agents are entitled to receive commission for the rest of their lives and later, the heirs can receive the commission after the agent’s death:

- if the agents have worked for at least five years and at least business of Rs. 50,000 has been done one year prior to cessation of agency; or
- if they have worked for at least 10 years.

### 4.3 Term Insurance and Gratuity Benefits payable to agents of LIC of India

These rules may differ from one insurance company to another. Gratuity is the sum of money given to a person at the end of the term for services rendered.
Diagram 3: Gratuity benefits at the time of death of an LIC agent
(These rules may vary from one insurer to another)

In the case of “L.I.C.”, an agency year is the period from the date of the agent’s appointment to the end of the month in which they complete twelve months as agent and every successive period of twelve months thereafter.

4.4 Continuation of agency

All insurers insist that a minimum amount of business must be done by an agent in each agency year. (These rules may differ from one insurance company to another.)

Example

A number of insurance agents pay a part of their commission to the policyholders (called rebating) in order to increase their business. This is illegal and offering concession (rebates) to policyholders is not allowed as per section 41 of the Insurance Act 1938. This leads to cancellation of the agent’s licence. In addition, the agent has to pay penalty.
Question 3

In what circumstances will the agency be terminated?

- Non-renewal of licence
- Permanent incapacity
- Offering rebate
- All of the above

Discuss the trends in life insurance distribution channel.

Agency and brokerage systems are the most common and contribute the maximum share of life insurance business in developing countries and even developed countries. In India, the contribution from brokers is very little in the life insurance business. The Japanese Life Insurance industry depends mostly upon agents. Part-time agents and women agents form a good proportion of the agency force.

In European countries, notably France, Holland, Belgium and Spain distribution also takes place through banks (Bancassurance). Banks are being used extensively in India as “corporate agents” by almost all insurers. The advantage with banks is their extensive network in the interior parts of the country and the fact that customers of banks are the natural customers for insurance. Direct mailing is becoming increasingly popular in developed countries. In a small way, this has also started in India. The scope and the experience are being observed.

In India, life insurers are using banks as intermediaries. Some insurers depend heavily on business from banks as corporate agents. Some insurers resort to direct marketing, contacting prospects through telephones, direct mails and the internet. In the year 2008-2009, about 97% of business LIC came through individual agents. In the case of private insurers, individual agents contributed about 83%, with corporate agents and banks contributing about 8% each and the balance through other modes like web-portals or direct mailer business.
Test Yourself 4

Question 4
All insurers in India use extensively ___________ as corporate agents.

Agents
Banks
Brokers
None of the above

Summary

In the case of life insurance, the insurer agrees to pay the insured or their heirs, a certain sum of money on death or on the happening of an event dependent upon human life, in consideration of premiums paid by the assured.

In 1956, the life insurance business in India was nationalised and the Life Insurance Corporation of India (LIC) was formed on 1st September 1956.

In India, in the year 2000, the insurance sector was opened up to private players.

The primary objective of Life Insurance Companies is to spread life insurance widely and to maximise mobilisation of people’s savings.

The Life Insurance Corporation transacts business throughout India with a four tier structure.

Agents are essential for selling life insurance.

The major function of the agent is to solicit and procure life insurance business for the insurer.

Agents may be remunerated in terms of fixed monthly salary or commission as a percentage of premium paid.

All insurers insist that a minimum amount of business must be done by an agent in each agency year.

The agency may be terminated on non-fulfilment of the minimum business requirements.

Answers to Test Yourself

Answer to TY 1

The correct answer is A.

Actuarial and investment functions are usually handled at the Central Office.
Answer to TY 2
The correct answer is B.
The supervisory level between the agent and the branch office is Development Officers.

Answer to TY 3
The correct answer is D.
An agency can be terminated in the case of permanent incapacity, non-renewal of licence or offering rebates.
The correct answer is B.
Banks are being used extensively in India as corporate agents by almost all insurers.

Self-Examination Questions

Question 1
Which of the following is not a private life insurance company?
A. Oriental life Insurance Company
B. Life Insurance Corporation of India
C. Birla Life Insurance Co. ltd
D. Reliance Life Insurance Co. Ltd

Question 2
The main objectives of life insurance are:
A. Risk covering
   Savings
   Economic protection for old age and some untoward happenings
   All of the above

Question 3
Why are insurance agents required?
A. To get insurance commission
B. To give personalised guidance to the prospect
C. To collect all relevant and material information from the prospect
D. B and C
Question 4
In case of LIC, to continue holding the agency for the next year, what is the minimum number of lives that the agent should insure?

A. There is no minimum requirement to retain agency
B. Twelve lives anytime throughout the year
C. Compulsorily one life every month
D. Twenty four lives anytime throughout the year

Question 5
The main function of an insurance agent is to ____________

A. Solicit and procure life insurance business
B. Offer rebate to policyholders
C. Act against the interests of the insurer
D. None of the above

Answers to Self Examination Questions

Answer to SEQ 1
The correct answer is B.
Life Insurance Corporation of India is not a private life insurance company.

Answer to SEQ 2
The correct answer is D.
The main objectives of life insurance are covering risk, savings and economic protection for old age and covering pre-defined happenings or events.

Answer to SEQ 3
The correct answer is D.
An insurance agent is required to give personalised guidance to the prospect and to collect all relevant and material information from the prospect.
**Answer to SEQ 4**

The correct answer is B.

The agent has to insure a minimum of twelve lives anytime throughout the year to retain his agency.

**Answer to SEQ 5**

The correct answer is A.

The main function of the insurance agent is to solicit and procure insurance business.
Chapter Introduction

Most insurance companies operate with the aim of earning profits and rewarding their policyholders and shareholders. The biggest worry for insurance companies is to maintain solvency i.e. income earned by the company should be enough to recover the cost of expenses and liabilities. If the income earned is more than the required amount to meet expenses and liabilities then the company is said to have earned profits.

The premiums charged are the prime source of income for the insurance company. An inadequate amount of premium collected can affect the entire operations of the business making it unviable. In this chapter we will try to understand the concept of premium and analyse the ways in which companies recover cost by arriving at appropriate premiums. We will also explore the concept of bonus and learn the difference between simple revisionary bonus and compound revisionary bonus.

### Learning Outcomes

- Understand the concept of premium.
- Analyse different types of premium.
- Determine the factors that are considered in calculation of premium.
- Understand the concept of bonus.
Look at this scenario

Nishant has been in a dilemma since the time he met one of his old friends. While discussing various aspects, they had a conversation regarding the various insurance policies that are available in the market. During the discussion, Nishant found out that his friend also had the same term insurance plan from ABC Company that he had bought 2 years ago. He is now 35 years old. His friend had purchased the policy about 10 years ago when he had joined his first job. He was 25 years old then. Nishant was surprised to find out that his friend was paying only Rs 3000 per month as the premium, while for the same policy, he was paying Rs 7,000.

Nishant couldn’t understand why there was a difference in the premium amount of the same plan by the same company. He had always looked at premiums as the cost of insurance plans. Has inflation resulted in change in premium of the plan in 8 years? Also can companies charge two different people two different premiums? On what basis does the company calculate the premium? These were some questions in Nishant’s mind.

This chapter aims to clear all doubts about premium: its types and the factors that go into its calculation.

1. Understand the concept of premium.  
   [Learning Outcome a]

What is premium?

Before addressing Nishant’s dilemma about premium, let us first a few things about an insurance plan. When an individual purchases an insurance plan, following things happen:

A contract is signed between the proposer and the insurance company.

In the contract the insurance company generally agrees to make a payment of sum assured along with bonuses, (if applicable) to the nominees, in case something happens to the insured or to pay the same to the policyholder, if he survives the specified term, if the client pays the appropriate premium within the stipulated time. The benefits payable differ from one product to another.

For the same, the insured (or proposer) agrees to pay a consideration (premium/s) to the insurance company as specified in the contract.
Diagram 1: Insurance contract in which insurer provides risk cover for a consideration (premium)

From the above we can conclude that premium refers to the amount (consideration) that the insured has to pay to the insurance company periodically for the insurance cover purchased. Premium can also be paid in a lump sum amount as a single premium.

An insurance company has mainly two source of income. (a) The first is premium amount collected from policyholders and (b) through the returns on investments made by the company. The funds for investment come from the premium collected. Hence the main source of income for the insurance company is the premium.

In this respect an insurance company has to calculate the premium amount very carefully. The premium should be sufficient enough to meet all the expenses of the company. The expenses include the payment that needs to be made in case of claims made by the insured (sum assured), administrative expenses and other infrastructure costs.

Basically the premium depends upon the sum assured and the type of insurance plan taken. Premiums can also be referred to as the cost of the insurance plan that is purchased by the individual.
Before moving further, let us first understand some of the important terms related to premiums that will be used in this chapter.

**Important terms defined:**

**Sum assured:** the insurance company signs a contract with the insured, where it promises to pay a certain amount to the beneficiaries of the policyholders in case the policyholder (insured) dies during the term of the policy or to the policyholder himself, if he survives the term of the policy. The amount is paid to the beneficiaries is also known as death benefit. This sum assured is the amount predetermined by the individual, based on his future liabilities and current income.

**Lapsed policy:** a default in the payment of premium can result in the cancellation of the policy. This is known as a lapsed policy. A certain grace period is provided by insurance companies to make the payment, if the policyholder fails to make the payment during this period the policy is considered to be lapsed.

**Age of the policyholder:** the correct age of the policyholder needs to be determined for calculating the premium. The general rule is “higher the age, higher will be the premium”. Age of the policyholder on the date of the commencement of the policy needs to be calculated by insurance companies. For calculating age by and large insurance companies consider only the number of years completed and ignores months and days. There are three methods using which the age of the policyholder can be determined:

**Age next birthday:** life insurance companies calculate premiums based on the age that an individual will achieve on his next birthday. In other words the age as on the birthday coming after the commencement of policy.

<table>
<thead>
<tr>
<th>Scenario 1</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Date of birth</strong></td>
<td>4th July 1982</td>
</tr>
<tr>
<td><strong>Date of commencement of the insurance plan.</strong></td>
<td>4th Dec 2010</td>
</tr>
<tr>
<td><strong>Age will be</strong></td>
<td>29 years</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Scenario 2</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Date of birth</strong></td>
<td>10 Oct 1976</td>
</tr>
<tr>
<td><strong>Date of commencement of the insurance plan.</strong></td>
<td>11th Aug 2010</td>
</tr>
<tr>
<td><strong>Age will be</strong></td>
<td>34 years</td>
</tr>
</tbody>
</table>
**Age last birthday:** this method is also known as actual age method. In this method insurance companies calculate age based on the last birthday. In other words the age is taken as on the birthday coming before the commencement of policy.

**Example**

**Scenario 1**

<table>
<thead>
<tr>
<th>Date of birth</th>
<th>4th July 1982</th>
</tr>
</thead>
<tbody>
<tr>
<td>Date of commencement of the insurance plan</td>
<td>4th Dec 2010</td>
</tr>
<tr>
<td>Age will be</td>
<td>28 years</td>
</tr>
</tbody>
</table>

**Scenario 2**

<table>
<thead>
<tr>
<th>Date of birth</th>
<th>10 Oct 1976</th>
</tr>
</thead>
<tbody>
<tr>
<td>Date of commencement of the insurance plan</td>
<td>11th Aug 2010</td>
</tr>
<tr>
<td>Age will be</td>
<td>33 years</td>
</tr>
</tbody>
</table>

**Age nearest (nearer) birthday:** In this method insurance companies calculate the age based on the nearest birthday, which could be either the last birthday or next birthday. In other words the age is taken as on the birthday within 6 months before or after the date of commencement of policy.

**Example**

**Scenario 1**

<table>
<thead>
<tr>
<th>Date of birth</th>
<th>4th July 1982</th>
</tr>
</thead>
<tbody>
<tr>
<td>Date of commencement of the insurance plan</td>
<td>4th Dec 2010</td>
</tr>
<tr>
<td>Age will be</td>
<td>28 years</td>
</tr>
</tbody>
</table>

**Scenario 2**

<table>
<thead>
<tr>
<th>Date of birth</th>
<th>10 Oct 1976</th>
</tr>
</thead>
<tbody>
<tr>
<td>Date of commencement of the insurance policy</td>
<td>11th Aug 2010</td>
</tr>
<tr>
<td>Age will be</td>
<td>34 years</td>
</tr>
</tbody>
</table>
Mortality table: mortality tables are also known as life tables or actuarial tables. Mortality tables are used by insurance companies for calculating premiums for insurance products. The mortality table contains the mortality rate for each age. The mortality experience for each plan is different. Mortality table is prepared by actuaries on the basis of past experiences.

A mortality rate is the probability that a person will die within the next one year. Based on this, insurance companies can calculate the probability that a person would survive a certain age. This mortality rates are based on the past data.

Mortality studies reflecting the experience of Indians are made by the Mortality and Morbidity Investigation Bureau (MMIB) set up jointly by the Life Insurance Council and the Actuarial Society of India, to help insurers.

Actuaries: Actuaries are trained professionals who deal with the financial aspect of risk to life. They are people qualified from the Institute of Actuaries London or Actuarial Society of India. They analyse the occurrence of risk and their impact, by using various mathematical, statistical and financial models. Actuaries study probability and analyse the whole operation of insurance business.

Duties of actuaries

Listed below are the duties of an actuary:

- They have the legal duty to protect the benefits promised by insurance companies.
- They provide actuarial advice on the insurance companies.
- They analyse the trends in mortality rate of the policyholders.
- They analyse the past trend of the company’s expenses incurred and the revenues generated.
- They provide technical expertise in designing insurance products.
- They help in financial analysis while deciding on the pricing of products.
- The prepare mortality tables which are used as basis for product development and valuation studies
- They help in the construction of the premiums.
- They define and evaluate the standards to assess risk.
- They evaluate the solvency of the insurance company.
- They provide advice to the insurance company in the investment related decisions.
- They help in ascertaining the profits that need to be distributed to the policyholders.
- They are responsible of valuation of insurance companies.
- They ensure compliance with law.
Actuarial Valuation: This valuation refers to the evaluation of the entire gamut of financial operations of an insurance company. It is done to check the validity of assumptions made, to ensure that the business is on sound lines. It involves analysis of income generated (or expected to be generated) from premiums and investments. The income is compared with the expected liabilities or expenses of the company. This is done to evaluate the overall solvency of the business.

In a valuation, the actuary estimates the liability of the insurer in respect of the business in the books. He then estimates the amount of premiums that are due to be received in future, as these will add to the funds to meet the liability. The difference between the two is the fund that the insurer must have, to remain solvent. This is compared with the actual existing life fund. If the present life fund is more, the insurer is solvent. The excess in the life fund is called ‘surplus’. This is also called ‘valuation surplus’ or ‘actuarial surplus’.

If the fund is less, the insurer is not solvent. The difference is called a ‘deficit’. The method of estimating the liability of the business and of the future premiums is very technical and complex, involving actuarial principles. It has to be done by an actuary with professional qualifications.

Test Yourself 1

Question 1

If the company follows the actual age method for determining the age of an individual, then in this case the company will calculate the:

- Age next birthday
- Age last birthday
- Age nearest birthday
- Age on the day of commencement of policy
2. Analyse the different types of premium.  

[Learning Outcome b]

Types of premium:

Diagram 2: Premiums can be classified into following types:

- Risk premium
- Net premium
- Gross premium

The business of insurance is based on the probabilities of risk. Risk premium is calculated on the basis of a probability that a person of a certain age is likely to die before his next birthday. This expectation is calculated by actuaries based on the past experience which is presented in a mortality table. Let us have a look at the case of an insurance Company XYZ.
**Details for Company XYZ**

<table>
<thead>
<tr>
<th>Description</th>
<th>Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>The insurance company has 1000 policyholders whose age is 50 years and each policy is issued for a sum assured of 50,000/-</td>
<td>All of them are healthy at the commencement of policy.</td>
</tr>
<tr>
<td>Probability that a 50 year old person would die before his next birthday is 1%</td>
<td>10 persons out of 1000 (1000 x 0.01)</td>
</tr>
<tr>
<td>Total claims made to the company in case of death of 10 policyholders (probability of 1%)</td>
<td>Total claim would be of Rs 5,00,000</td>
</tr>
<tr>
<td>Premium collected from 1000 policyholders will be</td>
<td>This is risk premium that will be paid by the policyholder</td>
</tr>
<tr>
<td>Total funds received by the company will be</td>
<td>Total collected premium will be Rs 5,00,000. This amount will be sufficient to settle the claim.</td>
</tr>
</tbody>
</table>

**A) Net or pure premium**

The premiums collected by insurance companies every year are not all used up for payment of claims for various reasons. The real experience may be different from the probabilities indicated by the mortality tables. Also the portion of the premium is meant to meet survival benefits and must be kept aside. The balance premium kept aside, after outgoes of various kinds, will be invested and will earn some interest. To the extent of these interest earnings, the premium charged can be reduced. The premium worked out after taking into account the interest likely to be earned is called “net premium or pure premium.”

**Investment earnings:** The premium received by the insurance company from policyholders is invested in various funds and securities. The insurance company calculates the expected return on investments of premium amount, based on past trends and also regulatory mandates (if any). If the interest earnings are expected to be high, then the premium amount can be reduced.
Based on the expected returns on investment, the net premium is calculated.

Loading is the part of a premium that includes various expenses incurred by the insurance company. Loadings are the extra charges that are added to the premium by the insurance companies.

**B) Level premium**

In level premium, the premium amount is fixed for the entire period of the policy term. If the total policy term is for 20 years, then, the same premium amount is fixed for the entire term of the policy.

Level premiums are charged by insurance companies for two main reasons:

- In the later years of his life the risk profile of an investor increases substantially and so does the risk premium. As the cost of risk to life will be high in the later years; this could make premium payment very challenging and could trigger defaults in payment of premium, as he would not be able to afford such a high premium. Also, the insurance company would find it difficult to administer annual changes in the premium, once the contract is signed. Hence the insurance company spreads the risk premium towards the whole time period of the policy (also called as premium paying period) and charges “level” premium.

- Adverse selection: If a high premium amount is charged in later years, then it could result in most of the healthy people quitting the plan at that point of time, as they would feel that they do not require the insurance plan. People, who suffer from various diseases, would be ready to continue the plan to receive the benefit available with the plan. They will be ready to pay the high premium. This would lead to adverse selection i.e. proportion of unhealthy people in the portfolio would be more as compared to healthy people. This would adversely affect the calculations of the insurance company based on mortality tables.

**Office premium**

The major expenses of an Insurance Company incurs is commission, salaries to employees, in addition to other expenses like rent, electricity and other administration expenses. These are known as office expenses.
The level premium figure arrived at after loading the net premium or pure premium is called the office premium. They are now ready for use. The premium figures printed in the promotional literature and brochures are office premium. They are also referred to as the “Tabular premium”.

The risk (of death) is more in a policy with a longer term than in a policy with a shorter term. But because of the practice of level premium, the tabular premium charged (per annum), would be less for a longer term policy than for a shorter term policy. On the aggregate, the total premium over the entire term would be higher in the longer term plan than in the shorter term plan.

If the mode is yearly, the probability of default in the subsequent renewal premium to complete the year, does not arise. The insurer can utilize this amount for the entire year and earn more interest than if the premiums were paid in instalment. Therefore, the premium rates would have to be slightly increased or decreased depending on the chosen mode of payment.

Some insurers provide increases or additional amounts in premium for quarterly or monthly modes, but no adjustments for yearly modes. This depends on how the insurer concerned has worked out the office premiums.

Similarly there may be adjustments to be made depending on the Sum Assured (S.A.). If the policy is for a small SA, the administrative costs would, as a proportion of premium, be more than if the policy is of a large SA, because many expenses like clerical costs, printing of policies, accounting overheads etc. are constant, and do not vary according to the SA of the policy. Depending on the manner of the loadings made, insurers will provide rebates for higher SA or extra for small SA.

**Extra premium**

Extra premiums may be charged on a particular policy. This may happen because of the grant of some benefit in addition to the basic benefits under the plan like accident benefit or premium waiver benefit. Extra premium may become chargeable because of decisions relating to the extent of extra risk in any particular case, if the risk of the person to be insurer is assessed as more than normal because of health or because of occupation, residence or personal habits, insurers may charge extra premiums.
Premium Loading

Some of the reasons for which insurers load net or pure premiums are:

a. **Administrative expenses**: these include the administrative, investment management, infrastructural expenses etc.

**Contingency charges**: the expenses that are expected to arise in case of unexpected contingencies that can result in sudden increase in the mortality rate. The premium payments are calculated on the basis of the mortality rates in the mortality table, which are determined for normal circumstances. In case some natural disasters like tsunami, earthquakes etc. occur, where large number of deaths take place, the number of deaths can be more than the expected (assumed) number of deaths while pricing. In this case, the insurance companies would have to pay much larger amount of money as insurance claims than the amount that was originally estimated or assumed. In such events, the solvency of the company could get impacted adversely. To avoid this situation, companies load the charges for meeting these contingencies through additional amounts being factored in the premium amount.

**Bonus**: will be paid to the with-profit policyholders. The policyholders that are entitled to the bonus have to pay some additional premium amount.

Some of the factors that need to be considered for gross premium are as follows:

a. **The policy term**: the gross premium for long term insurance plans would be high as compared to the short term insurance plans. In case the term of the policy is for a long period of 20 years, then in this case the risk on life would be high as compared to a policy for a short term of 5 years. In other words the probability that a person would die in next 5 years would be low as compared to the probability that the person would die in next 20 years.
b. Periodicity of the premium payment: (1) Insurance companies offer different modes/frequencies at which premiums can be paid (yearly/half yearly/quarterly/monthly) (2) Insurance companies prefer the annual mode of premium payment as the administrative charges and risk of default of payment by the policy holder in this mode is low as compared to that of monthly mode premium payment. The benefit of annual mode is that the company gets a lump sum amount for the investment as compared to the monthly mode of payment where the amount available for investment would be less and received over 12 small monthly instalments. The risk of default in payment of premium under monthly mode is high.

Some companies prefer the annual premium payment. Accordingly the companies provide a rebate on the annual mode of premium payment as it is received in one lump sum during the beginning of the policy year.

<table>
<thead>
<tr>
<th>Reasons why Annual mode of premium payment is preferred</th>
<th>Annual premium payment mode</th>
<th>Monthly premium payment mode</th>
</tr>
</thead>
<tbody>
<tr>
<td>Administrative expenses</td>
<td>Administrative expenses are less as the premium payment is done only once in a year i.e. annually.</td>
<td>Administrative expenses are high as the reminder notice for premium payment and issue of receipts has to be done on a monthly basis.</td>
</tr>
<tr>
<td>Risk of default in premium payment</td>
<td>Once the company receives the annual payment, the company is secured against any default for at least a year until the next annual premium payment falls due.</td>
<td>Risk of default is high in a monthly premium payment as every month the company has to track the receipt of payment, thereby increasing the expenses incurred</td>
</tr>
<tr>
<td>Return in investment</td>
<td>The company can earn good return on the lump sum investments.</td>
<td>The earning in this case would be less as the premium available for investment is less.</td>
</tr>
</tbody>
</table>
Test Yourself 2

Question 2

After selling the policy an insurance company finds out one of the policy holder has not furnished correct information related to his poor health condition at the time of taking the policy. This is a case of ________

Adverse selection
Loading
Level premium
None of the above

Determine the factors that are considered in the calculation of premium.

[Learning Outcome c]

Premium calculation
Insurance premium for each individual differs and is based on several factors. Some of these factors are as follows:

The age of the person to be insured: if the age of the person is high, then premium will also be high to cover the cost of risk on his life.

Medical condition: an individual suffering from some disease may be charged a higher premium as compared to a healthy individual depending on the nature of medical impairment etc.

Sum Assured: premiums also depend on the sum assured of the insurance policy. Higher the sum assured, higher will be the premium.

Type of insurance plan: premium also depends upon the type of insurance plan. The insurance company will charge higher premium on “with – profit” (bonus) insurance plans’ as compared to ‘without profit / without- bonus insurance plans’.

Mortality table: mortality tables determine the risk associated based on several factors, based on which the premiums are determined by the actuaries.

The interest amount: the rate of interest at which the company will offer guaranteed benefits, will increase or decrease the premium.
If you remember the scenario that we discussed in the very beginning of the chapter, Nishant was concerned about the difference in the premiums paid by him and his friend.

From the above discussion, it is clear that one of the primary reasons for the difference in premium is age at which the policy is purchased. Nishant’s friend had taken the policy, when he was 23 years of age. Hence the premium for him is lesser, for the same sum assured as compared to Nishant who is of the same age. Nishant purchased the policy when he was 32 years old; hence he paid a higher premium.

Apart from age, the other factor that could impact the premium could be his medical conditions, his occupation etc. at the time of commencement of risk.
### Steps in premium calculation

<table>
<thead>
<tr>
<th>Steps</th>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1.</strong> Find out the office premium for a given age based on the required insurance plan and term of the plan. The given age could be either of the following: Age next birthday, Age last birthday, Age nearer birthday. The premium mentioned is per thousand sum assured.</td>
<td>Tabular premium of ABC insurance company for the given age (age next birthday) of the policyholder for a term insurance plan is Rs. 32.50 per thousand sum assured.</td>
</tr>
<tr>
<td><strong>2.</strong> If the insurer provides rebates on the sum assured, then deduct these from the sum assured. This is known as adjustments on rebate.</td>
<td>The following rebates per thousand SA are offered by ABC insurance company on the sum assured:</td>
</tr>
<tr>
<td></td>
<td>Rs 20,000/- - 49,999/-</td>
</tr>
<tr>
<td></td>
<td>Rs 50,000/- - 99,999/-</td>
</tr>
<tr>
<td></td>
<td>Rs1,00,000 /- and above</td>
</tr>
<tr>
<td><strong>3.</strong> If the insurance company offers rebate on the mode of payment of premium, then further deductions for the same are made.</td>
<td>The company offers rebate of 1.5% on the annual mode of payment. The policyholder has selected annual mode of premium payment. The deducted premium will be Rs 30.54 (31 – (31 X 1.5/100 ))</td>
</tr>
</tbody>
</table>

Rs 60,000, then the premium will be Rs 31 (i.e., 32.50 -1.50)
4. Add the extra premiums

The extra charges levied by the company are as follows:

<table>
<thead>
<tr>
<th>Benefits payable</th>
<th>Rs 2 per thousand</th>
</tr>
</thead>
<tbody>
<tr>
<td>Administrative expenses</td>
<td>Rs 1 per thousand</td>
</tr>
</tbody>
</table>

The total addition has to be made for Rs 3, hence the total premium will be Rs 33.54

5. Multiply the amount with the sum assured

The sum assured is Rs 60,000 and the premium per 1000 SA is Rs 33.54.

Premium will be $33.54 \times 60 = Rs 2012.40$

6. If the premium amount arrived at is having paisa in the final figure, then they could be ignored could be rounded off to the next higher integer could be rounded off to nearest 50 paisa

Any one of the above rules are followed by insurance companies.

### Rules

<table>
<thead>
<tr>
<th>Rules</th>
<th>Premium will be</th>
</tr>
</thead>
<tbody>
<tr>
<td>could be ignored</td>
<td>Rs 2012</td>
</tr>
<tr>
<td>could be rounded off to the next higher integer</td>
<td>Rs 2013</td>
</tr>
<tr>
<td>could be rounded off to nearest 50 paisa</td>
<td>Rs 2012.50</td>
</tr>
</tbody>
</table>
Additional information

It is to be remembered that insurance companies have choice over the steps to be followed for calculating premium amount. In the above calculation, the deductions for the rebate on mode of payment are done after the deductions for the rebate on sum assured. Insurance companies have the choice to first deduct the rebate on mode of payment and then further deduct the rebate on sum assured. In the above example

<table>
<thead>
<tr>
<th>Office premium</th>
<th>32.50</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rebate on mode of payment</td>
<td>1.5% on annual payment of premium</td>
</tr>
<tr>
<td>Premium after deductions on sum assured</td>
<td>32.50 - (32.50 X1.5/100) = 32.02</td>
</tr>
<tr>
<td>Rebate on sum assured</td>
<td>Rs 1.50</td>
</tr>
<tr>
<td>Premium after deductions on sum assured</td>
<td>32.02- 1.50 = 30.52</td>
</tr>
<tr>
<td>Premium amount</td>
<td>Rs 1831</td>
</tr>
</tbody>
</table>

The above calculation has been done for the annual mode of premium payment. If the premium payment option selected is half yearly, quarterly or monthly then the premium amount will be different as the rebate offered for annual payment is higher and rebate reduces in case of half yearly, quarterly or monthly modes resulting in an increase in the premium.

Question 3

The premium charged by an insurance company depends on ______________

- Age of the person
- Type of insurance plan
- Participation in bonus
- All of the above

4. Understand the concept of bonus. [Learning Outcome d]

Bonus

The distribution of valuation of surplus to policyholders is done through the declaration of bonus.”
Bonus is the benefit in addition to the sum assured that is distributed to” with profit” or “participatory” policyholders. Only the policyholders – holding “with-profit” policy are entitled to a share in the bonus.

**Types of bonus:**

**Simple reversionary bonus:** in this method the bonus is generally indicated as a percentage of the basic sum assured under the policy added to the sum assured. Such addition of bonus to sum assured is called vesting. The simple reversionary bonus is calculated as below:

<table>
<thead>
<tr>
<th>Sum assured</th>
<th>Rs 60,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bonus declared</td>
<td>Rs 3000.00 (@ Rs 50 per thousand or 5% of sum assured)</td>
</tr>
<tr>
<td>Total amount that will be paid to policyholder will be (sum assured + Bonus)</td>
<td>Rs 63000</td>
</tr>
</tbody>
</table>

Simple reversionary bonus is declared generally annually and remains attached to the policy but is payable on maturity of the policy or prior death of the policyholder. Once declared it cannot be withdrawn and is payable on maturity or on the death of the insured. If the bonus declared in the subsequent year is 6% (Rs.60 per thousand) then the bonus for that year will be Rs. 3600 in the above example. This will get added to the sum assured and the total sum assured at the end of the year will become Rs. 66,600 (original sum assured Rs. 60,000 + first year bonus Rs. 3000 + second year bonus Rs. 3600)

**Compound reversionary bonus:** in this method the bonus is calculated on compound interest basis. Compound reversionary bonus is added to the existing SA including vested bonuses. (In the above example, if a 5% compound reversionary bonus is declared in the subsequent year, the next SA will be Rs 66150 (63000 + (63000 x 5/100))

**Terminal bonus:** This is a one-time bonus provided for long term policies, on attaining maturity or death of the insured person, so long as the policy has continued for a specified period.. The bonus paid, depends on the profits made by the insurance company. Terminal bonus is the sum added to the policy at the time of its maturity. Terminal bonus is assigned to the policy only when the policy reaches its eligibility period, and which may differ from one insurance company to another. This works like an incentive, encouraging the policy holder to continue keeping their policies in force.
**Interim bonus:**

Interim bonus is payable to policy holders who become claimants between two valuation dates. Bonus is declared after valuation as on 31\textsuperscript{st} March every year. Only the policies, which were in force on 31\textsuperscript{st} March, would be included for providing bonus. The policies that commenced after 31\textsuperscript{st} March would not be able to get benefits till the next valuation date. Hence, Interim bonus is declared for these policyholders, to make payment to the policies that get concluded between two valuations.

**Test Yourself 4**

**Question 4**

What is the type of bonus which is payable to policyholders who become claimants between two valuation dates?

- Terminal bonus
- Interim bonus
- Simple reversionary bonus
- Compound reversionary bonus

**Summary**

- Premium refers to the specific amount that the insured has to pay to the insurance company periodically as per the policy terms.
- A default in premium payment can result in the policy lapsing.
- The mortality table contains mortality rate for each age and gender, which is used for calculating the premium.
- A mortality rate is the probability that a person will die before his next birthday.
- Actuaries are professionals who also deal with the financial aspects of risk to life. They analyse the occurrence of risk and their impact by using various mathematical, statistical and financial models along with many other functions.
- Premiums and income earned from investments by insurance companies are maintained in a fund known as **life fund**.
- Loading is a part of the premium that includes various expenses incurred by the insurance company to manage operations of the business.
- In level premium, the premium remains fixed for the entire term of the policy.
The premium charged by insurance companies is different for each individual and premium calculations are based on many factors: age of the individual, his/her medical condition, sum assured, morality rate, type of insurance plan and several other factors which differ from person to person like his family history, social habits, occupation, etc.

Bonus is the benefit in addition to sum assured that is distributed to ‘with profit’ policyholders.

Interim bonus is payable under policies where a final payment is payable between two valuation dates.

<table>
<thead>
<tr>
<th>Some important terms / definitions you have learnt in this chapter</th>
</tr>
</thead>
<tbody>
<tr>
<td>Actuary</td>
</tr>
<tr>
<td>Actuarial valuation</td>
</tr>
<tr>
<td>Mortality rate</td>
</tr>
<tr>
<td>Loading</td>
</tr>
<tr>
<td>Adverse selection</td>
</tr>
</tbody>
</table>

### Answers to Test Yourself

**Answer to TY 1**

The correct answer is B

In the actual age method, the insurance companies generally tend to calculate the age based on the last birthday.

**Answer to TY 2**

The correct answer is A

This is a case of adverse selection.

**Answer to TY 3**

The correct answer is D

Age of the person, type of insurance plan, participation in bonus; all of these factors affect the premium calculation.
Answer to TY 4

The correct answer is B

Interim bonus is declared to include the policyholders, whose policies commence between two valuation dates.

Self-Examination Questions

Question 1

The one-time bonus that is provided for long term policies, on maturity or death of the insured is known as:

A. Simple reversionary bonus
B. Compound reversionary bonus
C. Terminal bonus
D. Interim bonus

Question 2

What kind of premium is charged for life insurance plans, to keep the premium constant throughout the policy term?

A. Risk premium
B. Net premium
C. Gross premium
D. Level premium

Question 3

____________ are the extra charges that are added to the premium by the insurance companies

A. Adverse selection
B. Actuarial valuation
C. Life fund
   Loading
Question 4

Based on the following data, what will be the age of the policyholder, based on age next birthday method?

<table>
<thead>
<tr>
<th>Date of birth</th>
<th>02 Feb 1978</th>
</tr>
</thead>
<tbody>
<tr>
<td>Date of commencement of the</td>
<td>12 Jan 2010</td>
</tr>
<tr>
<td>insurance policy.</td>
<td></td>
</tr>
<tr>
<td>Age of the policyholder</td>
<td>?</td>
</tr>
<tr>
<td>A. 31 years</td>
<td></td>
</tr>
<tr>
<td>B. 32 years</td>
<td></td>
</tr>
<tr>
<td>C. 33 years</td>
<td></td>
</tr>
<tr>
<td>D. 34 years</td>
<td></td>
</tr>
</tbody>
</table>

Question 5

Based on the following data, what will be the age of the policyholder, based on age last birthday method?

<table>
<thead>
<tr>
<th>Date of birth</th>
<th>04 April 1981</th>
</tr>
</thead>
<tbody>
<tr>
<td>Date of commencement of the</td>
<td>4th March 2010</td>
</tr>
<tr>
<td>insurance policy.</td>
<td></td>
</tr>
<tr>
<td>Age of the policyholder</td>
<td>?</td>
</tr>
<tr>
<td>A. 28 years</td>
<td></td>
</tr>
<tr>
<td>B. 29 years</td>
<td></td>
</tr>
<tr>
<td>C. 30 years</td>
<td></td>
</tr>
<tr>
<td>D. 31 years</td>
<td></td>
</tr>
</tbody>
</table>

Answer to Self-Examination Questions

Answer to SEQ 1

The correct answer is C

Terminal bonus is the one-time bonus provided for long term policies, on maturity or death of the insured.
Answer to SEQ 2
The correct answer is D
Level premium is charged on life insurance plans to keep the premium constant throughout the policy term.

Answer to SEQ 3
The correct answer is D
Loadings are the extra charges that are added to the premium by insurance companies.

Answer to SEQ 4
The correct answer in B
Age of the policyholder based on next birthday method will be 32 years.

Answer to SEQ 5
The correct answer is A
Age of the policyholder based on last birthday method will be 28 years.
CHAPTER 3

PLANS OF LIFE INSURANCE

Chapter Introduction

In recent times, there have been drastic changes in the social structure we live in. There has been an increase in nuclear families, leaving the senior citizens alone, to manage on their own. Senior citizens today do not want to be dependent on their children for meeting their post retirement expenses. They want to be financially independent. With changed life styles, every parent aspires to provide the best of education to their children, without compromising on their life styles.

Today while investing in insurance, individuals not only want security against unforeseen circumstances, but also good returns on their hard earned money so that they can make provisions for their children’s education and marriage expenses, their own retirement etc. Hence insurance companies are launching new insurance plans, with various features to fulfil the requirements of today’s generation. In this chapter we will discuss about the various insurance plans that are available in the market and analyse their various benefits.

Learning Outcomes

- Analyse various life insurance plans.
- Understand Unit Linked Insurance Plans (ULIPs).
- Understand the concept of riders.
- Earn about industrial life insurance
- Understand the benefits of MWP Act
- Understand the importance of keyman insurance
- Understand the importance of health insurance
Look at this scenario

Rahul is a software Engineer, working in a leading MNC. He has been working with the company for the past 5 years. He is a happily married man who has a two year old child, Jagat. Over the years he has invested his savings in banks and some mutual funds. He has been apprehensive of insurance policies as his belief is that they do not provide good returns on the money invested. He looks at insurance policies as an expense, where he would have to pay premiums for a long period, without any returns.

One day, his boss Mohan Kumar suffers a severe heart attack and dies on the way to the hospital. He is survived by his wife and a 10 year old child. He is quite disturbed on hearing that the family has to move into a smaller apartment as they were facing a financial crisis after Mohan Kumar’s death. Apparently Mohan Kumar had left a large debt in the form of personal, home and car loans. Their savings were limited and consequently, the child had been taken out of the exclusive school that he was studying in, as they could not now afford the fees.

Rahul was quite disturbed after visiting Mohan Kumar’s family. Rahul wanted to make sure that his family does not have to go through the same situation if something had to happen to him. He decides to take an insurance to safeguard his family’s future. He decides to buy an insurance plan that can help him meet all his financial commitments such as his son’s education, medical expenses and so on, easily.

The question is can the insurance companies offer such plans to Rahul, through which he would be able to save for his above mentioned financial needs? We will learn about it in this chapter.

1. Analyse various life insurance plans. [Learning Outcome a]

There are several life insurance plans that are being provided by insurance companies to fulfil various needs of an individual such as:

- meeting post retirement expenses
  - providing financial security in the case of untimely death of the earning member of the family
- creating a child education fund and child marriage fund
- providing for medical expenses of self and family

Individuals today have become quite demanding when it comes to what they are being offered in an insurance plan. There are various life insurance plans that are available in the market to meet the requirements of these individuals.
All insurance plans basically provide two kinds of benefits to an insured person:

Death Cover: The amount which is paid to the nominee or beneficiary when the insured person dies within the specified period

Survival benefit: The amount which is paid if the insured person survives the specified period. Insurance plans.

Example

In the scenario discussed above, Rahul requires an insurance plan which can provide financial security to him and his family. He has two options. He can either take an insurance plan that offers death cover (Pure Term Plan) or an insurance plan which also has a survival benefit along with death claim benefit (Endowment Plan, Money Back Plan, ULIP etc.).

An insurance plan which offers only death cover (term plan) will provide financial security to his family in the case of his premature death. The sum assured will be paid to the family in case Rahul dies during the policy term. However, if he survives the term, no payment will be made to him.

Insurance plan (endowment plan) will help Rahul in meeting his future financial requirements. In an Endowment plan, he will receive the sum assured along with other benefits if he survives the policy term. In case of his premature death, the sum-assured will be payable to his family (including bonus if it is “with-profits policy”).

Life is very uncertain. No one knows how many years a person will survive nor have knowledge of his date of death.

Life insurance companies combine the features of the two basic plans Term Plan & Pure Endowment (where claim amount is payable only if the life-assured survives the term and nothing is payable if he dies during the policy tenure), and offer it as a single product to their customers in the form of an ‘Endowment Assurance’ Plan, which covers for both the contingencies, of survival and death.

Example

One can go in for an Endowment Assurance Plan for 25 years which will pay the nominee / beneficiary Rs. 50 Lakhs if the insured person dies during the tenure of the policy or pay Rs. 50 lakhs at the end of 25 years if the insured person survives the entire tenure of the policy.
This endowment assurance plan is nothing but a combination of the below two plans:

- one pure endowment plan which will pay Rs. 50 lakhs if the insured survives the entire tenure of the policy of 25 years and

- one term assurance plan which will pay Rs. 50 lakhs if the insured dies during the tenure of the policy

Under such a plan the sum assured (SA) is paid on survival of the specified period or on death, whichever is earlier.

Features of a traditional plan

All traditional plans are generally a combination of two basic plans of insurance i.e. pure endowment and term assurance. They provide living benefit if the insured survives the entire tenure of the plan or death benefit in case death happens during the tenure of the plan. A traditional plan has a set of features. By making certain changes in these features or adding and combining some of them, any number of plans or products can be developed by insurers by adding special innovative features and riders etc., to make it lucrative for customers to buy insurance.
### Features of a Traditional Plan

<table>
<thead>
<tr>
<th>Feature</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Life Insured</td>
<td>The life insured person can be an individual adult, minor or two or more people, jointly, under one policy.</td>
</tr>
<tr>
<td>Minimum / Maximum Sum Assured</td>
<td>Most of the plans stipulate a minimum sum assured amount. Some plans specify a maximum sum assured also. Some plans don’t specify any maximum sum assured, but this is subject to underwriting. There can be limits on riders also.</td>
</tr>
<tr>
<td>Sum Assured Payment</td>
<td>The plan specifies when the liability will arise on the insurer to make a payment. This can be on the death of the life insured, on the maturity of the plan, some contingency stipulated in the riders or on some other date. The plan also specifies whether the SA payment will be made lump sum or in instalments.</td>
</tr>
<tr>
<td>Minimum / Maximum Entry Age</td>
<td>The plan specifies the minimum and maximum entry age. Most plans also specify the maximum maturity age while whole life plans go on till the life insured survives.</td>
</tr>
<tr>
<td>Minimum Premium Amount</td>
<td>Some plans specify the minimum annual premium or the minimum instalment premium.</td>
</tr>
<tr>
<td>Plan Tenure</td>
<td>The plan specifies the minimum and the maximum policy tenure (duration). Whole life plans go on till the life insured survives. Some plans provide benefits even beyond the policy term.</td>
</tr>
<tr>
<td>Premium Payment Frequency</td>
<td>The plan specifies the options available for premium payment frequency. The options can be monthly, quarterly, half yearly, yearly or a single premium. Some plans provide for premiums to be paid for a period less than the term.</td>
</tr>
<tr>
<td>SA Step-Up / Step-Down Option</td>
<td>Some plans provide the option of increasing the SA on happening of important events like marriage, purchase of a house, childbirth or certain policy anniversaries. This happens due to participation in surpluses and bonus additions or due to guaranteed increases. Some plans also provide the option of reducing the SA on happening of events like reduction of liabilities under a mortgage, achievement of certain milestones / objectives or certain policy anniversaries.</td>
</tr>
<tr>
<td>Riders</td>
<td>Some plans offer additional or supplementary benefits by way of riders in addition to the basic cover.</td>
</tr>
</tbody>
</table>
Diagram 1: Features of a traditional plan

- Life Insured
- Minimum / Maximum Sum Assured
- Sum Assured Payment
- Entry Age
- Minimum Premium
- Plan Tenure
- Premium Frequency
- Step-Up / Step-Down
- Riders
Life Insurance Plans

The insurance plans available in the market are as follows:

1.1 Term Insurance Plan

The most basic insurance plan that is available in the market is a term insurance plan. In fact term insurance is referred to as the purest form of life insurance, as it provides protection against risks to life. The features of term insurance are as follows:

- Term insurance provides only death cover i.e. the sum assured is paid to the beneficiary if the insured dies within the specified period. If the insured does not die within the specified period, no payment is made.
- Term insurance as the name suggests provides insurance cover for a specified term or period say 5, 10, 15, 20 or 30 years as chosen by the insured.
- Premiums paid under term insurance plan are lowest as compared to the other life insurance plans.
- Sum assured is a pre-agreed amount between the policyholder and the insurance company. Sum assured can be a fixed amount that is to be paid during the specified period, or it can increase or decrease during the period.
- Term insurance does not provide the savings element and hence, if the insured person survives the term plan, he gets nothing.
- Term plans do not acquire any surrender value.

Term insurance policy is useful in following cases:

- When an individual looks for a low cost insurance without any savings benefits, but the sole purpose is to cover financial needs of the family in case of unfortunate premature death of the bread-winner.
- When the individual is at that stage of life where insurance cover is vital and he cannot afford a high premium.

As an additional benefit, linked with the other insurance plans.
- To provide cover against financial responsibilities like mortgages and large amount of housing loans etc.

Based on the premium payment method, a term insurance plan could be categorised as the following:

**Single premium term plan:** insured person pays a lump sum premium and avails the life insurance cover for a specified period.

**Regular premium term plan:** premium payments are to be made at regular intervals, by the insured person for the whole term of the policy. Premiums could be paid either monthly, quarterly, semi-annually, or annually.
Based on the increasing or decreasing amount of premium payment, term insurance plan could be categorised as:

**Level term insurance**: the sum assured or benefit remains constant throughout the term of the policy.

**Decreasing term insurance**: the sum assured or benefit decreases over the term period and is targeted towards individuals whose financial obligations decrease over time. In due course of time an individual might be able to pay off the debts such as repayment of home loan, car loan and others and hence the liabilities decrease over time.

**Increasing term insurance**: the sum assured increases over the term period. It is useful when a person who is drawing a less income at the time of commencement of risk, but whose income is expected to rise in the future and he would be able to afford a higher premium required for the higher benefits or sum-assured, to meet all his future liabilities. For example, the individual gets married and has children, and hence the liabilities increase in the form of bearing these expenses of, children’s education and marriage and so on.

### 1.2 Endowment Plan

Pure endowment plans are exactly the opposite of term insurance plans i.e. sum assured is paid, if the insured survives the specified period.

Insurance companies combine the benefits of term assurance plans and pure endowment plans and sell them as Endowment Assurance Plans which pay death cover amount if the insured dies during the term of the policy or pay the maturity benefit if the insured survives the entire tenure of the policy. A certain part of the premium gets allocated towards the risk of death (mortality). After making some deductions to meet administrative expenses etc. the balance premium is invested to generate returns which are paid back to the policyholders in the form of bonus.

### Double Endowment Insurance Plan

Double endowment insurance plan is a combination of term assurance plan and double pure endowment plan under which the amount payable on survival is double the amount payable on death.
1.3 Whole Life Insurance Plan

Whole life insurance plan as the name suggests provides insurance cover for the whole life of the individual. It could also be termed as a combination of pure endowment plan and term insurance plan with an unspecified period, as the total term for which the individual will live cannot be determined. The sum assured along with bonus, if applicable, will be paid to the beneficiary on death of the insured.

Whole life insurance plans were originally designed to provide only death benefits. There is an increased life expectancy of the individual due to which the needs of the individuals have changed. Hence insurance companies have started offering survival benefit with whole life insurance plans where sum assured along with bonus will be paid to the insured if he survives a specified term or if the insured attains a certain age say 100 years.

Commonly seen features of whole life insurance plan

The eligible age for this plan is generally between 15 years and 60 years

This plan is suitable for individuals, who want to invest in some plan, through which they can leave behind some sort of estate as a part of their legacy to their legal heirs. The plan is suitable for individuals, who wish to provide financial security to their families, in case of their premature death.

Whole life term insurance plan, is best suited for married couples with children as it provides risk cover for entire life.

Example

In the above scenario, the conditions quoted above are:

- providing financial security to his family in case of his untimely death
- financial security for his future (retirement) and
- his wishes to leave behind some estate as a part of inheritance for his children

Whole life insurance plan can take care of all of the above mentioned needs. In the case of an individual's premature death, the sum assured along with bonuses will be paid as lump sum to his family (nominee).

Also if he wants to leave behind an estate for his children, then a whole life insurance plan will be best suited for him.

1.4 Money Back Insurance Plan:

Money back insurance plans are designed to meet the requirements of the individuals who look for a product that provides both savings and insurance cover. It is a combination of a term assurance plan and multiple pure endowment plans. It also ensures some form of liquidity in the form of periodic return of money as specified in the product.
In a money back insurance plan, a certain percentage of the sum assured is returned to the insured at regular intervals during the lifetime of the policy. Money back insurance plan provides periodic payments of partial survival benefit during the term of the policy. In case the insured survives the specified term then he is paid the remaining amount. If the life insured dies during the term of the policy then the death benefit is paid along with the accumulated bonuses till then. An important feature of this policy is that the death claim comprises full sum assured without deduction of the survival benefit amounts, which might have been paid as money back component. This insurance plan is best suited to individuals, who look for periodic, regular income along with the insurance cover.

If an individual takes money back policy for Rs 5 lakhs with a term of 20 years, then a certain percentage of this amount becomes payable each after 5, 10, 15 years and the remaining balance (sum assured and bonus) is payable on completion of the term (maturity), i.e. 20 years.

Rahul has bought a money back policy with a sum assured of Rs. 2,00,000 for tenure of 20 years. The policy specifies a payment of 20% of the sum assured every 5 years and 40% on the maturity of the policy. If Rahul dies after taking two survival payments, then the insurance company, will pay the full basic sum assured of Rs. 2,00,000 without deducting the the survival benefit payments made till the date of death, and the policy will be closed.

This policy offered by the insurance company to Rahul, if analysed, is effectively a combination of 5 policies.

- 3 pure endowment plans which promise to pay Rs. 40,000 each at the end of 5 years, 10 years and 15 years respectively.
- 1 pure endowment plan which promises to pay Rs. 80,000 at the end of 20 years.
- 1 term assurance plan which promises to pay Rs. 2,00,000 if Rahul dies anytime during the tenure of the policy (20 years).

**Comparison between money back insurance plan and endowment plan**

The money back policy differs from endowment plan in the sense that in an endowment plan, the benefit, which is the sum assured with bonus, is payable at the end of the endowment period or on death during the term of the policy, whereas in money back policy a certain amount is returned in periodic instalments (unlike the endowment policy) within the policy term as survival-benefits and on death of the life-assured.
1.5 Convertible Plans
Convertible insurance plans allow the insured to convert a term insurance plan into an endowment plan or whole life plan or any other conversion as allowed by the insurance company within a specified period. These policies have two advantages:

- The individual can choose to pay low premium in the beginning with term plan and later on convert the plan into endowment and choose to pay higher amount of premium.
- No underwriting would be necessary at the time of plan conversion from term plan to the endowment one.

A convertible whole life plan can also be changed to an endowment plan. In case it is not converted, it continues as the original plan. This type of plan has two advantages. With the increase in income, the life assured would be able to afford higher amount of premium in later stages and also there will be no underwriting at a later stage when he decides to convert the plan. The medical ailments that the insured suffers, after the policy has been issued, will not affect the benefits associated with the insurance plan.
1.6 With Profit and Without Profit Insurance Plans

Under whole life and endowment insurance plans, the insured can choose to receive profits or bonus along with the sum assured. These are known as **with profit** or **participatory policies**. The premium of these policies is higher as the insured gets the benefit of bonus along with the sum assured. Hence the insured participates in the profit of the insurer.

Under **without profit** or **non-participatory** insurance plans, the insured will not be entitled to profits or bonus which is declared after actuarial valuation. Pure term insurance policies are without profit policies and their premium is lesser as compared to with profit policies.

1.7 Joint Life Insurance Plans

Joint life policies provide life cover for two lives simultaneously. This policy is very useful for married couples or business partners. There can be many variations in the joint-life products that the insurers have made available. The features of this policy commonly comprise of the following features:

- The sum assured is paid on the death of the first joint policyholder.
- The sum assured is payable again in the case of death of the survivor during the term of the policy.
- No further premiums are to be paid after the death of the first policyholder or at the end of the policy term whichever is earlier.
- Vested bonus along with the sum assured is paid to the beneficiary after the death of the survivor.
- If either of the policy holders survives the policy term, then the sum assured along with the vested bonus is payable to him / her on maturity date.
- Proposal has to be signed jointly by both the persons getting insured
- Each person to be insured will be underwritten separately.
- Both the persons will have to undergo a medical examination, unless the policy offers insurance without any medical examination.
- Premiums depend on the age of both the persons getting insured.

1.8 Child Insurance Plan

In case of a child insurance plan, the premium is paid by the parent to fund the child’s future requirements like education and marriage expenses. In case of unfortunate death of the parent during the term of the plan the child’s future does not suffer. The insurance company generally continues the insurance plan and pays the premium.
Child plan assists the parents in accumulating sufficient wealth for their children’s future. Also child plan secures the child’s future, in case of any unfortunate event. The main worry of the parents is securing their child’s future, if something untoward happens to them. The main features of this plan are:

**Deferment period:** it is the duration between the commencement of policy and the commencement of risk. It is the duration for which one has to wait before the benefits of the insurance plan actually begin. There is no insurance cover during the deferment period. If the child dies during this period, only premiums paid will be returned.

**Deferred date:** the date on which risk commences. This is the date from which the insurance cover on the child becomes applicable. From this date the insurance cover is applicable to the child.

**Commencement of the risk:** risk will commence automatically on the deferment date. No medical examination is necessary.

**Premiums:** Since the child is a minor when the policy is taken, the premium of the plans is quite low. The premiums are to be paid by the parents as they are the owners of the policy, till the vesting date.

**Vesting:** the process of passing the title of the insurance policy to the insured child, once he turns major (18 years) is known as vesting.

**Vesting date:** it is the date on which the child completes 18 years of age and the title of the policy passes to the insured child. The policy now becomes a contract between the insured (the child) and the insurer. The deferred date and the vesting date need not be same.

**Age of the child:** child insurance policies could be taken for the child aged a few months and above, however risk on the life of the child begins only at a specified age, as various plans are now available in the market.

**Waiver of premium:** there are certain benefits available with the plan where the premiums can be waived, in case the proposer of the policy dies during the term of the policy. This benefit is available as a rider-benefit and is generally optional in nature but is also available sometimes as a bundled product where this is a part of the product feature .In cases, where the premium waiver is available, generally the proposer has to be medically underwritten and waiver of premium facility needs to be granted by the underwriter after an underwriting process.
The Premium Waiver benefit is not applicable in the case the proposer commits suicide within one year of the policy.

Example

Rahul’s son Jagat is 2 years old. Rahul decides to buy a child insurance plan for Jagat, wherein the risk cover starts at age 7 years. As Jagat is two years old, the life cover on Jagat will not start till he turns seven. On the premium being paid by Rahul, no mortality charges will be deducted at this stage as the life cover on Jagat has not yet commenced. The first policy anniversary after Jagat’s seventh birthday will be the deferred date on which the risk on Jagat’s life will be commenced i.e. the insurance cover on the child will become applicable. The day on which Jagat will celebrate his 18th birthday, the title of the policy passes automatically to Jagat. This process is called vesting. Hence the first anniversary of the policy after Jagat’s 18th birthday will be the vesting date. After vesting, the contract will now be between Jagat and the insurance company. Jagat now has a right to nominate a person under this policy.
Diagram 3: How the child insurance plan will work

Jagat's Age: 2 years
Policy starts

Jagat’s Age: 7 years
Deferred date: Risk on Jagat’s life commences

Jagat’s Age: 18 years
Vesting date: Policy passes on to Jagat

Subsequent years:
Insurance contract is between Jagat and the insurance company
Life insurance plans offered by Postal Life Insurance (PLI)

Following are few plans, which are offered by Postal Life Insurance:

A. Whole Life Insurance Plan:

The entry age limit for this policy is 19 – 50 years.
- Premium payment ceases at the age of 55, 58 and 60 years. The minimum premium payment duration is for 5 years under this plan.
- Sum assured could be of Rs. 5 lakhs and is payable to the nominee or beneficiary of the insured.
- Bonus accrues till the date of maturity. In this plan the premium is lower than the endowment plan.

B. Endowment Insurance Plan:

- Insured gets the sum assured and bonus at the time of maturity. In the case of premature death, the nominee or beneficiary gets the sum assured along with the bonus.
- The entry age limit is 19 to 50 years for this policy.
- Premium ceases at the age of 35, 40, 45, 50, 55, 58 and 60.
- Maximum sum can be assured can be Rs 10 lakhs. Can be converted into whole life insurance plan.

C. Anticipated Endowment Insurance Plan (also called Money Back Plan):

- This policy is also known as money back policy, and is preferred by people who require periodical returns.
- Survival benefit is paid to the insured person periodically. These payments are not considered at the time of payment of sum assured in case of premature death of the insured.
- The anticipated endowment assurance plan could be for 15 or 20 years.
- Maximum sum assured can be for Rs. 5,00,000

Some other insurance plans offered by Postal Life Insurance (PLI) are:

-Convertible Insurance Plan
- Joint Life Endowment Insurance Plan
- Child Insurance Plan
Test Yourself 1

Question 1

What is the minimum age of the child, for getting child insurance?

As soon as the child is born
Generally Three months
5 years and above
10 years and above

2. Understand the importance of ULIPs. [Learning Outcome b]

Definition
A unit linked insurance plan (ULIP) is an insurance plan which is a combination of insurance protection and investment.

A ULIP can be an ideal investment vehicle for people who are looking for the triple benefits of:
- insurance protection
- investment
- income tax benefits

ULIP Premium
The premium paid by the insured in a ULIP is divided into 3 parts:

Expenses: A portion of the premium that goes towards meeting the expenses of issuing the policy like agent’s commission, policy set-up costs, administrative costs, and statutory levies.

Mortality: A portion of the premium goes towards covering the risk of providing life cover to the life assured.

Investment: After deduction of the two amounts mentioned above, the balance premium goes towards investment on behalf of the life-assured as per the choices of funds he has indicated.
The policyholder can select from various funds available to invest his premium. Some of them are indicated below:

- Equity Fund
- Debt Fund
- Balanced Fund
- Money Market Fund

These are the basic funds offered by insurance companies. They may offer the investor a choice of more funds to select from which may be variants or combination of the above four funds. Insurance companies call these funds with different names.

A ULIP is effectively two plans. One plan covers the risk of providing protection to the life insured. The second plan acts like a mutual fund where the life insured can make regular investments. Generally, on maturity, the fund value is paid. On the death of the life insured during the tenure of the policy either the sum assured or the fund value, whichever is higher, is paid. Some insurance companies have the provision to pay both.

"Switching" and "Redirection" are two options available to the policyholders under the “ULIP” policy whereby they can choose the kind of funds to be invested.

The investments in ULIPs are termed as units and Net Asset Value (NAV) refers to the value of each unit of the fund on a certain day. The premiums collected from various individuals are pooled together in a unit fund.

The following are the types of charges that are applicable to ULIP policy and these have to follow regulatory norms:

- Premium Allocation Charges (PAC)
- Mortality Charges
- Fund Management Charges (FMC)
- Policy Administration Charges
- Surrender Charges
- Fund Switching Charges

(Details of the ULIPs are explained in detail in subsequent chapters)
Question 2

In a ULIP NAV stands for __________

- New Asset Value
- Net Actual Value
- Net Asset Value
- New Actual Value

3. Understand the importance of riders. [Learning Outcome c]

Concept of Riders

A rider is an additional clause or condition added to the base policy that gives additional (add-on) benefit to the buyer.

Riders can be compared to choice of different toppings in a pizza. A base policy is like a pizza base and choice of riders is like choice of different pizza toppings available to customize the pizza as per an individual’s requirement.

Riders help to customize different requirements of a person into a single

Diagram 4: Choice of riders
Features

**Enhanced protection:** riders enable a person to enhance the scope of protection offered by a policy, qualitatively and quantitatively.

**No underwriting:** Generally, riders do not involve set up costs like underwriting.

**Low cost:** No bonus is paid on riders. Hence the premium payable on riders is very low.

**Income tax deduction:** the premium paid for riders qualifies for tax deduction under Section 80C or Section 80D (based on type of rider) of the Income Tax Act. These depend on prevalent tax laws.

**Maximum limit:** amount of cover under a rider cannot be more than the base policy cover amount.

Some examples of riders are as follows:

**Increased death benefit rider:** this rider is more beneficial for primary earning members of the family. The benefit from this rider is that the policyholder can increase his death cover as his liabilities increase. Hence in case of premature death of the insured, the beneficiary gets more money than the normal sum assured.

**Critical illness rider:** this rider helps if the insured falls sick and requires hospitalisation and undergoes a major treatment due to a critical illness. The critical illness rider provides protection against major illnesses and diseases. Insurance companies specify the list of illnesses covered and exclusions under this rider. If the insured is diagnosed with any of these illnesses the rider amount is paid either in lump sum or in instalments. Some of the commonly covered critical illnesses under CI rider are:

- Heart attack
- Kidney failure
- Cancer
- Cardiac surgery
- Paralytic stroke
- Major organ transplant

The products of different companies could have CI covering varied conditions and diseases and their definitions too could vary.

**Major surgical assistance benefit:** This rider provides financial support in the event of medical emergencies that require surgery and a part of the sum assured is paid to the policyholder.
**Accidental Death Benefit (ADB) rider:** This rider helps if the insured meets with an accident and becomes permanently disabled or dies. This rider covers the risk of disability or death due to accident. In case of death due to accident this rider provides additional benefit over and above the base policy cover amount.

**Waiver of premium rider:** This rider helps if the insured becomes disabled and loses his income earning capacity. In such a state it would be difficult for him to pay the premium of his policy. Till the time the insured recovers and becomes employed once again, the insurance company gives up the right to collect premium or waives off the premium under this rider.

**Guaranteed insurability option rider:** Choosing this rider helps in increasing the insurance cover at regular intervals, without further medical examination. This option could be exercised, by young individuals, when their earnings are low, and with time, when their income increases, along with their liabilities, they can buy additional insurance cover. So even if one develops some kind of medical illness in due course of time, the insured can increase his insurance cover without undergoing any medical check-ups.

**Disability income benefit rider:** if the insured becomes disabled (falling within the scope of the definition), this rider provides a monthly income benefit to him. At the time of taking this rider the insurer specifies a fixed monthly disability income benefit amount or the monthly benefit amount can be linked to the sum assured (SA).

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**Test Yourself 3**

**Question 3**

If the insured person has taken ___________, then in case of his accidental death, the beneficiaries would receive additional amount over and above the normal sum assured.

- Critical illness rider
- Guaranteed insurability rider
- Accident death benefit rider
- Waiver of premium rider
Life insurance companies’ aim is to provide insurance cover to maximum number of individuals and at the same time ensure that their business remains profitable. They constantly try to identify the various needs of individuals as well as corporate customers and accordingly try to innovate and come out with new products to cater to the needs of different sections of society.

Apart from the basic insurance plans that we have discussed till now, insurance companies also offer some special need based plans that are quite unique in their conceptual design and differ in a lot of ways from the other basic insurance plans.

In the past, the insurance companies in the US identified the need for insurance among industrial workers. These were low wage earners and hence could afford to pay only a minimal premium. Several insurance companies launched insurance schemes for them, but they were all unsuccessful, until the launch of industrial life insurance by Prudential Insurance Company.

Industrial life insurance, offered a modest insurance cover for a small premium, which these industrial workers were supposed to pay weekly. The feature that differentiated this scheme from others was that Prudential appointed agents who were responsible for collection of premium from the policyholder’s home every week.

In the earlier policies, the industrial workers found it inconvenient to visit the insurance office to pay the premiums on a regular basis. This led to high rate of default in premium payment. Hence the simple solution of door to door collection of premiums from the policyholders made industrial life insurance scheme one of the most successful insurance schemes.

The above scenario highlights how if insurance companies come out with a special needs product for a specific segment and make it convenient for the customer (premium collection from home), the product can become successful.

4. Learn about industrial life insurance. [Learning Outcome d]

Industrial life insurance refers to a low cost insurance plan. Premiums are of small amounts that are paid monthly or normally weekly. The insurance coverage is modest and the benefit offered with the policy is either cash benefit on maturity or death cover in case of death before the tenure of the policy ends. Such products by insurance companies are important as they provide insurance cover to low income families.
Working of industrial life insurance:

The areas for procuring business are divided among the insurance agents. These agents are responsible for collection of premiums from the policyholders residing in that area. The agent has to visit each policyholder individually and collect the premium. After collecting the premium the agent duly signs the receipt book with the policyholder as a proof that the premium has been collected by him.

The important features of industrial life insurance are as follows:

The industrial life insurance plan targets low income groups.

- The agents who are appointed for the purpose collect the premiums door to door from the policyholders.
- The premiums need to be collected weekly or monthly. The agent generally visits the policyholder on the day the insured receives salary or wages.

  Receipt books: the policyholders are issued a receipt book each. The agent makes an entry into the receipt book when he collects the premium. The agent has to sign the receipt book as a proof that the payment has been collected by him.

  Debit list: this list contains the details of policyholders from whom the premiums have to be collected. The policyholders would be of one area only, who may be insured by the same agent or by some other agent.

Industrial life insurance is not very popular now-a-days as the mortality rate of low income workers is high as compared to other segments. The administrative cost of industrial insurance is also high as the agent has to personally visit each policyholder every week to collect the premiums.

Test Yourself 4

Question 4

In industrial life insurance the ____________ consists of the details of the policyholders from whom the premium needs to be collected.

- Receipt list
- Debit list
- Collection list
- Policyholder's list
5. Understand the benefits of MWP Act

[Learning Outcome e]

MWP Act
According to the Married Women’s Property Act or MWP Act 1874, Section 6,

A policy of insurance effected by any married man on his own life, and expressed on the face of it to be for the benefit of his wife,

   his wife and children, or
   any of them

shall ensure and be deemed to be a trust for the benefit of his wife,

   his wife and children, or
   any of them

according to the interests expressed, and shall not, so long as any object of the trust remains, be subject to the control of the life insured, or

   his creditors, or
   form part of his estate

The term ‘Children’ in the Act refers to the — sons and daughters both natural and adopted. The term “married man” includes a widower or a divorced man.

Married Women’s Property Act provides an easy process by which a married man can leave his inheritance to his dependents. Also the Act provides statutory privileges to the dependents, through which they can seek higher amount of protection in case of any dispute for the claim on the death of the insured.

Eligibility for MWP Policy (under Married Women’s Property Act)

The policy under MWP can be taken by

   Any married man who wants to safeguard the interest of his dependents, wife and children, can purchase this scheme.
   A divorcee or widower can also purchase the scheme, seeking protection for his children.
Beneficiaries:

Following person can be beneficiaries under this scheme:
Only the wife
Any one or more children
Wife and any one or more children jointly

If the individual decides to provide the benefit to two or more persons, then in this case equal or unequal shares could be given to the beneficiaries.

Non Mohammedan

The individual can form a trust in the name of his wife or in the name of his children. The individual has the freedom to decide as to whether he wishes to provide benefits to all of his children or only some. People whose names are mentioned in the trust will only be entitled to the benefits.

Example

Rajat is a married man with three children – one son and two daughters. He wants to bring his life insurance policies under the provisions of MWP Act. He submits an addendum for formation of trust, and includes his wife and his son as the beneficiaries and excludes the two daughters from the beneficiaries’ names. In this case, the daughters will not be entitled for any claim.

The individual can provide the name of the beneficiaries who will be entitled to the claim. The benefits will be shared by the beneficiaries jointly, or the survivors or the survivor among them. In this case only the surviving beneficiary or beneficiaries will be entitled to the claim.

Example

Mohan is a married man with two sons. He has chosen to affect his insurance policies under MWP Act, and named his wife, and two sons as joint beneficiaries. Mohan and his wife along with his younger son die in a car accident. In this case, the only survivor is his elder son. Hence he will be the only surviving beneficiary who will be entitled to the claim.
He can mention the name of the beneficiaries who will be entitled to either equal or unequal shares 1/3\textsuperscript{rd}, 2/3\textsuperscript{rd} and so on. In case the beneficiaries die before the policy becomes a claim, then their share will go to their legal representatives.

**Example**

Raghav is a widower and has one son – Anand and one daughter – Nitika. Both the son and daughter are married. Under the MWP Act provision, he has submitted an addendum to include son Anand and daughter Nitika as beneficiaries. He has provided 1/3\textsuperscript{rd} of his property to his son Anand and the remaining 2/3\textsuperscript{rd} to daughter Nitika. Unfortunately Raghav and Nitika suffer an untimely death in a car accident. Nitika is survived by one daughter. In this case the 1/3\textsuperscript{rd} of the claim will go to Anand and rest 2/3\textsuperscript{rd} will go to legal heirs of Nitika.

He can make a trust in the name of his wife and children as a class. In this case the benefit will go to the woman who becomes a widow on death of the insured and all of his children.

**Mohammedan**

An individual cannot make a trust as a “class” on the name of his wife or children. There is a condition that the wife and the children should be named persons and must be existing on the date of the policy.

In case there are two or more than two beneficiaries, the proposer cannot mention that the benefit could go to them jointly or to the survivors or survivor of them. He should define the total share of each beneficiary.

**Insurance policy**

Only a married man can affect an insurance policy under MWP Act. An important condition is that the policy should be on the life of the married man, and taken out by him. Hence only those policies which provide for exigencies of human life can be taken by the individual. Joint policies and child plans cannot be taken under MWP Act.

**Loan**

No loan can be granted under a MWP Act policy unless the proposer had while appointing the trustees, unless specifically authorised the trustees to obtain loan on the policy. The trustees cannot surrender the policy.
Process of affecting the life insurance policies under MWP Act:

**Addendum to insurance company**: when an individual decides to obtain insurance under MWP Act, he has to submit an addendum to the insurance company. For such a policy, he will not be able to nominate anybody, as the policy is issued under the MWP Act.

**Appointment of the trustees**: the life insured has to appoint a Trustee. The individual need not appoint an individual trustee; he also has the option of appointing corporate trustee as well. The life insured may reserve the power to revoke the appointment of trustee and appoint another one.

In case he wishes to change the trustees in future, he needs to add a provision for the same in the addendum.

**Payment of claim under MWP Act**

In an MWP Act policy, when a claim arises, the policy money will be assigned to either the beneficiary or the trustees as specified in the policy. The trustees hold the policy money for the beneficiary. In case the beneficiary is dead, his legal heirs will be entitled for the claim.

6. Understand the importance of keyman insurance

**Keyman insurance**

Key man insurance is the insurance cover extended to an important or key employee of the company, the loss of whom can affect the operations and profitability of the company.

Key man refers to an employee, having special skill set or significant responsibilities. His contribution to the company is quite extensive.

In case of death of the key man, two types of losses could be suffered by the company:
Loss in profits
Expense involved in replacement of the key man.
Features of key man insurance

Based on IRDA guidelines, only Term plan can be bought under the key man insurance.

The employer is the policyholder and hence pays the premium

The key man is the life insured

In case something happens to the key man, the claim will be paid to the employer (policyholder) and not the insured. The company gets the money to recover from losses.

The premium paid under the key man insurance by the company is treated as business expense and the company can claim deduction from taxable income.

The proceeds received by the employer from the policy are taxable

Test Yourself 5

Question 5

From the below options in a key man insurance who is insured?

- The proprietor of the firm
- Any employee of the company
- An employee with significant responsibilities, the loss of whom, can affect the profits of the company
- None of these

7. Understand the importance of health insurance

Learning Outcome 4

Over the last few years our economy has done well leading to good GDP growth. This has led to the rise in disposable income and better quality living standards. The increase in life expectancy exposes a person to health problems and diseases with increase in age. For an average person, in their retirement years, they do not have the income to meet healthcare costs. Moreover, healthcare costs have soared in the last few years. This leads to a double blow to the person who falls prey to critical illnesses or other diseases which require hospitalisation and result in huge medical bills. This underlines the importance of health insurance which is gaining popularity among the masses.
The health insurance products available in the market today come in many variations and combinations and are sold by many Life and Health insurance companies.

**Cashless Treatment**

In the case of medical emergencies, it is often difficult to find immediate cash to meet the medical expenses. Health insurance covers treatment costs which require hospitalisation (including domiciliary treatment). Health insurance companies tie up with hospitals across the country and include them in their network. Insurance companies issue cashless cards to the insured which does not require them to pay for treatment (allowed costs) when admitted to one of the network hospitals. If the insured gets admitted to a non-network hospital then they have to pay the hospital bill and claim the amount from the insurance company on a reimbursement basis.

Healthcare policies are generally available in three variants:

**Individual Policy:** this type of health insurance policy caters to the medical needs of only one individual. For example, Ram has taken a health insurance policy from Company ABC for a sum of Rs. 2,00,000 by paying a premium of Rs. 4,000. Under this policy, Ram will be covered against expenses for any illness (covered as per the policy terms) which requires him to be hospitalised, up to a limit of Rs. 2,00,000 in that particular year.

**Family Floater Policy:** this type of health insurance policy caters to the medical needs of a family. In family floater policies, normally insurance companies allow coverage for up to two adults and two children in a family. The sum insured can be shared by the family members covered in the policy. There are no fixed proportions in which the sum insured is shared by the family members. For example, Amit has taken a Family Floater Policy from Company ABC for Rs. 3,00,000 for his family. The policy covers Amit, his wife and his two children. In this policy, the sum assured of Rs. 3,00,000 will be shared by all the four members of the family in no fixed proportion. It can happen that Amit’s wife suffers a heart attack and the entire Rs. 3,00,000 is used up for her treatment.

**Group Policy:** this type of health insurance policy caters to the medical needs of a group of people brought together for a common objective or purpose.
For example, Company XYZ has taken a group health insurance policy from Company ABC for all their employees. This policy will take care of medical needs of the employees of Company XYZ up to a fixed amount, say Rs 2,00,000.

**Diagram 5: Types of Health Insurance Plans**

Healthcare policies normally have some exclusions such as dental treatment, diagnostic tests, expenses on vitamins, cosmetic treatment, homeopathic treatment etc. These policies also, exclude treatment for diseases prevalent at the time of taking the policy for the first time or contracted within 30 days of such commencement. These diseases are termed as pre-existing illnesses by health insurance companies. If there is no claim during the year the insurance company gives a discount on the renewal premium or keeps the premium same and increases the sum assured, which is known as ‘No-Claim Bonus’.

Health insurance generally provides cover for treatment of the following:

**Hospitalisation:** the hospitalisation charges are paid by the insurance company if the insured is hospitalised for more than 24 hours. Insurance is provided for pre and post hospitalisation treatment as well.

**ICU treatment:** if the insured is to be treated in ICU (Intensive Care Unit) then some companies have a provision of additional payment provided the insured has paid the additional premium for the same. Some health insurance companies also provide additional ‘Critical Illness Cover’ which can be specifically used to treat critical illnesses over and above the normal sum assured for extra premium payment.

**Surgery:** a fixed lump sum amount is payable if the insured has to undergo some listed surgery.

**Recuperating expenses:** some insurance companies pay the post hospitalisation benefit to help the individuals meet expenses like follow up tests and medical consultations.

**Health check-up:** some health insurance companies also provide annual health check-up on regular basis as part of the policy.
Day care expenses: there are some treatments which do require less than 24 hours hospitalisation. Such treatments are covered under day care expenses if they are covered under the policy.

Hospitalisation cash policy: both life insurance companies and non-life insurance companies provide this policy. This policy only covers the hospitalisation expenses and excludes other medical expenses. The insured gets a lump sum payment for hospitalisation on a daily basis. The hospitalisation charges are payable by the insurance company if the insured is hospitalised for more than 24 hours.

Test Yourself 6

Question 6

Which of the following plan provides health cover for the entire family?

- Critical care plan
- Family floater plan
- Group insurance plan
- Mediclaim

Summary

Death cover: amount paid by the insurer to the nominee / beneficiary on the death of the life insured during the tenure of the policy.

Survival benefit: amount paid by the insurer to the insured on the maturity of the policy.

Sum assured is a pre-agreed amount between the insured and insurer; payable by the insurer on the happening of a specific event.

The premium is based on sum assured and could be paid either as a lump sum payment or could be paid periodically (monthly, quarterly, semi-annually or annually).

Term insurance provides only death cover i.e. the sum assured is paid to the nominee / beneficiary if the insured dies during the tenure of the policy.

In an endowment assurance plan sum assured is paid to the nominee / beneficiary on the death of the life insured or to the life insured on the maturity of the policy.

Whole life insurance plan provides insurance cover for entire lifetime of an individual.
In a money back plan, a certain percentage of the sum assured is returned to the insured at specific intervals during the lifetime of the policy. ULIPs provide the triple benefits of life cover, returns and tax benefits.

A rider is an additional clause or condition added to the base policy that gives additional (add-on) benefit to the buyer.

Industrial life insurance refers to a low cost insurance plan for low income groups working in industries.

Key man insurance is the insurance cover extended to an important employee of the company, the loss of whom can affect the operations and profitability of the company.

Health insurance provides insurance cover for meeting medical emergencies that require hospitalisation.

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### Some important terms / definitions you have learnt in this chapter

- Sum assured
- Premium
- Deferment period
- Vesting
- NAV
- Family floater

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### Answers to Test Yourself

**Answer to TY 1**

The correct option is **B**

The minimum age of the child, for getting child insurance is generally three months.

**Answer to TY 2**

The correct option is **C**

In ULIP NAV stands for ‘Net Asset Value’
Answer to TY 3

The correct option is C

If the insured person has taken accidental death benefit rider, then in case of his accidental death, the beneficiaries would get additional money over and above the normal sum assured.

Answer to TY 4

The correct option is B

In an industrial policy the debit list consists of the details of the policyholders from whom the premium be collected needs to be collected.

Answer to TY 5

The correct answer is C

Key man insurance is the insurance cover extended to an important employee of the company with significant responsibilities, the loss of whom, can affect the profits of the company.

Answer to TY 6

The correct answer is B

A family floater plan provides health cover for the entire family.

Self-Examination Questions

Question 1

Under which type of plan the sum assured is paid only if the insured person survives the specified period.

Pure term plan
Pure endowment plan
Endowment assurance plan
None of the above
Question 2

In which of the following postal life insurance plan the insured gets the sum assured and the bonus at the time of maturity?

- Whole life insurance plan
- Endowment insurance plan
- Convertible whole life insurance plan
- Postal monthly Income plan.

Question 3

Under which of the following plans, a certain percentage of the sum assured is paid to the policyholder at specific intervals during the policy term?

- Term life insurance plan
- Endowment plan
- Whole life plan
- Money back insurance plan

Question 4

In a child insurance plan, the date on which the risk is commenced is known as

- Deferred date
- Vesting date
- Commencement of the risk date
- Insured date

Answer to Self-Examination Questions

Answer to SEQ 1

The correct option is B

In a pure endowment plan the sum assured is paid only if the insured survives a specified period.
Answer to SEQ 2

The correct option is B

In an endowment insurance plan of PLI the insured gets the sum assured and the bonus at the time of maturity.

Answer to SEQ 3

The correct option is D

In a money back insurance plan, a certain percentage of the sum assured is paid to the policyholder at specific intervals during the policy term.

Answer to SEQ 4

The correct option is A

In a child insurance plan, the date on which the risk commences is known as deferred date.
Chapter Introduction

Retirement planning is an important tool for an individual, which helps them to be financially independent even after retirement. Government employees are more secure in this sense as they receive regular pension from their employers after retirement. But now-a-days, there is an increase in the workforce of people who are either self-employed or work in private companies that do not offer pensions to its employees. Hence the biggest worry for these individuals is to plan for their retirement.

A proper retirement plan has therefore become necessary. Insurance companies now offer annuity products as a retirement solution to these self-employed individuals and salaried employees working in private companies. Annuity provides regular income or pension at the chosen retirement age. In this chapter, we will study the annuity products, their features and benefits.

Learning Outcomes

- Understand the concept of annuity.
- Analyse the different types of annuity plans.
- Understand the advantages and disadvantages of annuity.
Look at this scenario

Sharad Sharma is an executive engineer who works for a private electronics firm. He is 33 years old and wants to retire at the age of 60. Sharad and his wife are able to maintain quite a comfortable lifestyle in their present salaries. However, he wants to make sure that he invests the money prudently and earns a regular income after his retirement. He feels that regular income received throughout his lifetime will provide the necessary financial liquidity to meet his monthly expenses.

He therefore wants to go for an investment plan that provides him with regular income in the form of pension after his retirement, and also lets him maintain his standard of living that he enjoyed prior to his retirement.

1. Understand the concept of annuity. [Learning Outcome a]

Annuities are investments made by an individual with the aim of receiving regular income on a periodic basis after a specified period or immediately. Individuals invest in annuity to meet their post retirement or old age financial needs.

The concept of annuity is similar to pension, which an employee receives from their employer after retirement. Pension is the regular payment that is received by an employee after their retirement. But some private sector employees or self-employed persons do not enjoy the benefits of pension from employers. Insurance companies offer annuity plans for such individuals. The annuity is purchased by an individual from the insurance company and in return, the insurance company provides regular income (pension) to the individual. Hence, annuity is also known as a pension plan.

Annuities vs. Insurance plans

Both annuities and insurance plans are sold by insurance companies, but the similarity between the two ends there.

An insurance plan is a contract between an individual and the insurance company, in which the individual pays premiums for a specified period, against which the insurance company provides insurance cover to the individual. The insurance company makes a lump sum payment to the beneficiaries on the death of the individual, or to the individual on completion of the policy term.

Annuity is a contract between an individual and the insurance company, in which the individual pays a lump-sum amount or regular payments to the insurance company and at the end of a specified period, the insurance company provides regular income to the individual.
Some important terms used in an annuity:

**Annuitant**: an individual investing in annuity is known as an annuitant.

**Annuity income**: the annuity (periodic amount) that is paid to the annuitant is annuity income. It can also be referred to as pension, allowance or income.

**Annuitise**: to start the pension or annuity, an individual has to annuitise. Annuitising means instructing the insurance company to start the periodic payments.

**Deferment period**: once the contract between the annuitant and the insurance company commences, the insurance company can start paying the annuity immediately, or after a specified period of time, or from a certain age. Such specified period, from the date the annuity contract begins till the actual annuity payments begin, is called deferment period.

**Vesting date**: the date from which the annuitant starts receiving regular income is known as the vesting date. This date generally coincides with the retirement date of the annuitant.

**Commutation**: on the vesting date, the annuitant has two choices. The annuitant can either start receiving the regular annuity payment from the insurance company or withdraw 1/3rd of the total accumulated amount as a lump sum payment (commuted value) from the remaining balance, and request the insurance company to pay out regular annuity payments. This process is known as commutation.

**Commutated value**: at the beginning of the annuity, the lump sum that the annuitant withdraws is known as the commuted value.

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**Example**

Mihir has been investing in an annuity plan for the past 10 years. On completion of the deferred period of 10 years, his annuity contract with the insurance company will commence (i.e. on 12th September 2010). Hence 12th September 2010 is the vesting date for Mihir’s contract. If on this day he decides to withdraw a certain percent of his investments (commutation amount), then the remaining 75 percent will be used by the insurance company to provide regular payments (annuities) to Mihir.

In the above scenario:

Mihir is the **annuitant**.

- **Deferment period** is the 10 year period for which Mihir pays the premium.
- **Vesting date** is 12th September 2010, when the annuity contract commences.
- **Commutated value**: withdrawal of a certain percent of the accumulated amount.
- **Commutation**: the process of withdrawal of money.

If Mihir decides to exercise **commutation**, then the income that he will receive from the insurance company will be lesser than what he had originally planned out of the whole corpus.
The main features of annuity can be summed up as below:

Individuals purchase annuities to get a regular source of income (pension) after retirement or after certain age.

The annuitant can pay premium to an insurance company either in lump sum or in instalments.

No medical check-up is required for taking an annuity policy.

The insurance company and the annuitant can mutually decide the annuity payment which can be either monthly, semi-annually or annually, as preferred by the annuitant.

The annuity plans offered by insurance companies are very flexible. Annuity plans can either continue:
- for the annuitant’s whole life or
- or a fixed number of years or
- fixed number of years / life or
- in the case of joint life policy; till the joint applicant survives

The amount that the annuitant pays as premium for annuity to insurance companies depends upon several factors such as:

- **the regular income that the annuitant expects at the time of retirement**: the premium amount depends upon the current income of the individual and the amount that they can spare towards premium payment.
- **the amount that they have invested in other schemes and the returns that they expect**: this helps the annuitant in evaluating the income they expect to receive in future and the amount they require for retirement.
- Their **future financial liabilities** such as home loan, child education, medical expenses etc.

**Question 1**

The individual has to instruct the insurance company to start the annuity income. This is process is known as ____________.

- Annuitising
- Commutation
- Vesting
- Deferment
2. Analyse the different types of annuity plans.
Learning Outcome b]

Types of Annuities

Diagram: Classification of annuities

- **Premium Payment**
  - Single premium payment
  - Multiple premium payment

- **Payment of Annuity**
  - Life annuity
  - Annuity certain
  - Joint life last survivor annuity
  - Annuity for life with return of premiums
  - Increasing annuity

- **Purpose of Annuity**
  - Immediate annuity
  - Deferred annuity

- **Type of Investment**
  - Fixed annuity
  - Variable annuity
On the basis of premium payment: the annuitant has the option of making the premium payment either as a lump sum amount or in instalments. Based on the method of premium payment, an annuity could be categorised as follows:

Single premium payment: in this type of annuity an annuitant pays a lump sum amount as a single premium. This is preferred by individuals who are nearing retirement and who have not made any prior investments for meeting post retirement obligations. On retirement, the individuals can invest their savings by purchasing an annuity plan. In return, the insurance company can start paying pension immediately after receiving the payment. Salaried employees receive provident fund money on retirement, which they can put in an annuity plan.

Example
Amol is retiring in February next year and is worried about his post retirement financial obligations. He has accumulated a substantial amount in his provident fund account, which he plans to use after his retirement. He is looking for some investment avenue where his money can be safe and that can provide regular payments to meet his post retirement expenses.

Amol can select an annuity plan to invest his provident fund amount. The premium can be paid as a lump-sum. Once he pays the premium, he can immediately start receiving pension from the insurance company.

Multiple premium payment: here, the annuitant makes a series of payments to the insurance company. This kind of premium payment method is preferred by young salaried individuals, who choose to make the payment of annuity premiums in instalments and do not expect the returns immediately. They continue to make regular periodic payments of premiums in instalments, till retirement or till a specific time. The insurance company starts paying the pension after the deferred period to the annuitant.

Example
Dr. Mukund Gupta is a reputed paediatrician who runs a private clinic. Over the years he has built quite a name for himself. Though he earns good regular income and has invested it prudently in various investments, he is concerned about his post retirement financial obligations. As he is in private practice he would not be able to enjoy pension after his retirement.

Dr Mukund Gupta can choose to purchase an annuity plan, where he can pay monthly instalments for a specific period and after retirement, he can choose to receive regular pension.
2. On the basis of payment of annuity

**Life annuity**: in life annuity the insurance company promises to pay a certain amount of annuity to the annuitant as long as he/she lives. The annuity payment stops on death of the annuitant, and the rest of the accumulated fund is returned to his beneficiary.

**Example**

Mehul Kumar works as an executive engineer with a leading construction firm. He has invested money in an annuity and has chosen the option of annuity for life. In this scheme, he will start receiving pension after retirement for as long as he lives. The insurance company will cease the payment on his death. In case at the time of the death there are some funds left with the company, that amount will be returned to Mehul’s beneficiaries.

**Annuity certain and life thereafter**: in this option, the insurance company promises payment of fixed annuity for a fixed term. In case the annuitant dies during the specified term, the remaining amount will be paid to the nominees. In this option, the annuitant can choose to receive annuity payments for some specific period, say 5, 10, 15, 20 or 25 years irrespective of survival of annuitant and if the annuitant survives the chosen annuity certain period, the annuity will be paid for life thereafter.

**Example**

Rakesh Sharma is an executive working in a leading MNC. He has chosen to purchase an annuity guaranteed for a fixed period of 20 years. That means he will receive pension for 20 years. In case he dies after 12 years, the annuity will be paid to his beneficiaries for the remaining 8 years. In case he survives for more than 20 years, then in this case, the insurance company will pay annuity for the chosen term of 20 years and stop the annuity payment after the completion of the specified tenure.

**Joint life last survivor annuity**: in this option annuity is paid to the annuitant for their entire life. On the death of the annuitant, 50% of the pension will be paid to the spouse for as long as the spouse lives. A variation of joint life annuity allows annuity payment during the lifetime of the annuitant or their spouse, whoever lives longer.

**Annuity for life with return of premiums**: in this option, annuity is paid to the annuitant as long as they live and on their death, premiums are returned to the nominee or legal heirs.
increasing annuity: annuity is paid by the insurance company on any of the above terms but the annuity increases every year by a fixed rate or amount.

3. On the basis of purpose of annuity

Immediate annuity: this type of annuity is taken when the individual wants to start receiving the annuity immediately. Here, the individual starts receiving annuity payments as soon as the annuity product is bought. The annuitant has to make a lump sum payment for receiving immediate annuity.

Deferred annuity: when an individual wishes to receive annuity payment after certain specified period, they can choose deferred annuity. This specified period is referred to as deferment period. The annuitant can either make a lump sum payment at the time of commencement of contract, or make payment in instalments, during the deferment period.

The insurance company returns the amount of premium paid to the beneficiaries of the annuitant, in case the annuitant dies during the deferment period.

The annuity commences at the end of the deferment period, on a date which is known as the vesting date.

4. On the basis of type of investment

Fixed Annuity: in fixed annuity the insurance company promises to pay a fixed amount of annuity for a certain period of time or life thereafter. Fixed annuity guarantees the amount of annuity. The investment is made in low risk securities like government bonds. In immediate annuity, the insurance company will begin regular annuity payments immediately after the lump sum payment is made by the annuitant, whereas in deferred annuity, the payment will be made after a period of time, say after the annuitant retires.

Variable annuity: in a variable return annuity, the payment made by the insurance company depends upon the performance of the investment option that is chosen by the annuitant. In a variable annuity plan, the investments are generally made in mutual funds, money market instruments, stocks and bonds. The variable annuity helps the annuitant to participate in the growth of the investment avenue chosen. The premium that is paid by the annuitant is invested by the insurance company based on the investment option chosen by the annuitant.
Test Yourself 2

Question 2

In which annuity product does the annuitant start receiving the annuity payments instantly once they buy the annuity product?

Life annuity
Fixed annuity
Immediate annuity
Fixed payment annuity

Understand the advantages and disadvantages of annuity.  
[Learning Outcome c]

Advantages of annuity

- **Provides income for lifetime:** annuity helps to provide regular income throughout the annuitant’s life. The payment can start as soon as the investment in annuity is made or from some later date.
- **Assured income after retirement:** annuities provide assured income to an individual after retirement depending on the plan chosen by the annuitant.
- **Diversified portfolio:** annuities are an excellent option for diversifying one’s investment portfolio.
- **Immediate payment option:** if an individual is nearing retirement and has not been able to save much, then one can choose to start receiving annuities immediately by making a lump sum payment.

With the rising cost of living, an individual needs a regular source of income after retirement to meet their daily expenses and maintain a certain standard of living. Annuity provides the necessary financial independence after retirement to meet the monthly expenses.

Disadvantages of annuity

- The money invested in annuity gets blocked till retirement. There could be certain situations, where the need for a lump sum amount may arise such as:
- Payment for medical treatment, where a lump sum payment has to be made urgently.
- The annuitant wants to invest in some physical assets such as car, land or house.
A new investment scheme which promises good returns has been launched by a company, and the annuitant wishes to invest in the scheme.

If the person withdraws a certain amount of money invested on the vesting date (commutation), then the return income (annuity) will reduce, and might not be sufficient to meet requirements.

**Test Yourself 3**

**Question 3**

Which of the following is a disadvantage of investing in annuity?

- Regular payment after retirement
- Money gets blocked till retirement
- Provides financial independence
- An option for diversifying the portfolio

**Summary**

Annuities are investments made by an individual with the aim of receiving regular income on a periodic basis either immediately or after a specified period.

An individual investing in annuities is known as an annuitant.

To annuitize means to instruct the insurance company to start the periodic annuity payment.

The date from which the annuitant starts receiving regular income is known as the vesting date.

Commutation refers to the process where the annuitant can withdraw a certain portion of the money (as a lump sum) from their accumulated fund on the vesting date.

An insurance company has to make the payment monthly, quarterly, semi-annually or annually, as preferred by the annuitant.

There are various options for receiving annuity payments at the retirement age such as for a fixed term, for life, etc.
Some important terms / definitions you have learnt in this chapter

- Annuitant
- Annuitize
- Vesting
- Commutation
- Deferred period

Answers to Test Yourself

Answer to TY 1.

The correct option is A.

Annuitize means instructing the insurance company to start the periodic payment of annuity.

Answer to TY 2.

The correct option is C.

In immediate annuity, the annuitant starts receiving the annuity payments as soon as they buy the annuity product.

Answer to TY 3.

The correct option is B.

The money invested in annuity gets blocked till retirement. There could be certain situations, where the need for a lump sum amount may arise, but the annuitant will not be able to withdraw the money.
Self-Examination Questions

Question 1
On the death of the annuitant, 50% of the pension will be paid to the spouse. This option is available under which type of annuity?
- Fixed amount annuity
- Life annuity
- Joint life last survivor annuity
- Increasing annuity

Question 2
In which of the annuity does the payment made by the insurance company depend upon the performance of the investment option that is chosen by the annuitant?
- Fixed annuity
- Variable annuity
- Fixed amount annuity
- Guaranteed annuity

Question 3
The date from which the annuitant starts receiving regular income is known as
- Deferred date
- Immediate date
- Vesting date
- Commuted date

Question 4
Which type of annuity guarantees payment for life?
- Commutation of annuity
- Annuity guaranteed for fixed period
- Life annuity
- Fixed annuity

Question 5
Who is an annuitant?
- The person who buys annuity
- The person who guarantees the annuity
- The person who sells the annuity
- The person who advertises annuity
Answer to Self-Examination Questions

Answer 1

The correct option is C.

Joint life last survivor annuity: on the death of the annuitant, 50% of the pension will be paid to the spouse for as long as the spouse lives.

Answer 2

The correct option is B.

In a variable return annuity, the payment made by the insurance company depends upon the performance of the investment option that is chosen by the annuitant.

Answer 3

The correct option is C.

The date from which the annuitant starts receiving regular income is known as the vesting date.

Answer 4

The correct option is C.

In life annuity, the insurance company promises to pay a certain amount throughout the annuitant’s life.

Answer 5

The correct option is A.

The person who purchases annuity is known as an annuitant.
Chapter Introduction

In this competitive age, insurance companies are trying their level best to secure the highest client base. For this they try to come up with various innovative products to attract maximum customers towards them. They are also trying to expand their operations involving different customer segments. Corporate clients are one such customer segment that is being targeted by insurance companies.

Corporate clients in turn, are trying to outsource their various activities to specialists in the fields (e.g. Actuaries) such as managing the funds for gratuity, pension, leave encashment etc. who have the required expertise and experience for managing these. In this chapter we will study about how insurance companies try to provide solutions to corporate clients for managing these employee benefits through group insurance.

Learning Outcomes

Understand the importance of group insurance.
Learn about the different group insurance schemes.
Look at this scenario

Makheja Group is a leading textile manufacturer of the country. They have over 200 employees. Makheja Group’s main concern is to retain the best of talent in their company. They spend huge amounts of money in providing various benefits to their employees. This is done to discourage the employees from leaving the company and also seek corporate tax exemptions. Some of the benefits that are provided by Makheja Group are life insurance, superannuation, and gratuity, leave encashment, pension etc.

Gratuity and superannuation are long term liabilities, the provision for which has to be made today. Also gratuity that is provided to employees is a statutory requirement; hence the company has to make sure that the legal aspects are well taken care of. The biggest problem the Makheja Group faces is to determine the correct amount of liability (payments to be made towards gratuity, pension etc) that will arise in future. Also they need to efficiently invest these funds to get optimum returns.

The solution that the Makheja Group is looking for is to have these liabilities managed by personnel with the necessary expertise in managing the corporate benefits provided to their employees. It will help Makheja Group a great deal maximizing the benefits to their employees.

This is where insurance companies can pitch in with their expertise (e.g. by actuaries) and help companies like the Makheja Group and others. In this chapter we will learn about the various retirement benefits schemes offered by employers to their employees and how insurance companies help companies manage these schemes.

1. Understand the importance of group insurance.  [Learning Outcome a]

Group insurance

The solution to the plan discussed above is provided by insurance companies in the form of Group Insurance. Life insurance companies cater to corporate clients by providing services to manage various benefits such as term insurance, pension, gratuity etc. Insurance companies provide several group insurance schemes to their corporate clients to cater to their various requirements.
Group insurance schemes provide insurance to a group of people under one single master policy. The individuals who get insurance cover under the policy are referred to as ‘members’ of the group insurance scheme.

Individuals, who exit the organisation to join any other organisation, may or may not continue, to derive benefits of group insurance scheme, depending on the terms and condition of the scheme.

The amount of insurance cover for each employee depends upon certain criteria such as:

- Employee grade / designation
- Salary drawn by the individuals
- Duration of employment with the current employer etc

Group insurance can be terminated by the insurance company or the employer at the end of any year. Apart from the group insurance provided by the employer, personal insurance can also be taken by employees on their own.

As many person are covered under one single contract, the administrative cost are low, because the coverage is not at the choice of the individual concerned, the chance of an adverse selection is low.

The terms and the coverage can be re-negotiated at the time of renewal.

**Eligibility for group insurance**

**Employer - Employee groups:** The most important target group for group insurance scheme is the employer - employee group. Employer is a word used for either a large company or a small firm. The only condition is that there should be a minimum number of employees (say generally 15 – 20) working in that company.

The employees of an organisation are treated as one group, to whom insurance is issued as a single unit. The employees get the benefit of group insurance till they are employed by the company. The individual beneficiary members of the group cannot choose the amount of insurance cover. The amount will be determined on criteria which are applied uniformly to all the members of the group.

**Example**

The Makheja group, discussed in the concept given above is an example of this kind of a group. Makheja group as an employer can take group insurance for its employees. All 200 employees will be considered as a single unit for providing group insurance.
**Professional associations:** These groups are formed to protect the interest of professionals like doctors, engineers, lawyers, chartered accountants etc. These professional associations can avail the benefits of group insurance.

**Co-operative Societies:** are organisations which are managed by individuals for their mutual benefit.

**Creditor – debtor:** Under this group, the creditor, who has provided some loan to individuals, can take group insurance for covering the dues of debtors to safeguard his loans which have been advanced. Examples can be banks, NBFCs seeking insurance cover for loans given by them to their customers.

**Weaker sections of the society:** group insurance also targets the weaker sections of the society, who otherwise, would not have been able to take the advantage of insurance.

It should be remembered that if a group is formed specifically with the intent to get the benefit of insurance, it will not be eligible for group insurance.

**Main features of group insurance are as follows:**

**Master policy:** As a group is considered as a single unit, a single policy known as a master policy is issued to the authorised person of the group who pays the premium. The individual are the beneficiaries. They are not parties to the contract.

The amount and terms of insurance are negotiated by the policyholder and not by the individual beneficiaries. The benefits will be determined on basis that apply uniformly to all the individuals.

**Example**

In an employer – employee group, the employer is issued a “master policy” by the insurance company and the individual employees are covered.

In a creditor debtor group, the creditor will be issued the master policy. For example a bank will be issued a master policy for its borrowers(debtors) who have availed of housing or vehicle loans etc

**Certificate of insurance:** The employees who get covered under group insurance are issued certificates of insurance (COI).

Individual members are not separately evaluated on risk factors. Underwriting is based on an assessment of the group as a whole. Minimum requirements like “actively at work” and “no medical leave for the last 6 months” could be the simple conditions of eligibility (The definition of “actively at work” could differ from one group to the other.)
Everybody fulfilling specified criteria will have to compulsorily join the group. Usually, when the scheme is being introduced for the first time, the existing members will be given a choice of joining or not joining the scheme. The choice, to be made within a specified period, will be final. In other words, if a member opts not to join, he cannot change his mind later. These are methods to avoid adverse selection. Exits will be as per the conditions of the contract like on retirement or death or termination of membership from the group.

**Free cover limit:** In order to reduce administrative expenses, insurance companies try to simplify the whole process of managing a group insurance based on the pre-criteria mentioned above. For this, they stipulate a certain maximum amount, up to which medical check-up of employees will not be required. This amount is known as **free cover limit** or **no evidence limit** (as no medical evidence is generally called for).

**Example**

The insurance company for the employees of Makheja group provides a free cover limit of Rs 1,00,000. Hence employees will not be required to undergo medical check-up for insurance of upto Rs 1,00,000, if they fulfil the criteria of “actively at work” and “no medical leave for the last 6 months.” (these definitions could can vary from one group to the other).

The idea behind free cover limit is that the insurance company assumes that if the employee is working in an organisation, the employee is medically fit and able to work for the specified hours. Also employees generally have to undergo a medical check-up and provide medical fitness certificates before they join any organisation. Based on this notion the insurance companies grant group insurance upto free cover limit without a medical test. The amounts of free cover offered to the different groups can vary between groups and sub-groups.
Diagram 1: Group insurance policy for bank customers

Premiums

The premium payment in a group insurance policy is annual and is paid by the employer. However, in some schemes, the employee and employer together can make the contribution. Based on who pays the premium, group insurance plans can be categorised into two types:

- **Contributory insurance plan:** in this plan the members also pay a part of the premium. In employer-employee group, the employer deducts a certain amount of premium from the salaries of the employees. In a contributory insurance plan only the employees who wish to participate in the group insurance agree to allow deduction from salary and rest do not allow a deduction from salary and hence are not covered under the group insurance plan.

- **Non-contributory insurance plan:** in this plan the members do not contribute the premium. In a non-contributory employer–employee group, the employer pays the entire amount of premium. All the employees of the company get insurance cover under this plan.
Eligibility conditions in group insurance:

The general eligibility conditions in group insurance are as follows:

Formation of the group: Insurance cover must not be the prime motive for the formation or existence of the group.

Minimum number: there should be a minimum number of members in a group generally 15 – 20 or more persons may be adequate for group insurance and there may be no maximum limit.

Active at work: the employee should be active at work, on the date of insurance commencement i.e., employee should not be absent from duty due to sickness or any other reason for the last 6 months. The insurance cover will not be provided to such an employee till he joins duty.

Probation: probationary period can range between 6 months to 1 year and depends upon the policy of the company. Some companies provide group insurance only to confirmed employees after completion of probation. Some companies provide group insurance only to full time employees. Some companies provide group insurance only to employees above a certain grade.

Age limit: some companies have age limits for group insurance. It may be specified that an employee’s age should be less than 60 years for group insurance and he / she should have joined the organisation, before the age of 55.

New employees: in a non-contributory scheme, all new employees who join the organisation become eligible for group insurance. In a contributory plan, there may be a waiting period (usually a month) for the employee, after which he can join the group insurance scheme.

Cover limit: the beneficiary will not be able to choose the amount of insurance cover. It will be determined on a criterion which can be applied uniformly to all members of the group. This takes care of the risk of anti-selection.

Administration: there has to be a single administrative organisation to be willing and able to act on behalf of the group. Normally this is the administrative officer of the employer or association.
Benefits of group insurance:

Group insurance can be taken by an individual, who cannot afford to purchase individual plan due to a high premium.

Administrative costs for the insurer are low, as a single policy needs to be issued and managed.

Group insurance plan needs to be renewed each year. The employer or the insurance company can choose not to renew the contract if either of the two parties is not satisfied with the other.

**Free cover limit:** no medical checkup is required up to a certain amount due to following reasons:

As the employees are “actively at work”, the employees are considered healthy enough to work full time for the company.

The company, before selecting an employee, generally insists on a medical checkup, which ensures the good health evaluation of the employee.

Employees do not join an organisation for availing insurance cover and so the element of adverse selection is reduced.

**Note:** Even if the individual is suffering from a certain medical condition that would not enable him to get an insurance policy individually, he is generally able to receive insurance under group insurance. It is therefore advantageous to the member of the group.

**Test Yourself 1**

Question 1

A group insurance plan in which employees have to pay a certain portion of the premium along with the employer is known as ________

- Non-contributory insurance plan
- Contributory insurance plan
- Free insurance plan
- Deduction insurance plan
Learn about the different group insurance schemes. [Learning Outcome b]

Group insurance schemes can be classified as:
- Group term insurance scheme
- Group gratuity scheme
- Group superannuation scheme
- Group leave encashment scheme
- Group insurance scheme in lieu of EDLI
- Social security schemes

Diagram 2: Types of group insurance schemes:
Group Term Insurance Scheme

Group term insurance scheme provides life insurance cover to a group of people as a single entity. Like individual term policy, the group term insurance scheme, provides death cover to the members. In the case of the death of a member the nominee is paid the sum assured under the scheme. In an employer – employee group, the employer will act as the principal policyholder and the employees are the members who will be insured under the scheme.

Majority of the employees of an organisation are covered under the scheme. Any new employee, who joins thereafter, automatically becomes eligible for group insurance scheme depending on the terms and conditions of the organisation.

Features of group term insurance scheme

**Master policy:** A single master policy is issued to the employer.

**Certificate Of Insurance (COI):** is issued to each member as a proof of the insurance cover provided to them.

**Sum assured:** could be determined in different ways

- It could be the multiple of the annual salary of the employee
- It could depend on the designation or grade of the employee
- It could depend on the tenure of the employee in the organisation.

If an employer chooses to provide the sum assured based on organisational hierarchy, then the sum assured will be derived on the basis of designation / grade of the employee and his salary. Hence higher the grade, higher will be the sum assured available as insurance cover.

**Premium:** the premium is paid by the employer annually as a lump sum payment thereby keeping the administration costs low. The term of the scheme is only for one year. After the completion of each year the contract has to be renewed by the employer and insurance company. Premium charges may be revised annually at the time of renewal of the scheme. Premium payment for the group is considered as business expense of the employer in the books of accounts.
Premium pricing in group insurance is based on:

- Size of the group
- Age distribution of the group.
- Number of employees that have retired or have left the company.
- Number of new employees who have joined the company.

**Diagram 3: Premium pricing in group insurance**

In the case of a contributory scheme a certain percentage of the premium is paid by the employee and rest of the amount is paid by the employer. The amount of premium could be deducted from the employee’s salary. In a non-contributory scheme, the entire premium will be paid by the employer.
Eligibility:

**Groups:** group term insurance is generally provided to employer – employee relationships. It could also be provided to professional association of doctors, lawyers etc. Members of banks, trade unions and weaker sections of the society are also eligible for group term insurance.

**Age:** with regard to age, there may be a condition. For example, the age of the employee, to be eligible for group term insurance scheme should generally be between 18 to 60 years.

**Administration cost:** the administrative cost for group insurance policy is low as compared to individual policies.

**Claim:** when a claim arises, the details of the member along with a death certificate are required to be submitted. Claim settlement in group insurance is comparatively easy as compared to individual insurance.

**Free cover limit:** no medical check-up is required due to free cover limit. The disadvantage is that the members who have adverse medical conditions will get the advantage of insurance, who otherwise would not have been eligible for individual insurance.

**Tax benefits:** the amount paid as premium is treated as business expense, hence deductible under tax laws. Even death claims provided to nominees are tax free.

Group Gratuity Scheme:

According to the Payment of Gratuity Act 1972, any company having more than 10 employees, has to provide gratuity to its employees. Gratuity needs to be paid in the case of:

- the death of the employee
- disability of the employee
- on the resignation of the employee (subject to certain conditions)
- on the retirement of the employee
Diagram 4: Payment of gratuity

Hence gratuity is a statutory requirement for which each employer has to make necessary arrangements. Liability for gratuity payment arises on a future date, but the funds need to be managed prior to the payment of gratuity. Companies can purchase Group Gratuity Scheme from insurance companies and can add provisions that enhance the value of the benefit available to their employees.

Methods of gratuity payment

‘Pay- as – you- go’ method: gratuity could be paid by the company, when it falls due i.e. at the time of retirement, or the employee’s exit. Under this method the payment is made from the current revenues of the company. “Pay- as- you-go” method is not a prudent practice that should be followed by an employer as the gratuity payment depends largely on the amount of salary and number of years of service of an employee. An estimate of the future liabilities should be made and certain funds out of the revenues should be arranged for meeting these liabilities. In case a large number of employees decide to leave the company at the same time, it would be very difficult for the company to pay such a large amount under the “pay- as – you - go – method”.

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Create an internal reserve: the company makes an estimate of the future liability of gratuity payments and reserves some amount for meeting these liabilities in future. The disadvantage of this method is that it just a mere accounting entry in the books of accounts and the company might use these funds for meeting its current requirements or some other contingency. To prevent the diversion of funds for any other purpose apart from the payment of gratuity, the management of the company will have to be very strict and disciplined.

Setting up a Gratuity Fund: the company may set up a Gratuity Fund as an irrevocable trust. The trustees will manage the investments of the fund comprising the contributions, and make payments of gratuity from the fund. The trustees may or may not have the necessary expertise for investing the funds in the right avenues to earn high returns on the funds invested.

Group Gratuity Scheme: in this method, a trust needs to be created by the company for gratuity payments to employees. The trust may enter into a Group Gratuity Scheme contract with an insurer. The funds reserved for the gratuity payments are handed over to the insurer for managing the gratuity portfolio. The insurer with its massive investment portfolio is in a better position to secure maximum benefits from the market, in terms of protection from fluctuations as well as better spread, than an individual trust with its relatively small portfolio can do.

The benefit of group term insurance, given by an insurer helps the families of employees dying early get gratuity as if the employee had completed the full term of service.

If Makheja group takes the group gratuity scheme from an insurance company, it will have following advantages:

The funds for gratuity will be managed by the insurance company, which will have the necessary expertise and trained staff for managing the funds and secure good return on investments in various market securities and at the same time ensure the safety of the investment portfolio.

The insurance company can use its actuarial skills to estimate future liabilities of the company. Actuaries have necessary expertise in the field, hence future liability estimates are bound to be more accurate.
The insurance company can also provide the benefit of group term insurance to employees in addition to gratuity. In case an employee dies during employment, the nominee/beneficiary will get gratuity payment as if the employee had completed the full term of service. This is an additional benefit provided by the insurance company to the employee. This will be extremely helpful to the dependents of the employee in case of his early death during employment, as the nominee will get payment for the full service.

**Eligibility:** only those employees who are on direct payroll of the company come under the purview of Gratuity Act. The employee needs to complete 5 years of continuous service in the organisation, to be eligible for payment of gratuity.

**Gratuity calculation:** gratuity is calculated based on the number of years of service completed by the employee and the last salary drawn. The employer has to pay 15 days salary for each completed year of service. Gratuity upto a certain limit are tax free.

Gratuity is calculated as follows:

Gratuity = \((\text{Basic} + \text{DA}) \times \text{15 days} \times \text{number of years of service})/26

If there is an increase in years of service or the salary of the employee, the gratuity payment will also increase, thereby increasing the liability of the company. The company gets benefit in many ways, if they tie up with an insurance company for administration of these changes:

The insurance company manages the funding for gratuity on cash accumulation basis. The contributions that are made by the company and the interest payment by the insurance company, both are irreversible. This fund will be available for settlement of claims as and when required.

The contribution of the company towards gratuity fund is shown as business expense in the books of accounts. Hence the company gets tax benefit on the same.

If at a time large number of employees leave the company, then the financial burden in terms of gratuity payment will not be much as the company would have already discharged its liabilities in the form of premium payment to the insurance company.
Group Superannuation Scheme

Group Superannuation Scheme is a pension scheme, in which insurance companies provide superannuation at group level. Regular contribution is made by the employer towards the pension fund. After retirement this corpus can be used by the employee to take an annuity from the insurer. This will provide him with a regular stream of income after retirement.

The employer can purchase a group superannuation scheme from an insurance company and entrust the management of pension fund to the insurance company.

Types of group superannuation schemes

Group superannuation scheme can be of two types:

**Defined contribution scheme:** in this scheme, a certain amount is contributed regularly towards the pension fund. This amount from the pension fund is invested and managed by the insurance company. At retirement, the pension will depend upon the accumulated amount of the fund (amount invested and the return on amount invested). Hence in this case the amount of the pension that employee will receive after retirement cannot be predetermined in advance.

Disadvantage of the defined contribution scheme is that an employer has to make sure that the funds are invested prudentially; otherwise there can be a loss on investment.

**Defined benefit scheme:** in this scheme the pension that an employee will receive after retirement is predetermined. Certain amount of money is periodically deposited in a pension fund, which is invested and managed by the insurance company. But irrespective of the return received and the entire corpus of the fund, the pension that will be given to the employee will depend upon the last salary drawn by the employee. As the pension amount is known in advance and depends upon the salary and not on investments, hence this scheme is known as defined benefit scheme.

Advantages of defined benefit scheme:

The amount of pension fund could become quite substantial if the investments earn good return and there can be a surplus.

The employer does not have to worry about the amount to be paid, as this is predetermined and can be planned accordingly.
Disadvantages of the defined benefit scheme:

If the investment gives lower return than expected then there can be a deficit and the burden of that will have to be borne by the employer.

Types of pension:

The pension options that are provided to employees by insurance company are as follows:

**Pension for life:** in this case pension is paid throughout the employee’s life till his / her death.

**Pension for life with return of premiums:** in this case the pension is paid throughout the life of the employee. The premiums paid are returned to the nominee after employee’s death.

**Pension for specified time period:** in this case the employee gets a guaranteed pension for a specified term like 5, 10, 15 or 20 years and throughout his life thereafter. In case the employee dies within the specified time period then the nominee will be paid the pension for the remaining term.

**Pension for joint life:** in this case the pension is paid to the employee. On his death, the pension is paid to the spouse.
Eligibility: provision for pension is not a statutory requirement. Hence the management has a choice of including all the employees for superannuation scheme or to choose only the employees in selected hierarchies. Again here also the comments given under Eligibility of Group Gratuity scheme applicable.

Benefits of Group Superannuation Scheme

On retirement: of an employee, the corpus (contribution + interest) is used to provide pension to the employee.

On death: in case there is a group insurance scheme along with the group superannuation scheme then on the death of the employee during service, a lump sum payment is made to the beneficiary.

Expert help: insurance companies are responsible for ascertaining future liabilities of the employer, and to ensure that pensions are paid timely for a long period of time. They have the necessary expertise in management of funds as well. Hence the insurance company provides actuarial, legal, taxation and management expertise to the employer.
**Change in the employer:** an employee can choose to transfer funds to the superannuation scheme of the new employer or opt for immediate or deferred pension.

**Contribution:** the contribution is made by the employer. But in some contributory schemes, both the employee and employer can contribute.

**Tax benefit:** the amount contributed towards superannuation scheme is a business expense and hence the employer can claim deduction from taxable income for the same.

**Note:** There are considerable tax advantages both to the employer and the employee in both, Group Gratuity & Group Pension arrangements. The tax advantages are conditional on these schemes being approved by the Income Tax Authorities.

**Group Leave Encashment Scheme**

As per the Companies Act 1956, companies have to provide leave encashment facility to the employees. Leave encashment is a lump sum amount that is payable to the employee at the time of his retirement / leaving the company for the leaves that he / she has accumulated during the tenure of service in the company. The leave encashment amount depends on the number of unused days of leave and the salary of the employee at the time of retirement / leaving the company.

The company can get into a group leave encashment scheme arrangement with the insurer. The scheme enables funding of leave encashment. The insurance company can also provide a group term insurance cover along with this scheme which will result in a sum assured payable to the nominee in the case of the death of the employee during service. A small premium amount is collected along with the contribution for leave encashment fund. On the death of the employee, the nominee gets the amount of insurance cover along with the leave encashment amount.

The liability of the employer under leave encashment increases with time as leave encashment is directly related to the designation and the salary of the employee. The group leave encashment scheme provides help to the employer in meeting this liability. A group term insurance cover may also be provided along with group leave encashment scheme to the employees. Group leave encashment scheme allows the employee to encash unused days of leave.

For group leave encashment scheme, a running account is maintained by the insurance company, where all the contributions made by the employer are credited.
Benefits:
Leave encashment amount is paid to employee from the funds maintained for meeting this liability, when he leaves/retires from the company or when he decides to encash the days of leave.
In the case of the employee’s death, the beneficiary will be paid a lumpsum insurance cover.
The premium paid towards leave encashment scheme is treated as a business expense and hence the employer can claim deduction from taxable income for the same.

Employees’ Deposit Linked Insurance (EDLI) Scheme

If a company is covered under the Employee Provident Fund Scheme under the Employees Provident Fund and Miscellaneous Provisions Act 1952, there is a statutory requirement that, the company has to contribute towards Employees’ Deposit Linked Insurance (EDLI) Scheme.

A contribution of 0.51% of each employee’s monthly salary is made by the employer for EDLI. In EDLI the insurance cover will be dependent on the balance in provident fund account. EDLI has the provision of making payment to nominees in the case of employee’s death. The amount payable will be equal to the average balance amount in the employee provident fund during the past 12 months till his death. If the average balance exceeds Rs. 35,000 then the insurance cover will be calculated as below:
Rs 35,000 + 25% (balance above Rs 35,000)
The insurance cover cannot exceed Rs. 60,000.
Hence, if the duration of service and the salary of the employee are not significant, the insurance cover will be very limited; the benefit to the nominee will be inadequate.
Hence group insurance scheme in lieu of EDLI is an alternative plan offered by an insurance company.

Group Insurance Scheme in lieu of EDLI

Eligibility:
The employer has to claim exemption from the EDLI scheme from the Central Provident Fund Commissioner to provide insurance benefit though the alternative scheme “Group Insurance Scheme in lieu of EDLI”.
Benefits:

Employees get high insurance cover as compared to EDLI
Lower administration cost on part of the employer
Easy settlement of claim as insurance company requires only the death certificate
Premium paid is treated as business expense and hence the employer gets tax benefit on it.

Social Security Scheme
Social security is a concern in all countries throughout the world, although the dimensions may vary considerably. In some countries, the expenses of the elderly persons are borne by the State as a social measure. In some countries, medical care is free. Most of the funds are generated through levies and taxation. In India, group term insurance is a made available to poorer sections of society. In case of death, say a sum of Rs 5000/- is paid to the dependents of the deceased. The amount paid is double (Rs 10,000/-) is paid to the dependents, if the death is due to an accident.

According to the directives of the Central Government a Social Security Fund was created in the fiscal year 1998-99. This fund was conceived by LIC, with an aim, to provide insurance cover to the economically weaker sections of the society. LIC maintains it with half the amount drawn from the social security fund while the rest of the amount is collected from designated nodal agencies. Nodal agency refers to a State Government department which is concerned with the welfare of a vocation group, a welfare fund or society, village panchayat, NGO, self-help group etc.

The Indian Government has approved various occupations for the social security scheme. Some of the occupations which come under the purview of social security scheme are:
- Rickshaw pullers
- Handloom workers
- Artisans
- Tailors
- Barbers
- Masons
- Co-operative milk producers
- Landless agricultural workers etc.

Social Security Scheme offers life protection to weaker sections of the society.
Test Yourself 2

Question 2

In a pension scheme when the pension amount is known beforehand it is known as

- Guaranteed benefit pension scheme
- Group superannuation scheme
- Defined contribution scheme
- Defined benefit scheme.

Summary

Group insurance provides insurance cover to a group of people under one single master policy.

- The individuals who get insurance cover under the policy are referred as ‘members’ of the group insurance scheme.
- The employees who get covered under group insurance are issued certificate of insurance.
- Medical checkup of employees is not necessary if the insurance cover is up to free cover limit.
- If the employer deducts an amount of premium from the salaries of employees, it is known as contributory insurance plan. In a non-contributory plan the employer pays the entire amount of premium.
- Insurance companies offer Group Gratuity Schemes, Group Superannuation Schemes and Group Leave Encashment Schemes to employers.

Some important terms / definitions you have learnt in this chapter

- Free cover limit
- Master policy
- Certificate of insurance
- Nodal agency
Answers to Test Yourself

Answer to TY 1
The correct answer is B
A group insurance plan in which employees have to pay a certain portion of the premium along with the employer is known as contributory insurance plan.

Answer to TY 2
The correct answer is D
When the pension amount of the employee depends on the return on the investment it is known as defined benefit plan

Self-Examination Questions

Question 1
Free cover limit is __________
The stipulated amount till which the insurance cover is provided for free
The maximum amount till which the cover is provided by the insurance companies.
The stipulated amount by the insurance company till which the medical checkup is essential
The stipulated amount by the insurance company till which the medical checkup is not required

Question 2
Under which method do the employers pay gratuity to the employee, when he leaves the company, from the current year revenues?
Internal trust
Pay as you go method
Internal reserve method
Group gratuity scheme
Question 3

If the investment gives lower return than expected, then there can be a deficit and the burden of that will have to be borne by the _________

- employer
- Insurance company
- The Government of India
- None of the above

Question 4

Under the Group Term Insurance Scheme, can the employer claim tax benefits for the premium paid for the employees?

- Yes because the premium paid is a business expense
- No because the premium is paid for the employee and hence the employee can claim tax benefit
- Both the employee and employer can claim tax benefits equally
- None of the above

Question 5

EDLI stands for __________

- Employers’ dividend liability insurance
- Employees’ deposit liability insurance
- Employees’ deposit linked insurance
- Employees’ dividend linked insurance

Answer to Self-Examination Questions

Answer to SEQ 1

The correct answer is D

Free cover limit is the amount stipulated by the insurance company till which a medical checkup is not required.
Answer to SEQ 2

The correct answer is B

Under the pay as you go method, the employers pay gratuity to the employee when he leaves the company, from the current year revenues.

Answer to SEQ 3

The correct answer is A

If the investment gives lower return than expected, then there can be a deficit and the burden of that will have to borne by the employer

Answer to SEQ 4

The correct answer is A

Under Group Term Insurance Scheme the employer claims tax benefits for premium paid for the employees, as the premium paid is a business expense.

Answer to SEQ 5

The correct answer is C

EDLI stands for Employees’ deposit linked insurance
CHAPTER 6

LINKED LIFE INSURANCE POLICIES

Chapter Introduction

ULIPs gained a lot of popularity among investors during the bull run of Indian stock markets from 2003 to 2007. During this time period, the BSE Sensex rose from 3000 points to 20,000 points. With the BSE index multiplying six times over this five year period, the interest of investors in the capital markets was very high.

So keeping in mind the requirements of the investors, insurance companies came up with various ULIP products and their variants. The companies which already had ULIPs in their product portfolio have stepped up the marketing of these products in the last few years. In fact, ULIPs contributed 50% of the premium collected of some companies. For some companies, the percentage was much higher than 50%. ULIPs give the buyer the much needed life insurance protection and also an option to participate in the growth of the capital market. In this chapter we will study about ULIPs and their features and compare them with the other products that are offered by insurance companies.

Learning Outcomes

- Understand the concept of ULIPs.
- Understand the features of a ULIP.
- Compare ULIPs with traditional insurance products.
- Guidelines with reference to unit linked policies.
Look at this scenario

Arnab has earned Rs. 80,000 as annual performance bonus from his company. He wants to invest this money in some investment product where he can get good returns. Every day when he hears about BSE Sensex reaching new levels, his interest in capital market increases. However he is apprehensive about investing directly in shares as he has neither the required fundamental knowledge nor the technical expertise for investing in stock markets. Hence his first choice is mutual funds, where he can safely handover his money to the expert mutual fund managers and passively participate in the growth of capital markets. But his family wants him to start investing in an insurance plan, which they feel is more essential for meeting any eventualities than investing in mutual funds.

This is where products like ULIPs come in handy for people like Arnab, as ULIPs offer the twin benefits of participating in the growth of capital markets along with insurance protection.

3. Understand the concept of ULIPs

Introduction to ULIPs

Definition

A unit linked insurance plan (ULIP) is an insurance plan which is a combination of insurance protection and investment.

A ULIP can be an ideal investment vehicle for people who are looking for the triple benefits of:

- insurance protection;
- investment; and
- income tax benefits

ULIPs or Unit linked insurance plans are market linked insurance plans. ULIPs come with the combined benefits of investment and protection. With regard to protection, ULIPs are very similar to traditional insurance plans such as – endowment, money back and whole life insurance plans, but with a major difference – the investment risks in ULIPs are borne by the policyholder/investor and not by the insurance company.
Investment operations of ULIPs are very much similar to that of mutual funds. In fact ULIPS can be referred as mutual funds with insurance cover. As in mutual funds, in ULIPs too investors are allotted units, by the insurance company and a NAV is declared on a daily basis.

The premium paid by the insured in a ULIP is divided into 3 parts:

- **Expenses**: a portion of the premium goes towards meeting the expenses of issuing a policy- like agent’s commission, policy set up costs, administrative costs and statutory levies. This amount is also known as ‘Policy Allocation Charge (PAC)’.

- **Mortality**: a portion of the premium goes towards covering the risk or providing life cover to the life insured and is the cost of risk cover.

- **Investment**: after deducting the above two amounts, the remaining premium goes towards investment on behalf of the life insured. The individual is given a choice of funds to select from and decide where they want their premium to be invested.

**Diagram 1:** ULIP premium - breakup

In linked policies, the death benefit may be expressed as an integrated benefit, which means that in the event of death, the SA or the value of units in the funds, whichever is higher, is payable. In this case, the risk cover will reduce as the value of the units increases. As the risk cover decreases, the premium adjusted towards the cover will decrease and the amount allocated to investments will increase. The fund may grow faster.

The alternative or the integrated benefit is to pay a fixed SA as a benefit on death, in addition to the value of the units in the funds. In this case, the charge for the risk cover will increase from year to year, because of age, and the allocation to the fund will decrease correspondingly.
Some of the other features, offered by insurers along with the ULIPs are the following. These are not offered by all insurers. They are also not available with all ULIPs offered by the same insurer.

The policyholder can pay additional premium for investment at any time.

Partial or total withdrawal is allowed. Sometimes there are conditions attached. Some insurers, not all, charge a redemption fee in such cases.

-These policies will not be entitled to any bonus.

**Choice of Funds**

The policyholder can select from various funds available to invest their premium. Generally, the funds in which their moneys are invested are indicated below the funds are invested in various kinds of instruments, the differences mainly being in proportion in various kinds of instruments.

<table>
<thead>
<tr>
<th>Equity Fund</th>
<th>Debt Fund</th>
<th>Balanced Fund</th>
<th>Money Market Fund</th>
</tr>
</thead>
<tbody>
<tr>
<td>This fund invests major portion of the money in equity and equity related instruments.</td>
<td>This fund invests major portion of the money in Govt bonds and Govt guaranteed securities e.g. Government Bonds, Corporate Bonds, Fixed Deposits etc. In these funds, it is expected that the income, being interest on securities and bonds, will be steady and almost guaranteed, but there may not be much capital appreciation.</td>
<td>This fund invests in a mix of equity and debt instruments.</td>
<td>This fund invests money mainly in instruments such as Treasury Bills, Certificates of Deposit, Commercial Paper etc.</td>
</tr>
</tbody>
</table>
This fund is for those investors who are willing to take high risk and are looking for high returns.

This fund is for those investors who don’t want to take high risk and are satisfied with lesser but guaranteed returns.

This fund is for those investors who are willing to take moderate risk and are looking for moderate returns.

This fund is for those investors who want to preserve their capital and are satisfied with lesser returns.

Sometimes also called as Bond funds

Sometimes also called as Liquid funds.

<table>
<thead>
<tr>
<th>Type of funds</th>
<th>Risk category</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity funds</td>
<td>High</td>
</tr>
<tr>
<td>Debt funds</td>
<td>Low</td>
</tr>
<tr>
<td>Money market funds</td>
<td>Low</td>
</tr>
<tr>
<td>Balanced funds</td>
<td>Moderate</td>
</tr>
</tbody>
</table>

These are the basic funds offered by insurance companies. They may offer the investor a choice of more funds to select from, which may be variants or combinations of the above four funds. Insurance companies have different names for these funds e.g. Growth Fund, Balanced Fund, Protector Fund, Preserver Fund, Maximiser, Multiplier, Gilt Fund, Enhancer, Dynamic Fund, Sectoral Fund, Conservative Fund, Growth Super, Builder, Value Fund etc.

ULIPs have a lock in period of 5 years (since 1st of September 2010). Earlier, the lock in period used to be 3 years, after which the investor had the option to withdraw their investment from ULIPs. Since September 2010 the lock in period has been increased by IRDA, to encourage long term investments and to ensure enhanced benefits as compared to short term benefits.

ULIPs provide a lot of flexibility to the policyholder. The option of switching in one provision that gives the flexibility. Policyholders are also allowed to make a lump sum additional contribution at any time. The amount going into the fund for investment will increase. Top-up is the expression used to refer to the policyholder increasing the contribution for investment. There could be a top-up charge. The IRDA guidelines stipulate that top-up is allowed only if the regular premiums paid up to date.
It also states that if the top-up amount is more than 25% of the regular premium paid up-to-date, the life cover will increase by 1.25 times the excess top-up amount. There will also be a lock-in-period of five years (since 1st of Sept-2010) for each top-up amount, except during the last five years of the policy.

Policy holders may also be allowed to redirect the current premium into any fund, in any proportion, irrespective of the fund in which the earlier premiums have been invested. This facility allows the policyholder to take advantage of the market conditions, without exercising the switching option.

Policyholders may not pay the premium in a year, subject to certain conditions. If that happens, no new units will be added to his fund but some unit will be reduced to pay for the annual charges like for cover, administration, fund management etc. This is called a **premium holiday**. The arrangement can also be terminated at any time and the amount in the fund withdrawn. The loss will only be a nominal fee.

Premium is invested in various funds, as chosen by the policyholder, by the insurance company against which, they allot units to the policyholder.

The NAV of a fund represents the net value of the fund on a particular date and reflects the total value of the assets of that fund, after some adjustments for expenses. For example, the equity fund comprising of contribution from many policyholders would have been invested in a variety of equity shares in the stock market along with other instruments. The total market value of these shares and other instruments on an day, divided by the units in that equity fund would be the NAV for that day. As market values of shares vary, the NAV will keep varying from day to day.

Lock in period is the period which was earlier 3 years now stands raised to 5 years. During this period no withdrawals are permitted (Refer to IRDA or IRDA/Aetl/Cir/ULIP/124/08/2010 dated 04/8/2010 and IRDA/ACT/CIR/ULIP/102/06/2010 dt28/6/2010 given in the Annexure section of the book).

As in traditional policies, additional benefits are made available through riders which are optional in nature. Usually riders provide for:

- accident benefit
- disability benefit
- increase / decrease in death benefit
- critical illness rider
major surgical assistance benefit
hospital cash benefit
spouse insurance benefit etc

Additional premia will have to be paid for these rider benefits.

**Differences**

The important differences between traditional plans and ULIPs are:

<table>
<thead>
<tr>
<th>ULIPs</th>
<th>Traditional plans</th>
</tr>
</thead>
<tbody>
<tr>
<td>The premiums, in excess of risk cover, is invested in funds as desired by the policyholder.</td>
<td>All the premiums go into a common fund and are invested at the insurer’s discretion.</td>
</tr>
<tr>
<td>The investment return may vary, depending on the market movements and the investment risk borne entirely by Policyholder.</td>
<td>There are two categories of benefits – guaranteed and non – guaranteed. For guaranteed benefits, the insurer bears the investment risk. However, non-guaranteed benefits, such as bonuses, depend on the performance of the insurer.</td>
</tr>
<tr>
<td>Withdrawal allowed, at little or no loss. Loans are not allowed</td>
<td>Surrenders are allowed but at a loss. Loans may be allowed.</td>
</tr>
<tr>
<td>There are no bonuses</td>
<td>For participating policies, bonuses are payable.</td>
</tr>
<tr>
<td>The amount of the premium used for insurance coverage, other charges and the purchase of units are unbundled and transparent.</td>
<td>The premium amount used for insurance coverage, other charges and investment are bundled up and not known to the policy -holder.</td>
</tr>
<tr>
<td>Benefits are variable</td>
<td>Benefits are pre-determined.</td>
</tr>
<tr>
<td>Loss is likely</td>
<td>Loss is unlikely</td>
</tr>
</tbody>
</table>

**How ULIPs work**

The concept of ULIPs is very similar to mutual funds. The following process is involved in ULIP:

The premiums are paid by the policyholder to the insurance company. The premium could be paid either as a lump sum or at periodic intervals – monthly, quarterly, half yearly or annually. The insurance company can restrict the premium to be in multiples of Rs. 500 or Rs. 1000. Some companies also stipulate a minimum premium amount of say Rs. 5000 or Rs. 10,000. The term of the policy has to be a minimum of 5 years or more.
A certain portion of the premium is deducted by the insurance company to provide for premium allocation charges and mortality (cost of risk cover). The remaining premium is invested in funds chosen by the policyholder.

The sum assured or insurance cover, payable on death is equivalent to a multiple of the annual premium, say 10 times of the annual premium.

The insurance company allots units of various funds (equity, debt, balanced) as chosen by the individual. These funds are floated and managed by expert fund managers of insurance companies.

Each time premium is paid, the insurance company allots equivalent units out of that premium (after deduction expenses) to the policyholder.

Insurance company levies mortality charges and policy administration charges periodically (normally monthly) by cancellation of units.

The fund management charges (FMC) are adjusted from the NAV on a daily basis.

The policyholder has the choice of transferring his money from one fund to another e.g. equity to debt or vice versa. This process is known as **Switching**.

The units are redeemed and equivalent amount is returned to the policyholder on maturity.

In case of premature death of the insured, the beneficiaries will receive the claim benefit amount based on the product specifications.

**Top-up:** individuals are allowed to invest additional amount of money over and above the regular premium that they are paying. This is known as **top-up.** The expenses involved in top-up investments are also lower than the regular premiums paid. As per regulations, Top up premium once paid cannot be withdrawn from the fund for a period of 5 years from the date of payment of top-up. Top up premiums are also not permitted during the last 5 years of the contract.

All top-up premiums made during the currency of the contract, must have insurance cover treating them as a single premium, based on guidelines and formulae stipulated for the same.
Net Asset Value (NAV)

The NAV of a fund represents the net value of the fund on a particular date and reflects the total value of the assets of that fund, after some adjustments for expenses. For example, the equity fund comprising of contributions from many policyholders would have been invested in a variety of equity shares in the stock market along with other instruments. The total market value of these shares and other instruments on a day, divided by the units in that equity fund would be the NAV for that day. As market values of shares vary, the NAV will keep varying from day to day.

The NAV becomes the basis for new entrants and for exits from the funds. For example, if a new policy holder wishes to have Rs 10000 invested in an equity fund and on that particular day, the NAV of that fund is Rs 20. He will be allotted 500 units (the nominal cost of each being Rs.20) from that fund. When he wishes to exit from that fund, because of switching or final termination of the contract, he will get 500 units at the NAV of that date, which may be less than or more than Rs 20, at which he got in. If he is getting into another fund on that day, he will be given the number of units of that fund, calculated at the NAV of that fund, on that day.

In actual practice, the NAV used at the time of entry, called the Offer price, and the NAV used while existing, called the Bid price. These will be different, like the difference between the buying and selling rates of foreign currency. This difference is called the bid-offer spread and is normally around 0.5% . Some insurers do not have this difference for some plans. Both offer and bid prices are the same as NAV. Some insurers offer units at Rs. 10 per unit for a specified period from the date the scheme begins.

Insurers publish the NAVs of the various funds, which are offered to the policyholders. This enables policyholders to track the rate of growth of the various funds and to decide whether to continue in the same fund or to switch to other funds. The value of the investment on any day is the number of units held multiplied by the NAV.

\[
(\text{NAV of the equity fund will be } = \frac{\text{Market value of the equity shares and other instruments available in the fund}}{\text{Number of units}})
\]

NAV needs to be tracked regularly, as it keeps changing due to fluctuation in the value of shares. NAV determines the value of the individual’s investment in ULIP.
Value of an individual’s investment = Number of units held \( \times \) NAV

Insurance companies publish the NAV of various funds regularly in newspapers, websites and, individual statements at regular intervals. Policyholders can determine the growth of their investments based on this data and take decisions regarding switching or exiting the fund.

**Pricing of units**

There are two methods, based on which the units are priced:

**Appropriation method**

This method is applied when funds are expanding. The insurance company determines the price of the units based on appropriation method, while purchasing assets (shares, bonds and other instruments).

The unit price is calculated as follows:

\[
\text{Unit price} = \frac{\text{Market value of fund} + \text{Cost of purchase of assets} + \text{Current assets} + \text{Income} - \text{Charges applicable} - \text{Current liabilities}}{\text{Number of units in fund}}
\]

**Expropriation method**

This method is applied when funds are contracting. The insurance company determines the price of the units based on expropriation method, while selling the assets (shares, bonds and other instruments).

The unit price is calculated as follows:

\[
\text{Unit price} = \frac{\text{Market value of fund} - \text{Expenses involved in selling of assets} + \text{Current assets} + \text{Income} - \text{Charges applicable} - \text{Current liabilities}}{\text{Number of units in fund}}
\]

**Offer and Bid Price:**

**Offer price:** when a new policyholder decides to invest in a fund, then the NAV on that day used for allotting the units to him, is known as offer price.
Bid price: when an existing policyholder decides to redeem the units, then the NAV on that day used for redeeming the units is known as bid price.

Test Yourself 1

Question 1

Which of the below fund invests in instruments with maturity period of less than one year?

- Equity fund
- Balanced fund
- Debt fund
- Money market fund

2. Understand the features of a ULIP

ULIPs offer lot of flexibility to policyholders in terms of:

**Flexibility to increase the insurance cover**: the insurance cover or sum assured needs to be predetermined at the time of inception of the policy. As an individual becomes old, his liabilities may increase necessitating a higher insurance cover. Hence some ULIPs offer an option to increase the insurance cover during the tenure of the plan.

**Flexibility in change of premium**: ULIPs provide the facility of changing the premium amount during the term of the policy to suit the premium paying capacity of the individual.

**Liquidity**: in a ULIP the policyholder can redeem investments after 5 years. In case of traditional plans if the policyholder wants to premature close his policy then he needs to surrender the policy. Maturity amount after deduction of surrender charges is paid to the policyholder in case of traditional plans.

**Top up**: this is the additional amount that can be invested by an individual over and above the regular premium in funds of his choice.

**Riders**: the policies can be customised with the use of riders.
Choice of funds: insurance companies provide a choice of funds that the individual can choose from. The individual can choose to invest in equity funds, debt funds, money market funds and balanced funds to suit his risk appetite.

Switching: an individual is allowed to transfer his existing investments from one type of fund to another fund. He can switch his existing investments from an equity fund to debt fund / balanced fund / money market fund and vice versa.

Redirection: if a policyholder wants to invest his fresh premium in a fund other than his existing fund it is known as redirection. In this case the policyholder can let his previous investments continue in the same fund and route his fresh premium in another fund.

Premium holiday: the policyholder can stop paying the premium after 5 years and continue with the ULIP. The charges for the subsequent years will be deducted from the existing fund value. However the contract between the policyholder and the insurance company gets terminated, when after deduction of charges, the fund value becomes equal to or less than one year’s premium.

Transparency

Transparency is one of the most important features of a ULIP.

ULIPs provide complete information to the policyholder regarding the break-up of the premium paid. The policy statement clearly shows the premium allocation charges, the mortality charges and the remaining premium that is invested. The statement also clearly shows the break-up of policy administration charges and the fund management charges.

Insurance companies can show their prospects projected returns (benefit illustration) for the entire term of the plan, based on premium payment and sum assured. Under the guidelines of IRDA, two scenarios of future returns @ 6 % and 10 % respectively can be shown.

Insurance companies publish the NAV of funds on a regular basis, with which the policyholder can evaluate the value of his investments and take further decisions.

Charges
The various types charges levied in a ULIP are as below:

The charges recovered (i) by way of deduction from the premium and / or (ii) by cancellation of some of the units. IRDA has issued guidelines on the cap on charges (Ref:- 055/ IRDA/ Actl / ULIP/ 2009-10 dt 24/9/2009 (Please refer annexure section in the book for details)
Premium allocation charges (PAC): are deducted before allocating the units. These charges include the initial expenses for issuing a policy like agent’s commission, policy set up cost, administration cost etc.

Mortality charges: are the charges levied for covering the risk of providing insurance cover.

Fund management charges (FMC): are levied for management of funds offered by insurance companies as investment options. Fund management charges are deducted before determining NAV.

Policy administration charges: are levied for the administration of ULIPs. These charges are recovered by cancellation of units on a monthly basis.

Surrender charges: are applicable if the policyholder wants to close the policy before its normal tenure. Surrender means premature withdrawal of funds – partial or full. The charge is expressed as a percentage of fund value or annual premium.

Switching charges: are applicable when the policyholder wants to transfer (switch) his existing investments from one fund to another fund. Insurers allow few switches on a quarterly / yearly basis free of cost. Switches over and above the free switches are chargeable.

Statutory levies: Service Tax and Education Cess are applicable as per Government rules from time to time. These levies are deducted before allocation of units is done from the premium.

Riders: Similar to traditional plans, riders are also available with ULIPs. Additional premiums need to be paid by the policyholder for the rider. Some of the riders that are offered with ULIPs are as follows:

- Accidental Death Benefit (ADB) Rider
- Disability Benefit Rider
- Critical Illness Rider
- Hospital Cash Benefit Rider
- Waiver of Premium Rider

Revival of ULIP policies:

If a policyholder does not pay premium on the due date, the policyholder gets some days of grace during which the policyholder can pay the premium. This is known as grace period. The grace period for all types of linked products where the premium payment mode is monthly, the grace period is 15 days in all other modes, the grace period is 30 days.
If the policyholder doesn’t pay the premium within the grace period then the policy lapses.
Where the policies lapse, the policyholder is entitled to one of the following options:
- to revive the policy
- to continue the policy only to the extent of risk cover and
- to continue with the policy with the risk cover and as part of the fund.
- to withdraw completely from the fund without any risk cover.

For detailed regulations on lapsed policies please refer:
IRDA/CAS/CIR/EXD/083/05/2010 dt 18/05/2010

**Test Yourself 2**

**Question 2**

If the policyholder wants to shift his existing investments from an equity fund to a debt fund it is known as _____________

- Transfer of funds
- Switching
- Redirection
- None of the above

**Compare ULIPs with traditional insurance products.**

[Learning Outcome c]

The underwriting process for ULIPs and traditional insurance plans is similar. The company calculates the premium based on the sum assured and the information provided by the individual regarding his medical condition, age and other material facts.

Earlier traditional plans, had a predefined relationship of premium and sum assured, whereas ULIPs allow the policyholder to choose the sum assured within a certain limit, for a specific premium. Apart from this, there are several other differences among ULIPs and traditional plans.
<table>
<thead>
<tr>
<th>Difference based on</th>
<th>Traditional Plans</th>
<th>ULIPs</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Premiums</strong></td>
<td>The premiums are combined in a common fund known as life fund and are invested by the insurer</td>
<td>Part of the premium is deduction for PAC and mortality and rest is invested in the fund chosen by the policyholder.</td>
</tr>
<tr>
<td><strong>Benefits</strong></td>
<td>Could be either guaranteed or non-guaranteed and are predetermined.</td>
<td>Benefits depend on the performance of investment fund chosen by the policyholder. The benefits have to be within the scope of regulations issued by IRDA.</td>
</tr>
<tr>
<td><strong>Withdrawal</strong></td>
<td>The plan could be surrendered, but the policyholder has to bear the loss in the form of higher surrender charges.</td>
<td>The investments can be withdrawn after 5 years and the returns will depend upon the NAV at the point of time.</td>
</tr>
<tr>
<td><strong>Bonus</strong></td>
<td>Bonus is payable for participating policies (“with profit” policies)</td>
<td>Bonus is not payable. However some insurers pay persistency (loyalty) units for long term policies</td>
</tr>
<tr>
<td><strong>Loans</strong></td>
<td>Loans can be taken against the surrender value of the policy. Loan amount given is normally 75-90% of surrender value.</td>
<td>Loan amount are now allowed to be given for products on sale after 01/09/2010 subject to regulations/conditions which are issued by IRDA.</td>
</tr>
</tbody>
</table>
The breakup of charges

ULIPs are high on transparency and regulators insists premium break up in terms of PAC, mortality, FMC, administration charges etc. and caps on each of these charges.

Loss

There may be a loss if the NAV of the fund chosen by the client drops drastically as equity prices are very volatile.

Profits

The profits depend on the performance of constituents of the fund chosen by the policy holder.

<table>
<thead>
<tr>
<th>Transparency</th>
<th>ULIPs are high on transparency and regulators insists premium break up in terms of PAC, mortality, FMC, administration charges etc. and caps on each of these charges.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loss</td>
<td>Loss is unlikely as the benefits are normally predetermined</td>
</tr>
<tr>
<td>Proftis</td>
<td>Profits are received through bonus, under participating policy (“with profits”) policy by the insurers.</td>
</tr>
</tbody>
</table>

IRDA Guidelines

Recently IRDA has issued a lot of new guidelines for ULIPs which has resulted in a major overhaul of ULIPs. All insurance companies were asked to comply with these guidelines from September 2010.

Following are some of those guidelines:

The three year lock-in period for all Unit Linked Products will be increased to a period of five years, including top-up premiums. During this period, no residuary payments on policies which are lapsed / surrendered / discontinued will be made. The residuary payments for policies arising out of policies which stand lapsed/surrendered/discontinued during the lock-in period shall be payable on the expiry of the lock-in period and in accordance with the relevant Regulations of IRDA.

All regular premium / limited premium ULIPs shall have uniform / level paying premiums. Any additional payments shall be treated as single premium for the purpose of insurance cover.
All limited premium unit linked insurance products, other than single premium products, shall have premium paying term of at least 5 years.

The insurers shall distribute the overall charges, in ULIPs in an even fashion during the lock-in period.

All unit linked products, other than pension and annuity products shall provide a minimum mortality cover or a health cover, as indicated below:

(i) Minimum mortality cover should be as follows:

<table>
<thead>
<tr>
<th>Minimum Sum assured for age at entry of below 45 years</th>
<th>Minimum Sum assured for age at entry of 45 years and above</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single Premium (SP) contracts: 125 percent of single premium.</td>
<td>Single Premium (SP) contracts: 110 percent of single premium.</td>
</tr>
<tr>
<td>Regular Premium (RP) including limited premium paying (LPP) contracts: 10 times the annualized premiums or (0.5 \times T \times annualized premium) whichever is higher.</td>
<td>Regular Premium (RP) including limited premium paying (LPP) contracts: 7 times the annualized premiums or (0.25 \times T \times annualized premium) whichever is higher.</td>
</tr>
<tr>
<td>At no time the death benefit shall be less than 105 percent of the total premiums (including top-ups) paid.</td>
<td>At no time the death benefit shall be less than 105 percent of the total premiums (including top-ups) paid.</td>
</tr>
</tbody>
</table>

(In case of whole life contracts, term (T) shall be taken as 70 minus age at entry)

(ii) The minimum health cover per annum should be as follows:

<table>
<thead>
<tr>
<th>Minimum annual health cover for age at entry of below 45 years</th>
<th>Minimum annual health cover for age at entry of 45 years and above</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regular Premium (RP) contracts: 5 times the annualized premiums or Rs. 100,000 per annum whichever is higher,</td>
<td>Regular Premium (RP) contracts: 5 times the annualized premiums or Rs. 75,000 per annum whichever is higher,</td>
</tr>
<tr>
<td>At no time the annual health cover shall be less than 105 percent of the total premiums paid.</td>
<td>At no time the annual health cover shall be less than 105 percent of the total premiums paid.</td>
</tr>
</tbody>
</table>
All top-up premiums made during the currency of the contract, except for pension/annuity products, must have insurance cover treating them as single premium, as per above table.

The accumulated fund value of unit linked pension / annuity products is the fund value as on the maturity date. All ULIP pension / annuity products shall offer a minimum guaranteed return of 4.5 per cent per annum or as specified by IRDA from time to time, on the maturity date. This guaranteed return is applicable on the maturity date, for policies where all due premiums are paid. Mortality and / or health cover could be offered along with the pension/annuity products as riders, giving enough flexibility for the policyholders to select covers of their choice.

In the case of unit linked pension / annuity products, no partial withdrawal shall be allowed during the accumulation phase and the insurer shall convert the accumulated fund value into an annuity at the vesting date. However, the insured will have an option to commute up to a maximum of one-third of the accumulated value as lump sum at the time of vesting. In the case of surrender, only a maximum of one-third of the surrender value can be commuted after the lock-in period. The remaining amount must be used to purchase an annuity, subject to the provisions of Section 4 of Insurance Act, 1938.

Vide circular 3 cited above, caps on charges were fixed on Unit Linked contracts with a tenor of 10 years or less and for those with tenor above 10 years. However, taking into account the discontinuance / lapsation / surrender behaviour and with a view to smoothen the cap on charges, the following limits are prescribed starting from the 5th policy anniversary:

<table>
<thead>
<tr>
<th>Annualized Premiums Paid</th>
<th>Maximum reduction in yield (Difference between Gross and Net Yield (% pa))</th>
</tr>
</thead>
<tbody>
<tr>
<td>5</td>
<td>4.00%</td>
</tr>
<tr>
<td>6</td>
<td>3.75%</td>
</tr>
<tr>
<td>7</td>
<td>3.50%</td>
</tr>
<tr>
<td>8</td>
<td>3.30%</td>
</tr>
<tr>
<td>9</td>
<td>3.15%</td>
</tr>
<tr>
<td>10</td>
<td>3.00%</td>
</tr>
<tr>
<td>11 and 12</td>
<td>2.75%</td>
</tr>
<tr>
<td>13 and 14</td>
<td>2.50%</td>
</tr>
<tr>
<td>15 and thereafter</td>
<td>2.25%</td>
</tr>
</tbody>
</table>
The net reduction in yield for policies with term less than or equal to 10 years shall not be more than 3.00% at maturity. For policies with term above 10 years, the net reduction in yield at maturity shall not be more than 2.25%.

The maximum loan amount that can be sanctioned under any ULIP policy shall not exceed 40% of the net asset value in those products where equity accounts for more than 60% of the total share and shall not exceed 50% of the net asset value of those products where debt instruments accounts for more than 60% of the total share.

Test Yourself 3

Question 3

As per IRDA guidelines, the lock in period for ULIP is ________ years.

2
3
5
10

Summary

Unit linked insurance plans (ULIPs) are market linked insurance plans. ULIPs combine the features of investment and protection.

Amount that is invested in funds is termed as units and their values are expressed as Net Asset value (NAV)

Net Asset value of a fund means net value of a fund on a particular date

When a new policyholder decides to invest in a fund, the NAV on that day which is used for allotting the units to him is known as offer price.

When an existing policyholder decides to redeem the units from ULIP, then the NAV that is used to redeem the units is known as bid price.

The difference in NAV at the time of entry (offer price) and exit (bid price) is known as bid-offer spread

Top-up is the additional amount that can be paid by the individual to increase his investment contribution.

ULIPs have a lock-in period of 5 years.
Some important terms / definitions you have learnt in this chapter

- Unit
- NAV
- Top-up
- Offer price
- Bid price
- Bid - Offer spread

Answers to Test Yourself

Answer to TY 1
The correct answer is D
A Money market fund invests in instruments with maturity period of less than one year.

Answer to TY 2
The correct answer is B
If the policyholder wants to shift his existing investments from a equity fund to a debt fund it is known as switching.

Answer to TY 3
The correct answer is C
As per IRDA guidelines, the lock in period for ULIPs is 5 years.
**Self-Examination Questions**

**Question 1**

___________ is the additional amount that can be paid by an individual, to increase his investment contribution.

- Premium
- Sum assured
- Top-up
- Insured amount

**Question 2**

In a ULIP after how many policy completion years does the surrender penalty become zero?

- 3 years
- 2 years
- 5 years
- 4 years

**Question 3**

An individual wishes to invest Rs. 16,000 in an equity fund. NAV on that particular day for the fund is Rs. 40. How many units will he be allotted?

- 200 units
- 400 units
- 800 units
- 160 units

**Question 4**

The value of an individual’s investment is the ________

- market value of the equity shares X NAV
- NAV of the equity fund on any day X Units of the equity fund
- market value of the equity shares / Units of the equity fund
- number of units held X NAV
Question 5
ULIP’s are market-linked insurance plans and combine the features of:

- Investment and savings
- Investment and protection
- Annuity and protection
- Savings and protection.

Answer to Self-Examination Questions

Answer to SEQ 1
Correct answer is C

Top-up is the additional amount that can be paid by an individual, to increase his investment contribution.

Answer to SEQ 2
The correct answer is C

In a ULIP the surrender penalty becomes zero is after completion of a period of 5 policy years.

Answer to SEQ 3
The correct answer is B

400 units will be allotted.

Answer to SEQ 4
The correct answer is D

The value of an individual’s investment is = Number of units held X NAV

Answer to SEQ 5
The correct answer is B

ULIP’s are market-linked and combine the features of investment and protection.
CHAPTER 7
APPLICATION AND ACCEPTANCE

Chapter Introduction

This chapter aims to provide you with an understanding of the processes involved for both the proposer and the insurer when applying for a life insurance policy and its acceptance. It explains the importance of utmost good faith for insurance contracts, the essentials of an insurance contract and insurable interest. It also aims to provide an understanding of the role of underwriting and the process insurers use to assess risk and underwrite a proposal.

Learning Outcomes

- Understand the fundamentals of a life insurance contract.
- Understand the life insurance application process.
- Understand how life insurance policies are underwritten.
Look at this scenario

The life insurance business in India is growing at a rapid pace. More people are taking out life insurance and this growth puts more emphasis on the application and acceptance process for life insurance. Growth without adequate underwriting will place pressure on insurers to pay claims for policies which they may not have accepted initially and which can have serious consequences for the solvency of an insurer. It is essential that during a period of growth that underwriting processes and standards are maintained to ensure risk is accurately assessed and correct premium is charged for the risk being accepted by the insurer.

Understand the fundamentals of a life insurance contract. [Learning Outcome a]

A life insurance policy is a contract between the insurer and the insured. This creates obligations as well as rights on both parties to the contract.
Diagram 1: Essential elements of a valid contract

- Capacity to contract
- Free consent
- Offer and acceptance
- Consideration
- Legality of object
- Consensus ad idem
- Capability of being Performed
- Utmost good faith
- Insurable interest
The essential requirements for a valid contract are:

- capacity of parties to contract
- free consent
- offer and acceptance
- lawful consideration
- legality of object
- \textit{consensus ad idem} meaning the parties to the contract must be of the same mind regarding the subject matter of the contract
- capability of being performed

Insurance is a specialised contract. Apart from the usual essential requirements of a contract, insurance contracts are subject to two additional principles. These are:

- the principle of utmost good faith
- the principle of insurable interest

These 2 additional principles apply to both life and non-life insurance.

\textbf{1.1 Principle of Utmost Good Faith}

Commercial contracts are usually subject to the principle of \textit{caveat emptor} – let the buyer beware. This principle does not apply to insurance contracts as most of the facts relating to health, habits, personal history, family history that form the basis of a life insurance contract are known only to the proposer. Unless disclosed by the proposer, they cannot be known to the insurer. Non-disclosure of these facts puts the insurer and the community of policyholders at a disadvantage causing ‘adverse selection’. If there is non-disclosure there is ‘consensus ad idem’ in the contract and it becomes an unfair contract. It can be held to be void \textit{ab initio} (from the beginning or start).

In life insurance the duty of disclosure operates until the risk commences. Circumstances which may have arisen after the contract has commenced do not affect the validity of the contract unless the conditions of the contract make relevant stipulations to that effect. There would also be a duty of disclosure in the following situations as a new contract is being entered into:

- the terms of the policy are to be altered
- a lapsed policy is being revived
- a surrendered policy is being reinstated
The declaration made by the proposer in a proposal for life insurance turns the representations into warranties. If there are misrepresentations, the insurer is entitled to treat the contract as null and void and forfeit all monies paid. Section 45 of the Insurance Act 1938 limits the insurers right to cancel the contract by stipulating that a policy cannot be called into question after 2 years, on the grounds of inaccurate or false statement unless it is proved to be material and made with fraudulent intent.

The duty of full disclosure applies equally to both the proposer and the insurer. It is easier to see where the proposer may be in breach of the duty rather than the insurer. In practice, there could be breaches of the duty on the part if the insurer or the agent making representations on behalf of the insurer. Examples of where these breaches may occur are:

- making untrue statements during the sale
- not advising the proposer to disclose all material facts
  - not advising the proposer that loans may not be available under the plan offered or that bonus rates could be different
- withholding information that conditions such as being a non-smoker, are relevant to grant a reduced premium
- promises are made about the bonuses and returns

### 1.2 Insurable Interest

To understand insurable interest, consider the following situation:

**Example**

Ramesh is a 35 year old man working with a private company. Ramesh’s family includes his wife, a five year old son and dependent parents. They have their own house. Consider the following situations:

**Situation 1:** Ramesh fears falling sick and is not able to report to work for a few days due to ill health in future?

**Situation 2:** Ramesh fears meeting with an accident and dying prematurely?
Let us try to understand all the above situations carefully.

In **situation one**, it is in Ramesh’s interest to keep himself fit because if he falls sick then he will not be able to report to work, which will lead to loss of pay. To safeguard him from unexpected illnesses and the resultant loss of pay, Ramesh can take **medical / health** insurance.

In **situation two**, in case Ramesh’s untimely death, the family will suffer financial losses. Ramesh has responsibilities such as taking care of his family, planning for his son’s education, planning for his son’s marriage, planning for retirement etc. Ramesh’s family depends upon him to take care of all these goals. Ramesh can take **life insurance cover** to make sure that his family does not suffer in his absence.

In both the above situations, if any of the events happen (Ramesh falls sick, Ramesh meets with an accident), it will affect Ramesh’s financial position adversely. If none of the events happen and everything continues normally, then Ramesh stands to gain and enjoy the continued benefits from his property, his family’s good health and his own.

**Concept of insurable interest**

What makes an insurance contract a legal contract is that insured must have an insurable interest in the subject matter of insurance. The insured must be in a relationship with the subject matter of insurance because what is being insured is a financial or pecuniary interest in the subject matter of the insurance, whereby they benefit from the safety and well-being of the subject matter of insurance and would be prejudiced by its loss or damage.

From the above explanation and the four situations, we can say that Ramesh has an ‘insurable interest’ in his own well-being, his life, his property and his father’s health in a way that the continued well-being (safety) of all four would benefit Ramesh, and if something goes wrong with any of them, it would affect Ramesh financially and he would suffer a loss.

The Insurance Act 1938 does not define insurable interest. The circumstances under which insurable interest is deemed to exist have been clarified by court judgments. It has been held that a person has unlimited insurable interest in their own life.
Other clarifications that are relevant for life insurance are:

a husband has insurable interest in the life of the wife and vice versa
   an employer has insurable interest in their employee to the extent of the value of their services
   an employee has insurable interest in their employer to the extent of their remuneration for the period of notice
   a creditor has insurable interest in the life of the debtor, to the extent of the debt
   partners have insurable interest in the lives of each other to the extent of the respective financial stakes
   a surety has insurable interest in the life of their co-surety to the extent of the debt and also on the life of the principal debtor
   a company has insurable interest in the life of a key valuable employee (keyman)

If members of a family are in business together or there are other financial relationships, insurable interest arises out of the financial involvement and the business ties, not the family ties. It is presumed that parents have an insurable interest in the life of a child, for as long as he/she is a child. The insurable interest ceases when the child becomes a major. For this reason, policies on the lives of children incorporate a clause, where the policy vests in the child on their attainment of majority.

**Example**

Kiran and Sachin are brothers who have recently started a business together. Both have used all their savings to start the business together and are working hard to build the business. Neither brother has a life insurance policy and now want to take out policies so that in the event anything happens to either of them the other will not be disadvantaged. Because they have started a business together the brothers now have an insurable interest in each others lives and are able to take out life insurance for each other.
Test Yourself 1

Question 1
In life insurance how long does the duty of disclosure operate?
- Until the proposal for insurance is signed by the proposer
- Until the risk commences
- For the duration of the policy
- Until the first renewal

Understand the life insurance application process. [Learning Outcome b]

Example
Imagine that you are an insurance agent and a prospect approaches you for procuring life insurance. He has never bought a life insurance policy earlier and needs your advice. You need to explain to him the steps involved in determining the type of life policy that best suits his needs and the process involved in applying for the insurance, including completing the proposal form, personal statement and having a medical examination if required.
2.1 Prospectus

A life insurance contract is issued based on an application, called a proposal which is made by the person who wants insurance. This person is known as the proposer. The proposer may not be the person to be insured, as in the case of parents proposing to insure their minor children. The insurer considers and accepts the proposal. The application and the documentation have to satisfy the requirements of a valid contract.

The Companies Act 1956 requires public companies entering the capital market for funds, offering shares or debentures or through deposits to issue a prospectus giving therein complete details of the:

- the business they are in
- their set up
- the various products and services they offer
- statements showing their financial position

The prospectus may be called an ‘offer at large’ as it is an offer to the public to come forward and invest in the company. The prospectus is expected to give enough information to the prospective investor so they can make a decision regarding whether the investment is worthwhile or not.

A prospectus issued by a life insurance company is simpler. It generally gives details regarding the setup of the company, the insurance plans they offer and general terms and conditions. Due to the nature of life insurance business, an insurer’s prospectus will never be adequate for a prospect to make a decision on the plan or the terms of the life insurance policy that will best suit them.

In terms of the IRDA regulations the prospectus some of the details are listed below:

- the various insurance plans offered
- the terms and conditions
- whether the policy is “participating” (with bonus) or “non-participating” (without bonus)
- the riders available along with that policy and the scope of the riders
A prospectus does not have to be a single book with details of all the plans offered. Some insurers print separate pages for each plan detailing the benefits and obligations and also the terms and conditions of the particular policy.

Public opinion in certain countries is of the view that life insurance companies should also conform to the requirements of investment companies that solicit public funds for investment in shares, debentures and deposits. This is due in part because the boundaries in financial services are becoming blurred as linked life insurance plans are offered as part risk cover and part investment.

2.2 Proposal form and related documents

The proposal form is the application form for the insurance. These are printed by insurance companies and are made available to prospects through agents and in some cases insurance companies have the proposal form on the internet.

The person requesting the insurance is called the proposer and they must complete and sign the form themselves. If someone other than the proposer has completed the form they must declare the answers are as dictated by the proposer. If the signature is not in the same as the language the proposal form is printed, someone must declare and sign that they have explained the content of the questions to the proposer and the answers had been recorded after that. The signature of the proposer must be witnessed. If the proposer is illiterate, they have to affix an impression of their left thumb instead of a signature and this has to be attested by a third party. These procedures are essential to make the proposer accountable for their statements in the proposal form and to make the proposal form part of an enforceable contract.

The proposal has two functions, it is a request for insurance and it is also an offer to enter into a contract. In it the proposer provides the following information:

- information about himself (name, date of birth, address, occupation)
- name and other particulars, including family history (family members, their ages, health conditions) of the person to be insured
- amount of insurance cover
- plan and term preferred
- mode of premium opted for
- details of nominee
The completed proposal form is given to the insurer along with:
the personal statement of health which contains information regarding past sicknesses and hospitalisations and the habits of the person to be insured which is completed by the life to be insured, and the proposer, if the life to be insured is a minor.
the confidential report of the agent.

If a medical examination is required the personal statement is given to the medical examiner who will send it to the insurer with their report on the medical examination. The agents confidential report is important for the insurer to be able to assess the risk and acceptability of the proposal for insurance. The report contains information regarding the proposer’s financial position and lifestyle. The purpose of the report is to provide additional information to the underwriter for assessing the risk, particularly in relation to moral hazard if it exists. Occasionally if the proposal is for a large amount or the person to be insured is of advanced age and does not have any life insurance to date or for other reasons the insurer may request a report from another senior official.

The proposal form together with the personal statement are important documents for the following reasons:

- they contain valuable information about the proposer and the person to be insured
- the statements in the proposal and personal statement constitute the basis of the contract

The proposer declares at the end of the proposal form that the answers and statements given by them are true and complete. If any statement is shown to be untrue the contract will become null and void ab initio. The importance of this has been discussed earlier in this chapter while dealing with Utmost Good Faith.

If the proposal is completed in a language not familiar to the proposer or the proposer is illiterate (and can only affix an impression of their thumb imprint instead of a signature) someone familiar with the language must declare that they have explained the contents to the proposer and the proposer has understood. This person is then bound by the declaration in the proposal and the consequences of a false declaration. This would be a requirement in countries like India where there are many spoken languages other than the business language of the insurer and also because of the low literacy levels.
It is understood and explicitly stated in the policy that the proposal and its contents form the basis of the insurance contract evidenced by the policy. Some companies attach the proposal to the policy as part of it. The IRDA regulations require a copy of the proposal be given to the policyholder with the policy. Because the proposal is the basis for the contract it has extensive questions related to health, habits and family history of the life insured and makes it a lengthy document.

2.3 Medical examinations

Normally the person proposed to be insured is subject to a medical examination to determine the state of their health. The age of the person to be insured and the proposed sum assured determines the extent of the medical examination. As age and sum assured increase, so does the rigour of the medical examination. Increasing rigour results in more specialised testing such as radiology, cardiac tests like ECG or TMT, Blood tests etc. Insurers will usually authorise the medical examiners who can complete the medical examinations and apply limits for them. In remote areas only Government doctors may be available for these purposes. Senior doctors are authorised to examine for large sum assureds and those which require special tests for some reason.

A policy of waiving the requirement of medical examinations for people who satisfy certain conditions has been adopted by insurers over a period of time. Gradually with favourable claim experience and increase in the base of the insured population these conditions have been relaxed. A large number of cases are considered without medical examination, these are called non-medical insurances. The practice of underwriting cases without a medical examination has been adopted by almost all the insurers. The amounts for which the covers would be made available on non-medical basis varies from one insurer to another, and also from one product to another within an insurance company.

Non-medical insurance schemes result in:

- the simplification and hastening of the process of assessing risk
- reduced inconvenience for the parties concerned
- cost savings for the insurer as medical fees are not paid.
The elimination of medical examinations has not resulted in the lowering of the standard of selection. Non-medical insurance requires a more detailed proposal form to be completed and a more detailed report from the agent and other officials. The risk is assessed based on the statements in the proposal and personal history forms and on the agents confidential report. The insurer is still entitled to request a medical examination in a case that normally qualifies for consideration under the non-medical scheme, based on the personal details on the Proposal form, Agent’s report and the medical history of the life to be assured.

Employees working in Government offices, Quasi-Government offices such as Municipalities, District boards, Local boards etc., state corporations, Government industrial undertakings and reputed institutions such as private colleges and schools which normally insist on medical examinations prior to recruitment, provide good working environments, pay fair remuneration and maintain leave records are able to use the non-medical scheme.

The PLI (Postal Life Insurance) also has a non-medical scheme for applicants fulfilling certain defined criteria.

2.4 Special Reports

In addition to the proposal form, personal statement, agents report, medical examiners report and age proof, special medical reports may be required if:

- the sum assured is very high
- the age at entry is on the higher side
- the insurance cover applied for is under a high risk plan
- the normal medical examination or agent’s report discloses some adverse feature

The underwriter has the right and discretion to request additional information through special reports if they consider these reports necessary for a fair assessment of the risk. The reports may relate to things such as:

- medical conditions
- income & / occupation of the applicant
- habits & life-style of the applicant
2.5 Age Proof

As age increases so does the risk of death. The likelihood of a person aged 70 dying in the next year is more than that of a person aged 20. For this reason the age of the proposer plays a vital role in assessing the risk of death and therefore the amount of premium to be charged. Age, along with other factors such as health and habits are considered by the underwriter.

Fifty years ago age proof was not insisted on at the time of accepting the risk. Premium was calculated based on the age as stated on the proposal form. It was assumed that in the majority of cases the age stated would be correct and the proof of age could be submitted during the currency of the policy. The age had to be proved before a claim was settled. If the age was proved higher the arrears of the difference in premium was recovered with interest. This practice proved to be inconvenient and caused delays. Proof of age was not easily available, particularly for death claims. It was also found that the policy may not have been issued had the correct age been stated. For these reasons proof of age is required at the commencement of the policy.

Some of the standard age proofs acceptable to life insurance companies are:
- certified extract from Municipal or other records made at the time of birth
- certificate of baptism
- certified extract from school or college records
- certified extract from the service register in the case of employees of Government or quasi Government institutions and reputed commercial and educational institutions
- passport within its validity period
- identity cards issued by Defence department in case of defence personnel
- Driving License within its validity period.
- any other document where the date of birth has been proved on the basis of one of the other standard proofs of age acceptable to insurance companies.

If standard proof is not available alternate proofs of age are subject to the company norms laid down. They may also charge extra premium for non-standard age-proof or restrict the terms to safeguard against the possibility of the correct age being higher than what is stated.
Test Yourself 2

Question 2

The life insurance proposal has 2 functions. One is a request for insurance, what is the other one from the following options?

- Ensures the proposer fulfils their duty of disclosure
- Ensures that the proposer has an insurable interest in the subject matter of insurance
- An offer to enter into a contract
- Provides information about the amount of insurance required

Understand how life insurance policies are underwritten. [Learning Outcome c]

3.1 Underwriting

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. If the risk is assessed incorrectly the premium charged may be more than necessary or less than necessary, both of which are unfair.

Example

Imagine you are an underwriter working for a life insurance company. What factors do you think you would assess to determine the risk of a proposal for insurance you have received? These can include:

- the age of the life insured
- any pre-existing illnesses or disease
- occupation of the life insured
- family history of illness or sickness
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. They may also refer the case to a medical referee for an expert opinion if they deem it to be necessary. A medical referee is a senior doctor familiar with the implications of medical conditions on life insurance.

After reviewing the proposal papers and the medical reports the underwriter may decide to accept the proposal, as proposed (1) at standard rates also called as Ordinary Rates (O.R) or (2) on modified terms. The IRDA regulations state the proposer must be advised of the decision within 15 days.

Accepting at O.R. means that the person to be insured is a standard or normal risk and the premium can be charged as per the standard tabular rates. If the assessment is that the person to be insured is not a standard or normal risk the decision will be one of the following:

- accept for a lesser sum assured than proposed
- accept for a shorter term than proposed
- accept for a different plan than proposed
- charge a higher premium than the standard rate
- impose a lien which reduces the insurers liability under the policy for a period of time or under certain conditions
- exclude certain specified risks under the policy
- postpone for a specified period
- decline

The effect of each of the decisions above is detailed below:

<table>
<thead>
<tr>
<th>Decision</th>
<th>Effect of decision</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accept for a lesser sum assured than proposed</td>
<td>Reduces the risk level of an insurance company</td>
</tr>
<tr>
<td>Accept for a shorter term than proposed</td>
<td>Reduces the tenure of risk The risk of someone dying within the next 5 years is less than the risk they will die in the next 10 years. The risk in a longer term plan is more than the risk in a shorter term plan.</td>
</tr>
<tr>
<td>Accept for a different plan than proposed</td>
<td>Reduces the risk level for an insurance company. Modified plans can reduce the risk. Term plans are more risky than Endowment plans which have an element of savings.</td>
</tr>
<tr>
<td>Charge a higher premium than the standard rate</td>
<td>Increases the premium to cover the additional risk. This decision will be written as “Accept with extra Rs. Per thousand”</td>
</tr>
<tr>
<td>Impose a lien which reduces the insurers liability under the policy for a period of time or under certain conditions</td>
<td>This decision is made when the additional risk is assessed as likely to reduce over a certain period of time. In this case if death occurs during the lien period the sum assured will be reduced as stated in the lien clause.</td>
</tr>
<tr>
<td>Exclude certain specified risks under the policy</td>
<td>This decision is made when the additional risk is related to specific condition and not the person’s general health and the same is excluded from risk cover.</td>
</tr>
<tr>
<td>Postpone for a specified period</td>
<td>This decision is made when the assessment is adverse at the point of application but may improve over a period of</td>
</tr>
<tr>
<td>Decline</td>
<td>The risk is deemed to be too great to be accepted at any point of time</td>
</tr>
</tbody>
</table>

The factors taken into account by the underwriter when assessing the risk are physical, financial and moral hazards.
Physical factors taken into account at the time of underwriting include:

<table>
<thead>
<tr>
<th>Physical factors</th>
<th>Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age</td>
<td>The probability of death and sickness increases with age. These are written into the mortality and morbidity tables. The age factor is looked at along with other factors such as weight and blood pressure. Certain factors are positive indicators at younger ages and negative indicators at older ages and vice versa. Younger persons who are underweight need more scrutiny than older persons who are underweight. Similarly older persons who are overweight need more caution than young persons who are overweight.</td>
</tr>
<tr>
<td>Sex</td>
<td>In the mid 1950’s insurers were very selective about insuring female lives. Deaths related to maternity were high, particularly in remote areas. This situation has changed considerably with health care facilities becoming increasingly available in the country. Today insurers treat educated females as well as working females on par with men. Additional precautions may be taken with uneducated females.</td>
</tr>
<tr>
<td>Build</td>
<td>Height, weight, abdomen and chest measurements provide clues regarding lifestyle and possible tendencies to cardiac problems and diabetes. The actual measurements are compared with standard measurements and judgements are made on the basis of the extent of the variations.</td>
</tr>
<tr>
<td>Body</td>
<td>Medical examiners observe reflexes, pulse rates, heart sounds, blood and urine analysis, x-rays etc. And report any physical impairments such as deformities, blindness, deafness etc.</td>
</tr>
<tr>
<td>Family history</td>
<td>Family history will provide information on the possibility of hereditary diseases.</td>
</tr>
</tbody>
</table>
Occupational hazards | 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.

Financial underwriting looks at the relationship between the existing financial condition of the person to be insured and the proposed amount of the insurance. This is to assess whether there is any suggestion of potential for trying to gain an advantage, in which case questions regarding the legality would arise. If the likely premium seems too high a proportion of the income some questions may arise regarding the purpose of the insurance and the question of moral hazard would arise. 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. If moral hazard is suspected the underwriter would not accept the proposal at any cost.

The proposer will be advised of the terms under which the proposal will be accepted by the underwriter. If the proposal is accepted as O.R. the deposit paid along with the proposal if adequate will be adjusted as first premium and the risk will commence from that time. If the underwriter is willing to accept on modified terms, the proposer must agree to the modified terms before a policy is issued. Any balance of premium wherever required, must be paid. If all the requirements are fulfilled by the proposer, the first premium will be adjusted and the risk will commence. Until the policy document is issued the first premium receipt is evidence of commencement of risk.

3.2 Underwriting Standards

Risk assessment involves looking at how a number of individual factors may affect mortality and making a determination of the total effect of these individual effects. Underwriters are not actuaries or doctors and would have acquired their skills working in the office of an insurer. Underwriting is a matter of experience.
If each insurer had only one underwriter in their office all decisions would be consistent. In large insurance companies, especially those that are national or multinational the underwriter’s job is done by many different people. For this reason it is necessary to develop systems where consistent decisions are made across all the decision points.

One method which is used insurers is to have a numerical points system called as Numerical Rating. Variations from the standard measure regarding important risk factors such as the extent a subject matter of insurance is over or under weight are noted. Variations within a certain percentage may be ignored and variations over the percentage will be allocated points based on the significance attached to the factor. All the points are added to arrive at the total effect of variations and extras charged on the total.

Underwriting standards are constantly reviewed by insurers and related academicians and insurers also exchange data on their studies. Developments in medicine are making some illnesses such as diabetes less dangerous than they previously were. The risk attached to smoking, drinking, diabetes, polio, tuberculosis etc are examples of the changing attitudes of insurers to diseases.

**Test Yourself 3**

**Question 3**

What length of time does an insurer have to advise a proposer of their decision regarding the proposal?

- 5 days
- 7 days
- 10 days
- 15 days

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**Summary**

In life insurance the duty of disclosure operates until the risk commences, unless the conditions of the policy contract make relevant stipulations.

To take out a life insurance policy on someone else’s life the proposer must have an insurable interest in that person, whereby they benefit from the safety and well-being of the subject matter of insurance and would be prejudiced by its loss or damage.
The proposal has two functions, it is a request for insurance and it is also an offer to enter into a contract.

In life insurance it is understood and explicitly stated in the policy that the proposal and its contents form the basis of the insurance contract.

The forms to be completed to assess the risk for life insurance include the proposal form, personal statement, agents report and medical reports (where applicable).

The underwriting process 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.

The IRDA regulations state that an insurer must notify the proposer of their decision of acceptance or otherwise within a stipulated period.

Risk assessment involves looking at a number of individual factors may affect mortality and making a determination of the total effect of these individual effects on longevity of life.

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**Answers to Test Yourself**

**Answer to TY 1**

The correct option is **B**

The duty of disclosure operates until the risk commences.

**Answer to TY 2**

The correct option is **C**

The 2 functions of the life insurance proposal are it is a request for insurance and an offer to enter into a contract.

**Answer to TY 3**

The correct option is **D**

The IRDA regulations state the insurer must advise the proposer of their decision within 15 days.
Self-Examination Questions

Question 1

Some of the essentials of a valid contract are ________

Lawful consideration.
Capacity of parties to contract.
Consensus ad idem.
All of the above.

Question 2

Accepting a policy at O.R means that ____________

A. the person to be insured is a standard or normal risk.
B. the policy is accepted with additional premium.
C. the policy is accepted with exclusions.
D. the policy is accepted with a counter offer.

Question 3

When is the proposer generally required to supply age proof?

Only when a claim is settled
Within the first year of the policy
At commencement of the policy
On maturity of the policy

Question 4

Which process assesses the risk proposed to be insured?

Underwriting
Claims
Application
Contract
Question 5
Which factors are considered by the underwriter when assessing the risk?
- Physical factors
- Financial hazard
- Moral hazard
- All the above

Answers to Self-Examination Questions

Answer 1
The correct option is ‘D’.
Some of the essentials of a valid contract are lawful consideration, capacity of parties to contract and consensus ad idem (all the above options).

Answer 2
The correct answer is ‘A’
Accepting a policy at O.R means the person to be insured is a standard or normal risk.

Answer 3
The correct answer is ‘C’
Age proof is generally required at commencement of the policy.

Answer 4
The correct answer is A
The underwriting process assesses the risk proposed to be insured.

Answer 5
The correct answer is D
The underwriter considers all the factors related to physical, financial and moral hazards.
CHAPTER 8
POLICY DOCUMENTS

Chapter Introduction

This chapter aims to provide you with an understanding of the importance of the insurance document. Each different section of the policy document has a different purpose and it is important to be able to understand the sections and their purposes.

Learning Outcomes

Understand the importance of the policy document and the information contained in it.
Look at this scenario

Parties enter into agreements, and details relating to these agreements are documented in what is known as a contract. Life insurance is no different from any other agreement. Two parties agree to certain conditions based on details provided. A life insurance policy is a contract, with two parties (proposer and the life insurance company) agreeing on their duties and obligations to each other and the terms and conditions of the agreement (including payment). These details are documented in the life insurance policy document. Imagine what would happen if a customer took out a life insurance policy and paid the premium but received no documentation in return. It would be confusing, not only trying to prove who does and who doesn’t have a policy but also under what terms and conditions the policy is effective. At the time of claim it will be difficult to have the claim paid without proof of the agreement.

The policy document is an evidence of the insurance contract. The document contains the subject matter and the terms and conditions of the insurance. It sets out the rights, duties and obligations of both the insurance company and the policyholder.

Understand the importance of the policy document and the information contained in it.  

[Learning Outcome a]

1.1 Format of the document

All life insurance policy documents have a similar format. This is because the format and wordings have been developed over many years. The wordings used in the document may appear legalistic so some insurers also issue a small supplement in addition to the policy, which explains the main content of the policy in simple terms.

In order for the policy document to be enforced in a court of law, it must be signed and stamped as per the Stamp Act. In the case of Postal Life Insurance (PLI) the policy is exempt from stamp duty. The majority of the standard terms and conditions are printed on the document. Special clauses that are relevant to a particular contract are attached to the policy document and form part of the contract.
A policy document is usually divided into various sections as shown below:

Diagram 1: Sections of a policy document

1.2 Policy preamble, operative clause and proviso

Preamble

Policy documents generally begin with a paragraph which states that:

the insurer has received a proposal with a personal statement and the first instalment of premium

the insurer agrees to grant the insurance cover (promise to pay the specified sum should the specified event occur) on the terms stipulated in the policy document
it is understood and agreed that the insurance cover was granted on the basis of
the statements made in the proposal and personal statements signed by the
proposer
the insurance cover is subject to the proposer paying the premiums as specified
in the policy document by the due dates.

The opening paragraph is called the **preamble** and makes the proposal and
declarations signed by the proposer part of the contract. The truth of the statements
made in the documents is secured to be warranties. If untrue statements were made
in the documents the contract becomes null and void.

**Operative Clause**

The **operative clause** is contained in the preamble. This clause details the mutual
obligations of the insurance company and the insured. The policyholder has to pay
the premiums as they are stipulated in the policy. The insurer has to pay the benefits,
as promised, when one of the specified events occurs. The benefits include bonus
additions, if specified. The payment of a benefit is subject to the policyholder
providing proof of the following:

- the happening of the event
- the age of the life insured
- the title or right of the person claiming payment

**Proviso**

The preamble also includes the **proviso** which clarifies that the following are part of
the policy:

- the terms and conditions printed on the policy document
- the endorsements placed on it

It is called the proviso because the contract is conditional on these terms. The normal
terms and conditions are printed on the document. Any changes to these terms and
conditions will be clarified through endorsements.

The content of the endorsements will have been determined when the proposal was
underwritten and the policyholder must be advised of them and accept them. With
the consent of both the policyholder and insurer, changes can be made after the issue
of the policy.
1.3 Schedule

The schedule contains the specific particulars relating to the insurance contract, which the policy document is evidence of. The schedule follows the preamble and includes the following details:

- **policy number**
- **name and address of the proposer and the life insured**
- **date of proposal**
- **date of birth and age of life insured**
- **commencement date of the insurance plan and term**
- **sum assured**
- **mode of payment (yearly, half yearly, quarterly or monthly) and due dates**
- **installment premium**
- **date of last payment of premium**
- **name of the nominee (if nominee specified in the proposal)**
- **date of maturity**
- **conditions and privileges not applicable**
- **additional or special conditions**

All the particulars of the subject matter of the insurance are detailed in the schedule. It identifies the proposal that is referred to in the preamble.
Diagram 2: Policy schedule

- Policy number
- Name and address of the proposer and the life insured
- Date of proposal
- Date of birth and age of life insured
- Commencement date of the insurance
- Plan and term
- Sum assured
- Mode of payment and due dates
- Instalment premium
- Date of last payment of premium
- Name of the nominee
- Date of maturity
- Conditions and privileges not applicable
- Additional or special conditions
1.4 Attestation

The attestation is the signature on behalf of the insurer. It appears at the end of the first page of the policy. If insurers provide a supplementary contract for additional benefits, provided through riders, the supplementary contract will be attested separately.

Test Yourself 1

Question 1

In order for the policy document to be enforced in a court of law, it must be signed and stamped as per which Act?

- The Insurance Act
- The Stamp Act
- The Life Insurance Corporation Act
- The Insurance Regulatory and Development Authority Act

Understand conditions and privileges in an insurance policy.  
[Learning Outcome b]

2.1 Conditions and privileges

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
- **privileges**: these add to the benefits of the insurance and provide 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 if the policyholder did not pay the premium by the due date 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.
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 claim amount.

Restrictive conditions are designed to eliminate certain risks that are not taken into account when determining the premium. If any such risk is incurred, the assurance is limited to the payment of the surrender value, or the return of premiums or a proportion of the sum assured as stated in the conditions. These restrictive conditions are decided by the underwriter and have to be agreed by the policyholder.

One common restriction on all policies is that no claim will be paid if the life assured commits suicide in the first year, except to the extent of a third party’s bonafide beneficial interest. This restriction normally operates for one year from the commencement of the policy. In some countries the suicide clause operates for two years from the date of issue of the policy. Accident benefit is never paid in the case of a suicide. In some types of policies there is a condition that no loans are payable.

Restrictions are generally not imposed based on hazardous occupations but extra premium is charged to cover the extra risk to which the life insured is exposed due to their occupation. One such example is an occupation in aviation. Double accident and disability benefit are not available in the event of death as a result of an accident while the life insured is engaged in aviation, unless they are a passenger on a commercial airline. Some insurers require that they be notified of a change of occupation and failure to do so may invalidate the accident benefits or other benefits secured through riders.

In some policies, foreign travel and residence may be a restriction. In India, the LIC policy is free from restrictions for travel and residence. Some insurance companies exclude coverage in the event of death within 5 years or as a result of war, while travelling outside the country. The LIC insurance policies used to exclude deaths occurring as a result of war. Now they are free from war restrictions, except for double accident benefits.
2.2 Conditions which add to the benefits of the insurance and privileges

If the provisions of the contract as stated on the first page were strictly adhered to, it would make the contract very rigid and restrictive for the policyholder. For example, failure to pay premiums on or before the due date would result in complete forfeiture of the insurance. To reduce the severity of the contract some policy conditions (privileges) are inserted.

Diagram 3: Policy conditions (privileges):

All the above privileges are discussed in detail later in the book.
2.3 Conditions which provide extended or supplementary benefits

These are the benefits that are covered by riders. They may be incorporated in the policy document as policy conditions or they may be mentioned as riders, while the policy document deals with the standard terms and conditions. Previously, companies had separate policy document formats for:

- policies with accident benefits
- policies without accident benefits
- policies which participate in profits
- policies which do not participate in profits

These formats were printed and kept in inventory. With the increased availability and use of computers it is no longer necessary to keep these expensive inventories. Any combination of conditions can be immediately incorporated and printed. Some insurers’ policy documents refer to the additional benefits; and the benefits as such are detailed in separate forms which are annexures or addenda to the policy. This is similar to having separate endorsements.

The insurance policy is divided into four parts after the preamble. These parts are:

- part 1: contains the schedule
- part 2: provides the details of the benefits payable (amounts, relevant events, limitations, exclusions, bonuses, guaranteed additions etc.), including the benefits under the riders. This part also explains the policyholders’ rights to commute or accumulate in part or in full, the instalments due to them
- part 3: provides details of the terms and conditions relating to age, admission, lapse, non-forfeiture, revival, loans, surrender values, assignments, nominations, exclusions etc. related to suicide and documents required for making claims
- part 4: gives the amount of guaranteed surrender value

**Test Yourself 2**

**Question 2**

Which of the following are the conditions that are designed to eliminate certain risks?

- Explanatory
- Extended
- Supplementary
- Restrictive
2.4 Alteration

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. 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.

The types of alterations which may be requested are:

- alterations in plan or term
- reduction in sum assured
- change in mode of payment of premium
- alteration of name
- change of nominee
- removal of an extra premium
- splitting the policy into two or more policies
  - alteration from a without profit plan to a with profit plan and vice versa
  - grant of accident benefits
  - settlement option of payment of sum assured in instalments
  - grant of premium waiver benefits
- correction in policies – usually done soon after commencement of policy

Alterations are considered if the policy is in force for the full sum assured. Normally alterations are not allowed for the first year of the policy unless they are done for a correction or a change which does not affect the basic insurance contract, such as changes in address or change in nominee.

**Example**

An insured has a life insurance policy which he has held for 3 years. They have paid their premiums quarterly during this time and now wish to pay the premiums annually. This change would require an alteration to the current policy as the time of payment of premium is changing from quarterly to yearly.

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
- in an attempt to discourage frequency of alterations

2.5 Duplicate Policies

Because of the long duration of a life insurance policy, it is possible that policy documents are misplaced or lost, maybe if the policyholder moves to another place or re-arranges their personal belongings. Policy documents may also be damaged due to moisture or termites. Lost or damaged policy documents do not absolve the insurer of their liability to pay the policy moneys when a claim arises. Even without the policy documentation the claim must be paid to the claimant.

A policy document represents property and as such a policyholder may require the document for making an assignment or pledging it against a loan.

Insurers issue duplicate policies at the request of the policyholder, however, they do this with caution as they do not want to become a participant in any wrong doing which may be attempted. It is possible that a policyholder may report their policy document as lost or stolen to the insurer, when they have mortgaged or assigned the document to someone else. Although these attempts at fraud may be few, precautions are necessary in all cases. Therefore, insurers make enquiries to satisfy themselves that the reported loss is genuine.
Before a duplicate policy is issued, a policyholder may be asked to advertise in the local newspaper or provide an indemnity bond signed by the policyholder as surety. If the policy is stolen the policyholder will have to file a first information report (FIR) with the police and obtain the final investigation report from the police. If a policy document is partially burnt, mutilated or damaged, the remains of the document may be examined and if the identity is clear a duplicate policy can be issued without advertisement and indemnity bond. The policyholder will have to pay the costs associated with issuing a duplicate policy, which includes advertisement (if required) and stamp duty.

The duplicate policy document is clearly stamped with a rubber stamp to indicate that it is a duplicate policy; however, the duplicate is as good as the original document for all practical purposes. The duplicate policy will have all the same endorsements as the original and will be signed and stamped by the insurer with the original date on it.

**Summary**

In order for the policy document to be enforced in a court of law, it must be signed and stamped as per the Stamp Act.

Some alterations are made by having a suitable endorsement on the policy itself.

If the alterations are substantial a new policy may be issued.

The attestation is the signature on behalf of the insurer.

The opening paragraph is called the preamble and makes the proposal and declarations signed by the proposer part of the contract.

The preamble includes the proviso and the operative clause.

The schedule contains the specific particulars relating to the insurance contract such as the name and address of the policyholder or the life insured, plan and term, sum assured and mode of payment.

No changes can be made to the policy unless they are agreed upon by both the policyholder and the insurer.

The insurer must try to ensure that there will be no adverse selection against them when they consider a request for alteration.

A duplicate policy document is clearly stamped with a rubber stamp to indicate that it is a duplicate policy; however, the duplicate is as good as the original document for all practical purposes.

Explanatory conditions are for the insured’s information, and clarify the policy conditions.

Restrictive conditions are designed to eliminate certain risks that are not taken into account when determining the premium.
Answers to Test Yourself

Answer to TY 1

The correct option is B.

In order for the policy document to be enforced in a court of law, it must be signed and stamped as per the Stamp Act.

Answer to TY 2

The correct option is D.

Restrictive conditions are designed to eliminate certain risks.

Self-Examination Questions

Question 1

What is the signature on behalf of the insurer called?

Preamble
Proviso
Operative Clause
Attestation

Question 2

The preamble includes the proviso and ___________
Question 3
Which part of the policy document makes the proposal and declaration signed by the policyholder part of the contract?

- Schedule
- Conditions
- Operative Clause
- Preamble

Question 4
Which of the following changes would not increase the risk to the insurer?

- Increase in sum assured
- Increase in policy term
- Change in residence
- Change from the Endowment to the Anticipated Endowment plan

Question 5
Which of the following is an example of a restrictive condition?

- No claim will be paid if the life assured commits suicide
- If the policyholder does not pay the premium by the due date the policy would be null and void, all benefits under the policy will cease and any premiums paid will be forfeited
- If the information provided by the policyholder on the proposal, personal statement or declaration were untrue, then the policy would be null and void, all benefits under the policy will cease and any premiums paid will be forfeited
- If death takes place, the instalments of premium due for the remainder of the policy period will be deducted from the claim amount.

Answers to Self-Examination Questions

Answer 1
The correct option is D.
Attestation is the signature on behalf of the insurer.
Answer 2

The correct answer is C.

The preamble includes the proviso and the operative clause.

Answer 3

The correct answer is D.

The preamble makes the proposal and declaration signed by the policyholder part of the contract.

Answer 4

The correct answer is C.

A change in the policyholder’s place of residence would not increase the risk to the insurer.

Answer 5

The correct answer is A.

A restrictive condition eliminates risk from the insurance contract, therefore, the condition that no claim will be paid if the life insured commits suicide is a restrictive condition. The other conditions are all examples of explanatory conditions.
CHAPTER 9

PREMIUM PAYMENT, POLICY LAPSE AND REVIVAL

An Introductory Overview

Life insurance is an agreement that assures payment of a stated amount of money at the end of a specified term or on the death of the life insured if the client keeps his promise of paying his premium in time. It provides for financial security in the event of death or on the inability to earn due to physical disabilities. A life insurance policy is a long term contract between the policyholder and the life insurance company. The payment of premium is normally spread over the term of a policy. A policyholder has to pay the premium on or before the due date.

Some people - due to unexpected uncertainties - are sometimes unable to pay the premium on time. The reasons can be many. It can be due to loss of a job, unexpected and extensive medical expenses, forgetting to pay the premium on the due date, or losing interest in continuing with the policy. Sometimes people land in a financial crisis and can't afford to pay any further premiums. No matter what the reason is for not paying the premium, it’s important to know the possible consequences of not making timely payment of insurance policy premium. The effect depends on the type of policy and coverage the individual has and the terms and conditions of the policy. An individual’s inability to pay the premium due can result in lapsing of the policy, thereby triggering the chances of reducing or losing the policy benefits thereunder.

A lapsed policy can have serious consequences. If something happens to the bread winner, the dependents may be left with no source of income, if you stop paying premiums and let your policy lapse, you would lose valuable insurance protection and monetary benefits from it, thereby leaving your family at a financial risk. Actually, life insurance is the link that can provide financial protection to the family if the bread earner dies prematurely. Death benefit proceeds from a life insurance policy can provide the liquidity to settle final expenses, pay off debts, meet goals like children’s education and marriage expenses.
This chapter will give a detailed account of different modes of premium payment, circumstances in which a policy lapses and different ways in which a lapsed policy can be revived.

**Learning Outcomes**

- Understand the concept of premium, its calculation and frequency of payment of premium
- Discuss surrender value and non-forfeiture options
- Learn about the ways in which a lapsed policy can be revived
Understand the concept of premium, its and the pace of payment of premium.

[Learning Outcome a]

1.1 How are premiums calculated

Premium is the consideration paid by the insured person for purchasing the insurance product. Premium is to be paid by the insured person at the commencement of contract and thereafter throughout the term at periodical intervals as per the terms of the policy. The rates of premium vary as per age, term and benefits offered under the type of product.

There are several factors considered by insurance companies for arriving at the premium to be charged. Some of these factors include age, gender, profession, health conditions, profession and family history etc. of the prospect applying for insurance.

Factors affecting the premium

<table>
<thead>
<tr>
<th>Factors</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Age</strong></td>
<td>For people belonging to a given age bracket say 31 – 40 years, the higher the age, the higher will be the premium. Given that all other factors are same in this age bracket, the premium for the person aged 31 years will be the lowest and the premium for the person aged 40 years will be the highest.</td>
</tr>
<tr>
<td><strong>Sex</strong></td>
<td>Insurance companies charge different premiums for males and females based on their exposure to risks and longevity.</td>
</tr>
<tr>
<td><strong>Profession</strong></td>
<td>People who are in professions where risk is more than other normal professions are charged higher premiums. For example, people working in underground mines and explosive factories are exposed to higher risks than people in other professions such as the IT industry.</td>
</tr>
<tr>
<td><strong>Habits</strong></td>
<td>People who consume tobacco and alcohol or smoke beyond certain levels may be charged higher premiums compared to other people.</td>
</tr>
<tr>
<td><strong>Health Conditions</strong></td>
<td>People in good health will be charged lower premiums than people suffering from some diseases, disorders, ailments and disabilities.</td>
</tr>
<tr>
<td><strong>Family History</strong></td>
<td>If there is a strong family history of ailments like diabetes, cancer, heart problems etc. then the life to be assured may be charged a higher premium as compared to others, as science has proven that the likelihood of the life-to-be-assured suffering from such diseases / disorders in future being very high.</td>
</tr>
</tbody>
</table>
The above list of factors affecting the premiums is just indicative and not an exhaustive one. While these are some of the important factors influencing premiums, insurance companies do factor in many other factors in the process of arriving at premiums. Premiums are worked out on the basis of probabilities. Hobbies of a person can also influence the premium. These can include hobbies such as:

- Mountaineering
- Para Gliding
- Water Sports
- Trekking

The insurer refers to internal manuals or guidelines which specify the parameters of the hazard and work out the appropriate extra premium, if the life-to-be-assured participates in such hobbies or avocations.

If the risk is assessed to be greater than the standard, it is described as sub-standard and a higher premium may be charged.

**Example**

If smoking is considered a hazard, a standard premium is fixed for non-smokers. Smokers may be charged a higher premium.

If the extra risk is assessed to be very high, the insurer may also decline the proposal for insurance, as no amount of extra premium is sufficient to take care of the very high extra risk.

**Example**

If the applicant is suffering from terminal cancer, the chances of his survival for even one year are remote in view of the advanced stage that he is in. In such type of cases the insurance company may decline the proposal for insurance as the risk involved is extremely high. If such a case is accepted even with a very high extra premium in view of the high risk profile, the policy will result in a claim in the very first year of the policy, resulting in jeopardising the actuarial assumptions while also impacting both; the revenue of the insurer and the portfolio of policy-holders adversely.

1.2 Age

Nowadays, age of the life insured is proved and admitted at the commencement itself because age is an important factor that influences the contract. Both risk assessment and premium depend on age. The claim cannot be finally settled unless age is admitted.
If age remains to be proved when the claim arises, there could be delays in settling the claim. In the recent years, the process of age-admission is ensured prior to the issue of policy, as this avoids calling for age-proof from the clients at the maturity payment stage / claimants while settling death claims. It also helps that there is no understatement and overstatement of age related issues after the commencement of the policy. This process also ensures settling death claims faster without the procedure of the claimants having to submit the proof of age of the deceased person.

Age seems fairly simple to determine. However, many life insurance companies see it in a different way. Age of the policyholder on the date of the commencement of the policy needs to be calculated by insurance companies. Some insurers, for calculating age, consider only the number of years completed and ignore months and days. There are three methods using which the age of the policyholder can be determined.

**Age next birthday**: life insurance companies calculate premiums based on the age that an individual will achieve on his next birthday. In other words the age as on the birthday coming after the commencement of policy.

### Example

#### Scenario 1

<table>
<thead>
<tr>
<th>Date of birth</th>
<th>4&lt;sup&gt;th&lt;/sup&gt; July 1982</th>
</tr>
</thead>
<tbody>
<tr>
<td>Date of commencement of the insurance plan.</td>
<td>4&lt;sup&gt;th&lt;/sup&gt; Dec 2010</td>
</tr>
<tr>
<td>Age will be</td>
<td>29 years</td>
</tr>
</tbody>
</table>

#### Scenario 2

<table>
<thead>
<tr>
<th>Date of birth</th>
<th>10 Oct 1976</th>
</tr>
</thead>
<tbody>
<tr>
<td>Date of commencement of the insurance plan.</td>
<td>11&lt;sup&gt;th&lt;/sup&gt; Aug 2010</td>
</tr>
<tr>
<td>Age will be</td>
<td>34 years</td>
</tr>
</tbody>
</table>

**Age last birthday**: this method is also known as actual age method. In this method insurance companies calculate age based on the last birthday. In other words the age is taken as on the birthday coming before the commencement of policy.
**Example**

**Scenario 1**

<table>
<thead>
<tr>
<th>Date of birth</th>
<th>4th July 1982</th>
</tr>
</thead>
<tbody>
<tr>
<td>Date of commencement of the insurance plan.</td>
<td>4th Dec 2010</td>
</tr>
<tr>
<td>Age will be</td>
<td>28 years</td>
</tr>
</tbody>
</table>

**Scenario 2**

<table>
<thead>
<tr>
<th>Date of birth</th>
<th>10th Oct 1976</th>
</tr>
</thead>
<tbody>
<tr>
<td>Date of commencement of the insurance plan.</td>
<td>11th Aug 2010</td>
</tr>
<tr>
<td>Age will be</td>
<td>33 years</td>
</tr>
</tbody>
</table>

**Age nearest birthday:** In this method insurance companies calculate the age based on the nearest birthday, which could be either the last birthday or next birthday. In other words, generally, the age is taken as on the birthday within 6 months before or after the date of commencement of policy.

**Example**

**Scenario 1**

<table>
<thead>
<tr>
<th>Date of birth</th>
<th>4th July 1982</th>
</tr>
</thead>
<tbody>
<tr>
<td>Date of commencement of the insurance plan.</td>
<td>4th Dec 2010</td>
</tr>
<tr>
<td>Age will be</td>
<td>28 years</td>
</tr>
</tbody>
</table>

**Scenario 2**

<table>
<thead>
<tr>
<th>Date of birth</th>
<th>10th Oct 1976</th>
</tr>
</thead>
<tbody>
<tr>
<td>Date of commencement of the insurance policy.</td>
<td>11th Aug 2010</td>
</tr>
<tr>
<td>Age will be</td>
<td>34 years</td>
</tr>
</tbody>
</table>

Most life insurance companies use the Age Nearest Birthday method for age determination.
Mis-statement of age is generally dealt with, through the following three methods:

If the age is proved higher than stated at the proposal stage and his corrected higher age makes him uninsurable for the plan or product that he has already been issued, this policy will have to be cancelled and a new policy issued under another plan after underwriting is done (and subject to him being found insurable). Then, all terms and conditions of the new plan will become applicable.

In case, there is no plan that can be issued to him with the corrected higher age, then the policy will be cancelled from the date of issue of the policy and premium or contribution made to the insurer will stand refunded without interest and subject to deductions of expenses incurred and payments already made by the insurer under the policy.

If the correct age of the life-assured is found to be higher than the age declared in the proposal, and he is found to be uninsurable at this stage, then the premium or contribution made will be suitably corrected from the date of commencement from the policy and the accumulated difference in premium is calculated.

If the age proved at a later date is lower than what was mentioned in the proposal form then the premium or contribution payable under the policy shall be modified to the premium corresponding to the lower age of the life-assured and the corrected premium from the date of commencement of the policy. The insurer, based on their terms and conditions may, refund without interest the accumulated difference between the original premium or contribution paid and the corrected premium or contribution.

All these situations are avoided with the practice of proving the correct age at commencement of the policy.

**Example**

In the case of Postal Life Insurance (PLI), the clause in the policy says that (i) if age is proved to be lower than what was proved earlier justifying a lower premium, forthcoming premiums will be reduced, but there will be no adjustments for the past premiums paid at the higher rate and (ii) if the age is proved to be higher justifying a higher premium, the policy will be treated as null and void and the premium forfeited.

This clause exists although age is admitted at the outset, mostly on the basis of service records. There could be occasions to modify ages already proved and admitted.
1.3 Premium

The preamble in the policy acknowledges receipt of the first premium. The Operative clause refers to the obligation of the insured to pay subsequent premiums as set out in the Schedule of the Policy. The first premium paid is the consideration for the life insurance contract to come into force. The payment of subsequent premiums is the condition necessary for the contract to continue to remain in force.

The policy document will state:

- the dates on which premiums have to be paid
- the place/s where premium has to be paid.

in the event of failure to pay premiums on the due date, the policy will lapse.

This means that the policy will effectively terminate subject to safeguards written in the terms and conditions of the policy and the law. Insurers do not enforce these conditions as rigidly as they are stated and provide a grace period (normally 30 days) to pay the premium after due date.

**Timing of payment of premium**

Premiums are normally payable in yearly, half-yearly, quarterly or monthly instalments. Monthly payment of premium involves much more administrative work, like issue of receipts and accounting and adjustments, 12 times compared to once, in a yearly mode of premium payment.

A single premium, for an insurance policy suggests that there is no great need for insurance, as the policyholder is able to set aside a big enough sum of money. A single premium for an immediate annuity however, is commonly done. People, who retire, deposit their savings with the insurer for a regular annuity. Some insurers do not allow monthly payments because of the additional work involved. Some insurers accept the monthly mode only if it is paid through a bank by way of standing instructions (ECS) or under SSS schemes. The advantage here is that the payments would be regular and the chances of default are less.

**Calculation of Premium**

Premiums are calculated on the published rates. However, monthly premium may not be just one-twelfth of the yearly premium. There could be a small addition of say 5-8% of the tabular rate before calculating the monthly premium.
This is to provide for the additional administrative costs. On the contrary, there could be small reductions, called rebates or discounts, while calculating the yearly and half-yearly modes. In calculating instalment premium, care has to be taken to deduct permissible rebate (concession) for mode of payment and sum proposed for insurance. The rebates are offered for annual and half yearly mode of premium because there is less administrative cost and also the insurer gets the premium at the beginning of the year itself and hence can earn higher returns on it. These practices vary between insurers and depend on how a particular insurer has worked out its premium rates.

**Example**

The premium for an insurance policy of Rs. 25,000.00 may not be just 25 times the premium for an insurance policy of Rs 1000.00. This is because of adjustments justified by the distribution of overhead costs. Some costs are variable costs, like commission, and depend on the premium. But some costs are constant. The cost of printing a policy and creating the records for future servicing are the same, whatever is the size of the policy. This is the reason why there is differentiation in premium rates between policies of lower premium amounts and policies of higher premium amounts. These differences are referred to as Sum Assured rebates.

**Steps involved in calculation of premium**

**Note:** The actual method of calculation could differ from insurer to insurer. The method below, is just indicative, to illustrate the method used by the insurer.

The tabular premium is taken from the premium table for relevant age and terms of insurance.

<table>
<thead>
<tr>
<th>Table</th>
<th>Policy Term</th>
<th>Age</th>
<th>Tabular premium for Rs. 1000 Endowment Sum Assured</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>20</td>
<td>22</td>
<td>Rs. 50.60</td>
</tr>
<tr>
<td>2</td>
<td>20</td>
<td>26</td>
<td>Rs. 50.90</td>
</tr>
<tr>
<td>3</td>
<td>20</td>
<td>28</td>
<td>Rs. 51.20</td>
</tr>
</tbody>
</table>

The company allows 3% reduction in tabular premium for yearly mode of payment and 1.5% reduction is allowed for half yearly mode of payment, while 5% extra is to be charged for monthly mode of payment.

The company allows a reduction of Re. 1.00 in tabular premium per 1000 sum assured for sum assured of Rs. 25000 and above but less than Rs. 50,000 and Rs. 2 reduction is allowed in tabular premium per 1000 sum assured of Rs. 50000 and above.
After deducting the rebate for yearly or half yearly mode and large sum or charging extra for monthly mode, the balance of tabular rate should be multiplied by the sum assured and divided by 1000 to arrive at annual premium for sum assured required.

### Example

<table>
<thead>
<tr>
<th>Plan and term</th>
<th>Endowment Plan – 20 years</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age</td>
<td>30 years</td>
</tr>
<tr>
<td>Sum Assured</td>
<td>Rs. 35,000</td>
</tr>
<tr>
<td>Mode of payment</td>
<td>Yearly</td>
</tr>
<tr>
<td>Tabular premium rate</td>
<td>Rs 51.60 per thousand</td>
</tr>
</tbody>
</table>

#### Premium calculation

<table>
<thead>
<tr>
<th>Tabular rate</th>
<th>$1.60</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less rebate for yearly mode at 3%</td>
<td>- 1.55</td>
</tr>
<tr>
<td>Balance</td>
<td>50.05</td>
</tr>
<tr>
<td>Less rebate for sum assured</td>
<td>- 1.00</td>
</tr>
<tr>
<td>Balance</td>
<td>49.05</td>
</tr>
<tr>
<td>Balance X 35000 / 1000</td>
<td>1716.75</td>
</tr>
<tr>
<td>Rounded off to nearest Rupee</td>
<td>1717</td>
</tr>
</tbody>
</table>

The premium to be charged in this case will be Rs. 1717

### Example

<table>
<thead>
<tr>
<th>Plan and term</th>
<th>Money Back Plan – 20 years</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age</td>
<td>35 years</td>
</tr>
<tr>
<td>Sum Assured</td>
<td>Rs 50,000</td>
</tr>
<tr>
<td>Mode of payment</td>
<td>Half Yearly</td>
</tr>
<tr>
<td>Tabular premium rate</td>
<td>Rs 66.80 per thousand</td>
</tr>
</tbody>
</table>
Premium calculation

| Tabular rate | 66.80 |
| Less rebate for half yearly mode at 1.5% | - 1.00 |
| Balance | 65.80 |
| Less rebate for sum assured | - 2.00 |
| Balance | 63.80 |
| Balance X 50000 / 1000 | 3190.00 |
| For Half yearly mode | 3190/2 |
| Rounded off to nearest Rupee | 1595 |

The premium to be charged in this case will be Rs. 1595

---

### Example

<table>
<thead>
<tr>
<th>Plan and term</th>
<th>Endowment Plan – 22 years</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age</td>
<td>38 years</td>
</tr>
<tr>
<td>Sum Assured</td>
<td>Rs 2 lakhs</td>
</tr>
<tr>
<td>Mode of payment</td>
<td>Monthly</td>
</tr>
<tr>
<td>Tabular premium rate</td>
<td>Rs 49.50 per thousand</td>
</tr>
</tbody>
</table>

Premium calculation

| Tabular rate | 49.50 |
| Add 5% for monthly mode | + 2.48 |
| Balance | 51.98 |
| Less rebate for sum assured | - 2.00 |
| Balance | 49.98 |
| Balance X 200000 / 1000 | 9996.00 |
| For monthly mode 9996 / 12 | 883.00 |
| Rounded off to nearest Rupee | 883 |

The premium to be charged in this case will be Rs. 883
1.4 Place of payment of premium

The policy conditions stipulate that premiums must be paid in the office of the insurer by the due date. Strictly, this means that premium will be considered to have been paid only when it is received in the specified office of the insurer. Some years ago, the practice was that premiums paid in the office of an insurer other than the specified office, would not be adjusted till it is transferred to the specified office. This situation has changed these days, particularly with the applications of information technology. The premium can now be paid at any of the Branches, and not necessarily the Branch where the policy was procured. The current technology advancement allows the premium to be paid electronically through the internet, credit cards, phone-banking etc. Payment of premium through an authorized collecting agent like a bank is also used as one of the modes for collecting premium. “Drop-boxes” at convenient locations are also used for collecting premium.

The obligation of a policyholder to pay the premium as stipulated is not conditional on the insurer making a demand for the premium. In other words, it is not obligatory for the insurer to remind the policyholder that a premium is due. Yet many insurers do send such reminders, which are called premium notices. Receipts are issued for renewal premium payments. These renewal premium receipts (RPRs) may be required to prove that the premium has been paid, in case, there is a dispute whether a particular premium has been paid or not.

Grace periods allowed in payment

A grace period is an extended period of time a policyholder is permitted for making the premium payment after the due date. Depending on the mode of the premium, the grace period is generally 15 days for monthly mode and not less than 30 days for quarterly, half yearly & yearly mode of premium. If the last day of the grace period is a holiday, the practice is to extend it to the next working day. Grace period is

15 days in case of monthly mode of premium and
30 days or 31 days in all other cases.

The policy continues to remain in force during days of grace, even if premium is not paid. If death occurs within the grace period, the claim is paid in full though the policy is in full force, subject to the deduction of the last unpaid premium during the current year of the policy.
Rita is not able to pay her monthly insurance premium when it is due. It is due on 20.3.2008, but she will be able to pay the premium only by 31.3.2008. She calls her insurance agent and asks her what she should do. The insurance agent tells Rita that she has a 15 day grace period to pay her insurance premium and there will be no extra charge to pay the premium within that grace period. She also assured Rita that her insurance coverage will not cease as long as her insurance payment is received within the 15 day grace period.

Salary Saving Scheme (SSS) scheme

In case of SSS policies, premiums are deducted from the employee’s salary before it is paid to him and the total premium deducted for all SSS policies is sent by the employer along with the list of policy numbers to the insurer. The due date is made the same for all SSS policies. Due date may be close to the last date of the month, not far from the salary date. The ‘days of grace’ clause is not enforced in SSS cases. If deduction has been made by the employer, the premium is deemed to have been paid on time, even if it is received late.

When the premium is received by cheque through employer demand draft or banker’s cheque, it is adjusted immediately and the receipt issued ‘subject to clearance’. This is done to reduce the clerical work, as very few of these cheques are dishonoured. This means that credit is given for premium even before the money is credited into the insurer’s account. Also, the date on which payment was paid to the collecting bank, would be considered as the date of payment of premium, even though money will actually be received by the insurer after some time.

Premium in case of Postal Life insurance (PLI)

In case of PLI, premium can be paid at any post office. Acknowledgement on the premium pass book is adequate evidence of payment. No separate receipt is issued.
Question 1

_______________ is an extended period of time a policyholder gets for making their premium payment after the due date.

- Late fee payment period
- Grace period
- Bonus period
- None of the above

Discuss surrender value and non-forfeiture options

2.1 Surrender Value

Policy conditions state that if premium is not paid within the grace period, the policy lapses. If viewed very strictly no claim need be admitted by the insurer after the policy lapses and the premiums be forfeited. Despite such strict conditions, insurers have practices which are more beneficial to policyholders. The reason for not enforcing the insurer’s rights is because, under the principles of insurance, such total forfeiture will not be justified. The law, also, taking due note of the insurance principles, does not permit such total forfeiture. Therefore, the policy conditions have non-forfeiture clauses allowing protection to the policy holders.

Meaning of surrender value

It is the amount the policyholder will get from the life insurance company if he decides to exit the policy before maturity. A mid-term surrender would result in the policyholder getting a sum that has been allocated towards savings and the earnings thereon. From this will be deducted a surrender charge, which varies from policy to policy.
The relevant insurance principle is mainly related to the concept of level premium.

When premiums are charged uniformly throughout the term of the policy, it will be higher than what is required to cover risk, at younger ages and much lower than what is required at the advanced ages. The higher premium paid by a policyholder in the initial years of a policy has to be held on the policyholder’s account (in the life fund) for future and cannot be forfeited by the insurer.

Also the premium has a savings component to be accumulated for payment of survival benefit. This is a liability, which cannot be extinguished totally, even if the policy does not continue to be in force.

Unlike in a bank account, the insurer does not maintain a separate account for each policyholder or policy, indicating how much is the balance to the credit of the account. The insurer has only one life fund into which all revenues flow in and from which all claims (death as well as maturity) are paid. This fund is a pool of all policyholders’ accounts. This is so because the death claims can be paid only by drawing from the contributions of the policyholders. This is the basic insurance principle of sharing. Yet, it is possible to work out how much is each policyholder’s credit in the total life fund. The method of involves technical, actuarial and statistical principles.

The share of each policyholder in the life fund is a notional figure. It is the result of higher premiums paid in the early years of the policy premium paid for survivorship benefits interest earned on these excess premiums

These notional credits to each policy account are treated as the policyholder’s entitlement at all times. It is due to be returned to him when the policy is closed or discontinued, before completion of the full term. This amount is called the “surrender value” or the “cash value”. It is the surrender value that makes total forfeiture unfair and justifies non-forfeiture options.

**Conditions for availability of surrender value**

Surrender value or cash value is made available generally when the policy has remained in force for at least three years. The premiums during the first three years are unlikely to have any surplus for accumulation, because of heavy initial costs of procuring business. This is particularly so, in the case of low premium policies. Surrender values will vary the same way
A year long illness resulted in Ramesh’s life insurance premium of LIC being overdue for 11 months, just before his death. Since the policy premium was paid for more than five-years the claim was admissible. According to LIC’s policy provisions for such cases, if death occurs within 12 months from the last unpaid due and the policy is more than five years old, LIC pays the full claim after deducting the outstanding unpaid premiums with interest.

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.

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.

The calculation of surrender value is done after paid up value calculation as paid up value is needed for the calculation of surrender value.

2.2 Non-forfeiture options

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

Surrender value or cash value has already been discussed above.

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.
If the sum assured is Rs. 10,000.00 and the total number of premiums payable is 50 (i.e. term 25 years and mode of payment half yearly) and the payment of premium is discontinued after 25 half yearly instalments are paid, the policy acquires a paid-up value of Rs. 5000.00 as per the calculations shown below.

<table>
<thead>
<tr>
<th>Total number of premiums payable</th>
<th>50  (@ half yearly premiums for 25 years)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of premiums paid</td>
<td>25</td>
</tr>
<tr>
<td>Original Sum Assured</td>
<td>10000</td>
</tr>
<tr>
<td>Paid up value = Number of premiums paid x Sum Assured Total No. of premiums payable</td>
<td></td>
</tr>
<tr>
<td>= 25 x 10000</td>
<td>50</td>
</tr>
<tr>
<td>= Rs. 5000/-</td>
<td></td>
</tr>
</tbody>
</table>

The bonus which may have already vested in the policy will be added to this figure.

If the bonus accrued in last 12 and a half years is Rs. 600 per thousand, then

\[
\text{Paid up value} = 5000 + \left( \text{Accrued bonus} \times \text{Sum assured} \right) / 1000
\]

\[
= 5000 + (600 \times 10000) / 1000
\]

\[
= 5000 + 6000
\]

\[
= 11000
\]

In the same example, if surrender value rate is 80%,

Then surrender value = Paid up value x surrender value rate / 100

In the above example, surrender value = 11000 x 80 / 100

= Rs. 8800

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 nationalisation 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. 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.

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.
Test Yourself 2

Question 2

What is the minimum number of years a policy must be kept to be able to get surrender value in traditional plans?

- 2 years
- 1 year
- 3 years
- 5 years

Learn about the ways in which lapsed policy can be revived

[Learning Outcome c]

3.1 Need and meaning of revival of policy

When a policy lapses, neither the insurer nor the insured is benefited. The life assured loses the life insurance cover. It signifies a reversal of decision to arrange for the insurance cover. He also loses the full benefits for what he had paid for, till then. The insurer loses the further expected revenues and therefore, calculations for the future, are upset. The costs expected to be recovered from premiums due in future, are lost. The agent loses his future earnings.

Normally, people having bad health, value their insurance cover and continue the policies, while others with normal health may discontinue the policies. In that case, when a policy lapses, there is adverse selection or selection against the insurer which means that the insurer’s liability becomes greater than what was assumed, while fixing the cost of insurance.

As lapsing adversely affects all parties, and also a lapse is not always intended by the insured to happen, insurers facilitate the reversal of lapsed policies. This is called ‘revival’. The word ‘revival’ means ‘to bring back to life’. There are various schemes for revival and the procedures will vary between insurers.

A revival requires that the arrears of premiums be paid with interest. However, if a long period had elapsed after the last premium was paid, the interest on the accumulated arrears of premium could be very heavy. It may then be more beneficial for the policyholder to take out a fresh policy instead of trying to revive the lapsed one. LIC and many other insurers do not allow revival after five years of lapse, for this reason.
On the revival of a lapsed policy which has become paid up, the risk cover under that policy is being increased. Therefore, the process of revival is treated on the same lines as underwriting a new proposal for an amount of SA equal to the amount to be revived. Accordingly, the policyholder will have to produce proof of continued insurability. The nature of the proof would be the same as if a new proposal is being considered for the extent of the additional risk, non-medical or medical as the case may be.

If a policy is being kept in force under the option of automatic advance of premium from surrender value, the risk cover or any other benefits under the policy have remained unaffected. Therefore revival requires only that the amounts advanced from the surrender value be paid. This would be equal to the arrears of premium with interest. Therefore, there would be no need for any proof of continued good health. However, if the premium was being advanced from the surrender value for a long period say, nearly five years, the policyholder must look at the advantage of surrendering the policy, instead of interest accumulating on a compound basis.

3.2 Different revival schemes

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

The norms and types of revival may vary from one insurer to another. The one illustrated below is the one followed by LIC since the last so many years:

- Ordinary Revival Scheme
- Special Revival Scheme
- Instalment Revival scheme
- Loan-Cum-Revival Scheme

**Ordinary Revival Scheme**

The ordinary revival scheme followed by one insurer is indicated below. The rules for revival could vary from one insurer to another.
Diagram 1: Ordinary Revival Scheme without evidence of good health (as followed by one of the insurance companies)

The ordinary revival scheme generally asks for a satisfactory ‘Declaration of Good Health’ in a simple form.

Special Revival Scheme

The special revival scheme which is followed by one of the insurance companies is designed to meet the needs of policy holders who are interested in reviving the policy, but are unable to pay all the arrears of premium with interest.

Revival under this scheme (as followed by one of the insurers) may be allowed if the following conditions are satisfied:
Diagram 2: Special Revival Scheme (as followed by one of the insurance companies)

The terms on revival of the policy:

On revival, the policy will date back for such period, as the lapsed policy was in force subject to the condition that the date of commencement of the policy on revival does not fall beyond 2 years from the date of commencement of the original lapsed policy.

The policy will be endorsed for changes in the date of commencement, age, term, instalment premium, date of last instalment of premium and maturity date.

The revised premium payable would be calculated for the same term as that of the original policy at the rate applicable to the age of the life assured as at the new date of commencement.
The difference between the old premium and the new premium with interest thereon will have to be paid by the life assured. The life assured will be required to pay the endorsement fee. The revival consideration, in monetary terms, is quite low under the special revival scheme, as arrears of premium are to be paid for only 2 years, part of which will be the difference between the earlier premium and the new premium.

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.
Instalment Revival Scheme

Diagram 3: Instalment Revival Scheme (as followed by one of the insurers)

The arrears of premiums are calculated in the same manner as under ordinary revival scheme. Depending upon the mode of payment, the life assured 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.
In other words, in case the policyholder is unable to pay all the unpaid premiums in lump sum and special revival scheme also doesn't suit him, he can use this scheme to revive his policy. Under this scheme he can revive his policy by paying the following amount immediately:

Policy can be reinforced by paying minimum 6 months premium along with the yearly premium; it means that if the premium is paid yearly, a half of that premium should be paid extra.

If the premium is paid for 6 months, then same amount of extra premium is to be paid:
If it is quarterly premium, the two quarterly premiums more;
If it is monthly premium then an extra 6 months premium should be paid.

A suitable interest rate prevalent at that time will be added to the amount due in this scheme. This shows that the interest burden will increase with the increase of instalments. Rest of unpaid premium is to be paid in instalments within two years along with the regular premium.

**Loan cum Revival Scheme (as followed by one of the insurer)**

This scheme involves two functions, viz. granting of loan and revival of the policy simultaneously. This facility is used by policyholders who would like to avail of a loan to pay the arrears of premium. This is possible if the policy has acquired adequate surrender value from which a loan can be advanced.
The procedure adopted is as follows.

1. **Loan cum Revival Scheme**
2. Loan available under the policy is calculated assuming that the premiums are paid up to date
3. Amount available thus is utilised to adjust the arrears of premium and interest
4. Balance amount of the loan, after adjusting the revival consideration, is paid to the policyholder
5. If the loan amount is not sufficient, then the balance required for effecting the revival is to be paid by the policyholder
6. An evidence of health is to be submitted and loan papers are also to be signed
The above schemes of revival are not available with all insurers and if it does, then it may vary from company to company.

**Revival of Postal life Insurance Policies (PLI)**

In the case of PLI, Revival of Postal Life Insurance Policies (PLI) the policy is treated as lapsed if

- premium is not paid within 6 months in case of policies which are less than 3 years old
- premium is not paid for 12 or more months in the case of policies are more than 3 years old.

Revival procedures are simple. Arrears of premiums have to be paid with interest at 12% and a certificate of good health obtained from a Civil Surgeon or an Asst. Civil Surgeon. If arrears are for more than 6 months in case of a policy which has been taken less than three years ago or for 11 months in the case of older policies, the procedures could be a little more elaborate, requiring references to higher offices.

**Test Yourself 3**

**Question 3**

What is it known as when a lapsed policy is made active again?

- Policy activation
- Policy revival
- Policy survival
- Policy renewal

**Summary**

Premium is the price paid by the insured for purchasing the insurance product. The rates of premium vary as per age, term and benefits offered under the type of product. Most life insurance companies use the ‘age nearest birthday’ method for age determination.
Premiums are normally payable in yearly, half-yearly, quarterly or monthly instalments. An insurance grace period is an extended period of time a policyholder gets for making their insurance premium payment. Surrender value is the amount the policyholder will get from the life insurance company if he decides to exit the policy before maturity. Surrender value or cash value is made available normally when the policy has remained in force for at least three years. The word ‘revival’ means ‘to bring back to life’. There are various schemes for revival of insurance policies and the procedures will vary between insurers. The types of revival schemes followed by the leading insurer are:
- Ordinary Revival Scheme
- Special Revival Scheme
- Instalment Revival scheme
- Loan-Cum-Revival Scheme

Answers to Test Yourself

Answer to TY 1
The correct answer is B
Grace period is an extended period of time a policyholder gets for making their premium payment after the due date.

Answer to TY 2
The correct answer is C
Surrender value is made available under traditional plans, when the policy has remained in force for at least three full years and the premium for 3 full years is paid.

Answer to TY 3
The correct answer is B
When a lapsed policy is made active again it is known as policy revival.
Self-Examination Questions

Question 1
Surrender value becomes payable after how many years of policy operation since inception for ULIPS?

- At the end of 1\textsuperscript{st} year
- At the end of 2 years
- At the end of 3 years
- None of the above

Question 2
In case of a policy where the premium payment is annual how many days will be allowed as grace period for premium payment after the premium due date?

- 15 days
- 30 days
- Till the next premium due date next year
- In annual premium payment mode policies there is no grace period

Question 3
In which scheme is ‘days of grace clause’ not enforced?

- Whole life policies
- ULIPs
- Salary Saving Scheme
- None of the above

Question 4
Special revival scheme is available if the policy has not lapsed for more than …….. Years

- 2
- 5
- 3
- 4
Answer to Self-Examination Questions

Answer to SEQ 1

The correct answer is C
Surrender value becomes payable after 5 years of policy for ULIPS?

Answer to SEQ 2

The correct answer is B
In case of a policy where the premium payment is annual 30 days will be allowed as grace period for premium payment after the premium due date.

Answer to SEQ 3

The correct answer is C
The ‘days of grace clause’ is not enforced in SSS scheme.

Answer to SEQ 4

The correct answer is B
Special revival scheme is available if the policy has not lapsed for more than 3 years
CHAPTER 10

ASSIGNMENT, NOMINATION AND SURRENDER OF POLICY

Chapter Introduction

Insurance companies have diversified, and introduced insurance products that can cater to each and every financial need of an individual. When an individual invests in an insurance policy they are actually investing in a long term asset. This asset not only provides insurance cover and returns on the investment, but can also be used to avail loan in times of financial crunch. In this chapter we will discuss the loan facility and surrender benefits offered by insurance products, which provide sufficient liquidity to a policyholder. We will also discuss the nomination and assignment facilities available under a life insurance policy.

Learning Outcomes

- Learn about assignment of insurance policies.
- Learn about the nomination feature and its importance.
- Understand the concept of surrender of an insurance policy.
- Learn about loans and foreclosures against insurance policies.
**Look at this scenario**

Rajeev Tandon is a small businessman who owns a grocery shop. He wishes to purchase a house for which he is looking for various home loan options. He lives in a rented apartment and does not want to offer his shop as collateral as it is the main source of his livelihood. He is wondering what other option he has. He discusses his problem with the insurance agent who informs him that he can assign a policy in favour of the bank and take a loan with the insurance policy as a collateral. He could also avail of a loan under his insurance policy if the insurance product has this facility.

In this chapter we will see how the insured can take a loan against the insurance policy by assigning the policy in favour of the insurance company or the bank.

**1. Learn about assignment of insurance policies.**

[Learning Outcome a]

**Assignment**

The process of transferring the title, rights and interest on assets or property from one person to another is known as **assignment**. Assignment is generally done to provide security against loan. The person or policyholder who transfers the title on the assets or property is known as the assignor and the person to whom the title on the assets or property is transferred is known as the assignee.

**Features of assignment**

Assignment can be done only after the purchase of a policy.

Assignment is applicable to all kinds of insurance plans except pension plans and plans under Married Women’s Property (MWP) Act.

Section 38 of the Insurance Act, 1938 deals with assignment of insurance policy.

Assignment may be made with or without consideration.

Assignor should be a major and competent to contract.

Assignor should have complete ownership of the policy. The life assured, if minor or if not the policyholder or proposer, does not have any rights over the policy, hence cannot assign the policy. Only the proposer or policyholder can make an assignment. In the case of child plans, when the life assured (child) becomes a major and the title passes to him, he can make an assignment.
After assignment the assignee gets complete ownership and rights over the insurance policy. He can even surrender the policy. The assignee also gets the legal right to sue under the policy.

Assignment can be done towards a person or an institution.

There can be more than one assignee. In this case, each assignee will acquire the rights on the insurance policy as ‘tenants in common’. This means that each assignee has an undivided and specific interest in common with the other assignees. If one of the tenants dies, his interest does not pass on to his co-tenants, but gets transferred to his legal heirs.

Insurer has to record the fact of the assignment in their records.

Assignment once made cannot be cancelled. Policy can be re-assigned in the name of the life insured.

Types of assignment:
There are two types of assignments:

**Conditional assignment:** in this type of assignment, the rights, title and interest in the policy automatically revert back to the assignor on the occurrence of the specified conditions as mentioned below:
- on the death of the assignee before the death of the assignor
- the assignor survives the date of maturity of the insurance policy
- the loan is repaid

The consent of the assignee need not be taken for reversion of the policy if the condition becomes effective. It is automatic.

**Example**
A person who takes a home loan from a bank can pledge their insurance policy (if any) to the bank as a collateral security against the loan. In this case, the bank will be the assignee and the policyholder will be the assignor. The policyholder or assignor will continue to pay the premium, while the assignee (bank) gets the financial rights on the insurance policy, including the death benefit. The condition in this will specify that the bank will be entitled to benefit from the policy only to the extent of the outstanding loan. The balance amount of the claim amount is returned to the legal heirs of the deceased policyholder (in case the policy holder dies before repaying the loan)

**Absolute assignment:** in this type of assignment the rights, title and interest of the assignor passes completely to the assignee. Absolute assignment is generally done for valuable consideration. The policy vests in the assignee absolutely and forms part of his estate on his death.
Diagram 1: Types of assignment

- Conditional Assignment
- Absolute Assignment

Process of assignment

The assignment can be done by either of the following process:

Making an endorsement on the policy document: in this process stamp duty is not required. The assignment form along with the policy should be duly signed by the assignor, assignee and a witness.

Executing a separate assignment deed: in this case stamp duty needs to be paid. The assignment will be effective w.r.t. the insurer only if it is registered with the insurer in their records. The date on which the notice of assignment is delivered to the insurer shall regulate the priority of all claims under a transfer or assignment.

Question 1

In which of the following types of assignment does the assignee become the owner of the policy?

- Conditional assignment
- Absolute assignment
- Endorsement assignment
- Separate assignment
Learn about the nomination feature and its importance.  
[Learning Outcome b]  

Nomination  

Nomination is the right provided to the policyholder to appoint a certain person, who will receive the benefits of the policy in case of the policyholder’s death during the policy term. In case the life assured survives till the date of maturity, the nomination will be treated as cancelled automatically. The person to become entitled to the benefits of the insurance policy on the death of the insured is known as the nominee. There can be more than one nominees appointed by the policyholder. This is a simple method for speedy settlement of death claims.  

Process of nomination:  

Nomination can be done by either of the following methods:  

At the time of proposal: at the proposal stage, the policyholder needs to fill up the nomination column in the proposal form, with complete details of the nominee such as:  

- name of the nominee  
- age  
- address  
- relationship between nominee and the policyholder etc  

The information regarding the name and relationship of the insured with the nominee is included in the schedule of the policy.  

If sufficient space is not available in the form, then nomination can be mentioned on a separate piece of paper and pasted on the policy document and the life assured needs to sign at the edges where the slip is attached to the policy. This may also be needed when nomination is to be changed through an endorsement.  

After the commencement of the policy: a notice for nomination is served to the insurer by the policyholder, or life assured (in case the policyholder and the life assured are different persons). The insurer will then register the same in their records.
Features of Nomination:

Section 39 of the Insurance Act 1938 deals with nomination of insurance policies.
Nomination can be revoked or cancelled anytime by the policyholder of a policy on his own life during the term of the policy.
If the policyholder and the insured person in an insurance policy are two different people, then in this case the policyholder cannot appoint nominee(s)
The nominee cannot influence the policy in any way. He will be entitled to the benefits of the policy only if the death of the life assured during the term of the policy.

There can be more than one nominees appointed by the life assured. In case of death of one of the nominees before the death of the life assured during the term of the policy only the surviving nominees as on the date of death of the life assured will be paid the death benefit.
The nominee does not get the title to the death claim. He has to hold the benefits of the death claim, on behalf of the legal heirs of the life assured. The legal heirs need to be determined on the basis of their relationships with the life assured. If a will is presented, the people mentioned in the will become entitled to the death claim.

If the nominee dies after the death of the policyholder but before death claim settlement, then the policy moneys would form part of life assureds’ estate and his legal representatives will be paid the death claim.
In policies where the maturity amount is payable in installments, the remaining installments are paid to the nominees.
On assignment of the policy, nomination automatically gets cancelled. However, an assignment made in favour of the insurer for loan granted against the security of the policy does not cancel the nomination.

If the nominee is a minor:

If the nominee appointed is a minor, then in this case the life assured needs to duly appoint an appointee, who is a major. The appointee has to duly sign the document to confirm that he consents to fulfil the duties of an appointee.
The life assured can change the appointee at any time during the policy term.
When the minor turns major, the appointee loses his status.
In case the nominee appointed is minor and no appointee has been appointed, then the proceeds of the death claim will go to the legal heirs of the deceased.
Nomination Vs Assignment

<table>
<thead>
<tr>
<th>Basis of Difference</th>
<th>Nomination</th>
<th>Assignment</th>
</tr>
</thead>
<tbody>
<tr>
<td>What is Nomination or</td>
<td>Nomination is the process of appointment of a person to receive the death claim</td>
<td>Assignment is the process of transferring the title of the insurance policy to another person or institution.</td>
</tr>
<tr>
<td>Assignment?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>When can the nomination</td>
<td>Nomination can be done either at the time of proposal or after the</td>
<td>Assignment can be done only after commencement of the policy.</td>
</tr>
<tr>
<td>or assignment be done?</td>
<td>commencement of the policy.</td>
<td></td>
</tr>
<tr>
<td>Who can make the</td>
<td>Nomination can be made only by the life-assured on the policy of his own life.</td>
<td>Assignment can be done by owner of the policy either by the life assured if he is the policyholder or the assignee.</td>
</tr>
<tr>
<td>nomination or</td>
<td></td>
<td></td>
</tr>
<tr>
<td>assignment?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Where is it applicable?</td>
<td>It is applicable only where the Insurance Act, 1938 is applicable.</td>
<td>It is applicable all over the world, according to the law of the respective country relating to transfer of property.</td>
</tr>
<tr>
<td>Does the policyholder</td>
<td>The policyholder retains title and control over the policy and the nominee has no right to sue under the policy</td>
<td>The policyholder loses the right, title and interest under the policy until a re-assignment is executed and the assignee has a right to sue under the policy.</td>
</tr>
<tr>
<td>retain control over the</td>
<td></td>
<td></td>
</tr>
<tr>
<td>policy?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Is a witness required?</td>
<td>Witness is not required.</td>
<td>Witness is mandatory.</td>
</tr>
<tr>
<td>Do they get any rights?</td>
<td>Nominee has no rights over the policy.</td>
<td>Assignee gets full rights over the policy, and can even sue under the policy.</td>
</tr>
<tr>
<td>Can it be revoked?</td>
<td>Nomination can be revoked or cancelled at any time during the policy term.</td>
<td>The assignment once done cannot be cancelled, but can be re-assigned.</td>
</tr>
<tr>
<td>In case of minor:</td>
<td>In case the nominee is a minor, appointee has to be appointed.</td>
<td>In case the assignee is a minor, a guardian has to be appointed.</td>
</tr>
</tbody>
</table>
What happens in case of the nominee’s or assignee’s death?

| Case | In case of nominee’s death, the rights of the policy revert to the policyholder 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. |

What happens in case of death of the nominee or assignee after the death of the life-assured and before the payment of the death claim?

| Case | In case the nominee dies before the settlement of death claim, the death claim will be payable to the legal heirs of the life assured. | In case the assignee dies before the settlement, the policy money is payable to the legal heirs of the assignee and not the life-assured who is the assignor. |

Can creditors attach the policy?

| Case | Creditors can attach the insurance policy which has a nomination in it. | Creditors cannot attach the policy unless the assignment is shown to have been made to defraud the creditors. |

Test Yourself 2

Question 2

Which of the following is not correct regarding nomination?

- The witness has to duly sign the nomination papers.
- Nomination can be revoked at any time.
- Nominees have no right over the policy.
- In case the nominee is a minor an appointee has to be appointed.
Understand the concept of surrender of an insurance policy.
[Learning Outcome c]

Surrender of insurance policy

A life insurance policy can be withdrawn before maturity, and this process is known as ‘surrender of policy’. The amount payable to the policyholder once the insurance policy is surrendered is known as surrender value or cash value.

Insurance companies provide the surrender feature in a policy to overcome the biggest disadvantage of insurance policies which is ‘liquidity’. Hence in case of financial emergencies, a policyholder has the option to surrender his policy and withdraw the benefits, subject to certain conditions applicable under the policy. Insurance companies generally provide detailed data regarding surrender value for different years within the term of the policy.

Surrender value could be a guaranteed amount by the insurance company, although the actual surrender may be better than the guaranteed surrender value from the guaranteed one.

The rules for surrender of ULIP’s are bound by a different set of rules.

Features of Surrender:

Surrender value is usually a percentage of premiums paid or a percentage of the paid up value.

The higher the policy term, the lower is the surrender value factor. It does not depend on the actual premium or the mode of premium.

The percentage called the surrender value factor (S.V. Factor) increases as the duration of the policy since commencement increases.

Example

If there are two policies: ‘A’ for a 15 year term and ‘B’ for a 20 year term, then the surrender value factor after 10 years will be more for policy A than for policy B. The surrender value factor increases with an increase in the policy period.

Example

The surrender value of a certain policy after 15 years will be more than that of the same policy after 10 years.
Surrender value of the policy is kept low by insurance companies during the early term of the policy.
There are two reasons for this:

The premium collected in the early years is not credited to the policy account like a bank account, but a part of it is used for payment of death claims that may arise.

Insurance companies try to discourage early surrender of the policy. If the surrenders in the early years are made attractive, an individual would prefer to surrender the policy in case he faces economic difficulties. The healthier lives are more likely to surrender their policies than the unhealthy ones, distorting the expected averages of the experience of the pool of policy-holders i.e. this could lead to an adverse selection.

**Test Yourself 3**

**Question 3**
For which of the following insurance plans will the surrender value factor be the highest after three years from inception (if the sum assured of all the four policies is the same)?

- The insurance plan for 10 years
- The insurance plan for 15 years
- The insurance plan for 20 years
- The insurance plan for 30 years

**Learn about foreclosures and loans against insurance policies.**

[Learning Outcome d]  

**Loans**

There are many benefits of purchasing an insurance policy. One of those benefits is the availability of loans against an insurance policy. Under this facility, a policyholder can request for a loan and offer his insurance policy as collateral. The loan amount will depend upon the total surrender value of the insurance policy as the loan offered is limited to a certain percentage of 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:** the loan amount granted against a life insurance policy is generally 90% of its surrender value. In the case of fully paid up policies, the loan generally granted up to 85% of a policy’s surrender value. This formula can vary from one insurance company to another.

The rate of interest on outstanding loan charged is generally paid half-yearly to coincide with the due date of premium.

If the premiums are continued to be paid regularly, then the surrender value of the policy will continue to increase, which can be adjusted against the outstanding loan amount and interest.

The minimum period for which the loan can be granted is six months. If the policyholder wishes to repay the loan before six months, he will have to pay the loan interest for minimum six months.

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 during the policy term. The payment of loan can be delayed and adjusted at the time of death claim. The remaining balance left after repayment of the loan is paid to the legal heirs of the life assured.

**Broken period**

The period between the loan approval date and the anniversary date of the policy is known as broken period. Generally, if the date of the anniversary is more than six months away then broken period will be between the loan approval date and six months prior to the date of policy anniversary. Interest is charged separately for the broken period.

**Additional loan against insurance policy**

There can be more than one loan taken by the policyholder during the term of the policy. 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.
Money back policies are also not eligible for loan as a part of the sum assured is returned to the policyholder at periodic intervals.
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.

Foreclosures

The process of closing the insurance policy or writing it off before its maturity date by an insurance company is known as foreclosure.

When a policyholder decides to avail a loan, he has two choices:
repaying the loan amount with interest during the policy term; or
accumulating the loan debt over the policy term, and adjusting it at the time when claim arises

The second option can be exercised only when the premium has been paid regularly.
If there has been default in premium payment, then it needs to be ensured that the surrender value of the policy needs to be sufficient enough to meet the arrears of loan and interest. If the loan amount with interest due is likely to get more than the surrender value of the policy, foreclosure becomes essential.

Features of foreclosure

When the insurance company decides to foreclose the policy, the policyholder is intimated, and advised to make timely payment of arrears of interest on loan to avoid foreclosure. If the default in the repayment continues, then the policy is foreclosed i.e. policy is surrendered for repayment of the outstanding loan.
The balance surrender value (if any) that remains after the repayment of loan with interest is paid to the policyholder. Once foreclosure is done, nomination, if any, will not be valid. If the policyholder dies before the payment of the balance surrender value, then the payment will be made to his legal heirs and not the nominees.
Reinstatement of the policy: a foreclosed policy can be reinstated in following cases:

The policyholder is medically fit.
Outstanding loan interest with accumulated interest thereon is paid till date.

If the balance surrender value has been paid to the policyholder, then in this case the policy cannot be reinstated, as it indicates that the policyholder had accepted the foreclosure action. Any further request to revive the policy raises doubts about moral hazard.

Test Yourself 4

Question 4

The minimum duration of a loan against an insurance policy is of ________

- 15 days
- 3 months
- 6 months
- One year

Summary

The process of transferring the right title and interest on assets or property from one person to another is known as assignment.

Nomination is the right provided to the policyholder to appoint a certain person, who will receive the benefits under the policy in case of his death of the life-assured during the policy term.

The process of withdrawing a life insurance policy before maturity by the policy-holder is known as surrender.

The amount payable to the policyholder, once the insurance policy is surrendered, is known as the surrender value.

When loan is taken by a policyholder, the policy gets assigned absolutely to the insurer.

The period between the loan approval date and the anniversary date of the policy is known as the broken period.

The decision regarding foreclosure is taken by the insurance company if there has been default in loan repayment by the policyholder.
Some important terms / definitions you have learnt in this chapter

Assignment
Nomination
Surrender value
Foreclosure

Answers to Test Yourself

Answer to TY1

The correct answer is B.

In absolute assignment, the assignee becomes the owner of the policy.

Answer to TY 2

The correct answer is A.

A witness is generally not required to sign the nomination papers.

Answer to TY3

The correct answer is A.

The higher the policy term, the lower is the surrender value factor.

Answer to TY4

The correct answer is C.

The minimum duration of a loan against an insurance policy is of 6 months.
Self-Examination Questions

Question 1
When can nomination be done?

Before the issue of policy, while filling the proposal form
Any time after the commencement of policy
Any of the above
None of the above

Question 2
In assignment, if the policy is assigned to a minor then ____________ has to be appointed:

An appointee
An assignor
A guardian
A legal heir

Question 3
The period between the loan approval date and the anniversary date of the policy is known as_________

Deferment period
Vesting period
Broken period
None of the above

Question 4
The additional loan amount generally granted should not exceed what percentage of the surrender value?

80%
90%
100%
Additional loan cannot be granted
Answer to Self-Examination Questions

Answer to SEQ 1

The correct answer is C.

Nomination can be done at the time of filling the proposal form or any time during the policy tenure.

Answer to SEQ 2

The correct answer is C.

In assignment, if the policy is assigned to a minor then a guardian has to be appointed.

Answer to SEQ 3

The correct answer is C.

The period between the loan approval date and the anniversary date of the policy is known as broken period.

Answer to SEQ 4

The correct answer is B.

The additional loan amount generally granted should not exceed 90% of the surrender value.
CHAPTER 11

POLICY CLAIMS

Chapter Introduction

This chapter explains the different aspects of policy claims. After going through the chapter, you will get a clear picture of various kinds of policy claims and insurance riders etc.

Learning Outcomes

- Explain policy claims and their different types.
- Discuss the types of death claims: early claims and non-early claims.
- Learn about proof of title of claimant, claim concession and presumption of death.
- Understand Accidental Death Benefit, Permanent Disability Benefit and post maturity options.
1. Explain policy claims and their different types.  
[Learning Outcome a]

1.1 Policy Claims
In simple words, claim means to demand something for which one has a right.

**Example**
Arun deposits Rs. 4,000 every month with his friend, Hari, on the agreement that Hari will pay him back a lump sum of Rs. 50,000 at the end of 12 months. He keeps depositing money for 12 months so that he can have a lump sum of Rs. 50,000 at the end of the year, to buy a scooter. In this case, Arun can demand Rs. 50,000 after 12 months from Hari as he has the right to claim it.

Another example of simple claim is as follows:

**Example**
Anand buys a life insurance policy of Rs 50 lakhs to protect his family in case of his unfortunate death. He dies due to a serious scooter accident leaving the family behind. His wife, who is the nominee under the policy, can claim the insurance amount from the insurance company.

In insurance parlance, policy claim means asking for policy money under the terms of an insurance policy.

**Definition**
A demand on the insurer to fulfil its promise, as per the terms and conditions of the policy, is called a ‘policy claim’.

An insurance claim is:

- a formal request to an insurance company;
- asking for a payment;
- based on the terms of the insurance policy

Insurance claims are reviewed by the company for their validity and then once approved, are paid out to the insured (in case of survival or maturity claims) or requesting party (nominee / beneficiary on behalf of the insured).
An **insurer** is the company selling the insurance policy.  
An **insured** is a person or a company purchasing the insurance policy.  
The fee paid by the insured to the insurer for assuming the risk is called **premium**.

### Example

If a man toils hard in his youth, earns a lot of money, enjoys a prosperous life and dies after 70 years of age then his dependents may not suffer a great financial loss; other than an emotional loss. However, in case he dies in his youth, his family will be in a terrible state, both financially and emotionally. It is here that insurance cover can help the family financially. So, if the person was insured, the family could make a claim with the insurance company as per the terms of the insurance contract and use the policy claim money to handle immediate expenses.

The operative clause of a life insurance policy states that the insurer will pay to the policyholder or nominee or beneficiary or any other person who may have a right to receive it, certain sums of money on the happening of specified events. When such events happen, the insurer has to fulfil the promise of making the payments. When a claim is being settled, the insurer is fulfilling the promise made in the policy.

### Example

Mr. Tom worked on the 104th floor of the World Trade Center (WTC) and was in an elevator when the first place struck the tower during the terror attack. Harry died on the spot. His family was protected from financial distress when the insurance company paid out his large insurance claim from the insurance policy that he was covered under.

### 1.2 Types of policy claims

In a contract of life insurance, there are three common types of claims:

- **Claim by maturity**: claims may arise because of survival of the insured up to the end of the policy term, which is the date of maturity. This is normally paid in endowment assurance policies when the policy matures. Pure term plans do not have a maturity claim pay-out. Such policies are eligible for payment only as death claims, when the life-assured dies during the policy term.

- **Claim at periodic intervals - survival benefits**: claims may arise because of survival of the insured up to a specified period during the term. Such regular periodic payments are often made in money-back policies.
Claim by death: claim may arise due to the death of the life assured during the term of the policy.

Maturity claims
A maturity claim is payable as per the terms of the contract at the end of the term of the policy, if the life assured lives up to that date.

Example
Naresh has taken an Endowment insurance policy of Rs. 500,000 for 10 years for a premium of Rs. 7,333. If he lives up to the end of the term of the policy, i.e. 10 years, he can demand maturity claim as per the terms of the policy.

Maturity claim requires the following documents for settling the claims:

- original insurance policy document
- discharge form, duly stamped, signed and witnessed
- proof of age in case the policy was issued without the age proof where age was not admitted at the time of policy inception
- document of assignment, in case of any assignment

The maturity claim is equal to the sum assured plus bonus and other guaranteed addition (if any). Any debt or charge under the policy, such as loan, loan interest, outstanding premium (due but not paid), etc. will be deducted.

The discharge voucher will show the gross amount of claim, the deductions, if any, and the net amount payable. The gross amount normally consists of the basic sum assured or the paid up value, the bonus payable, any excess deposit lying in the said policy account and return of excess premiums collected, if any.

For example, extra premium for double accident benefit was lowered by the LIC a few years back, but it was decided to refund the excess premium at the time of settlement of claim. This was to be added to the basic sum assured.

The deductions (monthly in respect of salary savings scheme policies) from the gross amounts normally consist of loan amount, outstanding interest on the loan, unpaid premium, if any, and any other charges.
If there is a loan subsisting, the policy document would already be with the insurer, as the policy has to be assigned in favour of the insurer before getting the loan.

Settlement of maturity claims is usually free from complications relating to title, as policy moneys are generally paid only to the policyholder. The nominee is irrelevant in the case of maturity claim. In case the policy is absolutely assigned, then the settlement is made in favour of the absolute assignee.

Insurers generally initiate action on their own, well in advance from the maturity date so that the policyholder receives the claim cheque on the date of maturity. When maturity claim is paid, the insurance contract is revoked and then there is no insurance cover with the policyholder. There is another alternative for payment of maturity claims which is known as settlement option. Under the settlement option the policyholder can choose to receive the claim amount in instalments spread over a specified period as per mutual agreement with the insurer.

If at the time of claim the original policy document is not found, insurers may be willing to settle the maturity claim on the basis of an indemnity bond unless the circumstances warrant more caution.

1.3 Periodic survival benefits

The Money Back plans promise payment of part of the SA (sum assured) at specific intervals, during the term of the policy. The surviving policyholder is paid on a specified pre-determined periods a percentage of the sum assured as periodic survival benefit. As in the case of maturity claims, the specified amounts are paid on the due dates, after deduction of the outstanding loan interest, outstanding premium, X charge etc.

Survival benefit claims require the following documents:
- discharge form duly stamped, signed and witnessed
- original policy document

If the policyholder dies after the due date, but before settlement of claim, the rights for that survival benefit vest in the estate of the deceased policyholder. The claim amount is then payable to the legal heirs of the policyholder. The insurer may settle the claim on the basis of an indemnity bond or ask for a declaration of title from appropriate judicial authorities. Will (if any) has to be probated.
1.4 Death claims
The payment of the sum assured amount in case the insured person dies, is called death claim. It is necessary to scrutinize all documents submitted by the heirs of the deceased person. An insurance contract comes to an end after paying the insurance claim. Insurance agents should help the heirs of the deceased person to receive the insurance claim by submitting proper documents in time.

Procedure to be followed in case of death claim
The following is the procedure to be followed for receiving death claims:

(i) 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 nominee
- the assignee of the policy
- the relative of the deceased policyholder
- the employer
- an agent or the Development Officer

The letter of intimation of death should contain the following information:
- 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 (mandated by certain insurers at the point of claim intimation itself)

As soon as the branch office receives the intimation of death and is satisfied about the genuineness of the intimation, it 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 fulfilled by the claimant.
(ii) 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:

- 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)

(iii) Submission of age proof

The claimant should submit an age proof of the policyholder in case it was not submitted earlier. The following documents are generally accepted as valid age proof:

- Birth certificate
- School certificate
- Certificate relating to baptism ceremony among Christians
- Passport (which is within the validity period)

(iv) Proof of title of the claimant

If the policy has been assigned in a valid manner or the nomination is subsisting at the time of death, no proof of title is needed. In case there is no valid nomination or assignment, the claimant will have to produce satisfactory evidence of title to the estate of the deceased, from a competent judicial authority.

The authority may be the Administrator General or a court, and should grant:

- a succession certificate;
- letters of administration;
- letters of probate;
- a registered will

A Succession Certificate is issued by a competent court on the question of right to the property of the deceased. The Succession Certificate is issued on application and should specifically provide for disbursement of policy monies. If, however, the deceased has left a will, a probate (process of validation of will) of the will is required along with the copy of the will.
(v) Payment of the policy

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. Such person can be:

- the nominee, if nomination was made under the policy
- the assignee, if the policy was assigned
- the legal representative or successor

According to the IRDA regulations, a life insurer has to process the death claim without delay. The insurance company sends the cheque for the amount due to the person entitled to receive it, within 30 days from the date all formalities were completed (for non-early claims, as early claims would need to be investigated by the insurers before they pay out the claim).

Test Yourself 1

Question 1

Which claim needs submission of proof of death?

- Maturity Claim
- Survival Benefit Payment
- Death Claim
- None of the above

Discuss the types of death claims: early claims and non-early claims.

[Learning Outcome b]

Death claims are classified into two categories:

- early claims
- non early claims
2.1 Early claims

Claims arising within two years of the date of commencement or revival are termed as ‘early death claims’. They are also referred to as ‘premature death claims’.

Example

Jatin had taken life insurance on 30th November 2004. He died of sickness on 31st March 2006. If Jatin’s heirs lodged a death claim with the insurance company on 30th April, 2006, it would be considered an ‘early claim’, as the claim had arisen within two years of the date of commencement of the insurance policy.

Documents required in case of early claims

In case death occurs in less than two years from the date of commencement of policy, the following documents are required:

- 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 from the employer about the leave, if any, taken by the life assured on grounds of sickness
  - Certificate of cremation or burial

Early claims are to be dealt with cautiously. It is assumed that a person, who is accepted as good for life insurance, is not likely to die within two years. Therefore, when an early claim occurs, there is a need to make sure that there was no attempt to defraud the insurance company. Enquiries are made to confirm that no information was suppressed. This is done both to ensure the genuineness of the claim and safeguard the interests of the community of policyholders.

The decision to admit the claim is taken on the basis of information gathered during enquiries and the evidence collected. The insurer can deny liability under an early claim on the ground that material information had been suppressed at the time of proposal. A misrepresentation is adequate to repudiate liability, in case of early claims. However, insurers usually do not repudiate the contract only on grounds of misrepresentation unless there is evidence to the contrary.
In India, Section 45 of the Insurance Act, 1938 states that two years from the date of policy, the insurance company cannot question the contract unless certain conditions are fulfilled. The Supreme Court of India, in the case of Mithoulal Nayak vs Life Insurance Corporation of India (LIC), summarised the three conditions:

The information in doubt must be material.
The suppression must be fraudulently made by the policyholder.
The policyholder must have known at the time of making the statement that it was false.

**The onus of proving that these three conditions are satisfied is on the insurer. Thus, the repudiation of a death claim is done by insurers only after obtaining evidence in support of the fact of suppression.**

**Example**

We know that leave taken on medical grounds is material information. This does not necessarily mean that the claim can be repudiated on this reason, as he had disclosed it on his proposal form. Before coming to any conclusion, insurers would try to confirm whether the reason/illness for which the life-assured had taken leave and which was not disclosed in proposal form, was material to the terms of acceptance of the policy. Based on this, the insurance company would take a decision of admitting or repudiating the claim. This may warrant a claim investigation.

### 2.2 Non-early claims

Claims arising after more than two years of the date of risk or revival or reinstatement are non-early claims.

**Example**

Lalit had taken a life insurance policy on 22\(^{nd}\) May, 2005 from LIC. He died on 24\(^{th}\) October 2009. Now, if his heirs had lodged a death claim with the LIC on 30\(^{th}\) December, 2009, it would be considered a ‘non-early claim’ as the claim had arisen after two years from the date of commencement of the insurance policy.

Once the insurer is satisfied about the genuineness of the intimation, the status of the policy is verified and the documents are called for. In respect of non-early claims, the normal documents required would be:
Original policy document
   Discharge voucher duly completed, signed, stamped and witnessed
   Deeds of assignment, if any
   Claimant’s statement giving details of cause of death, nature of illness suffered,
   treatment, cremation etc.
   Age proof document, if not submitted earlier
   Proof of title of claimant
Original death certificate

Example
Many policyholders perpetrate fraud by cheating or lying on paper (proposal form) A fraud involves policy owners lying and reporting many claims on a single injury in health claims.
The policy holder does not declare that he is suffering from a disease.
The insurer can repudiate such claims in the case of any malpractice being proved true.

2.3 Death due to accident or unnatural causes

If death was due to accident or unnatural causes, following additional documents would be required, based on the mode of death (e.g. poisoning, murder, drowning, vehicular accident etc.):

   Post-mortem report
   Police inquest report
   Panchanama report
   Magistrate’s report/Coroner’s verdict
   Forensic report
   Chemical Analysis report of viscera (organs). The above mentioned documents would be required in early as well as non-early death claims.

While settling accident benefits under a life insurance policy, the insurer has every right to ensure that the cause of death is an accident. The cause that is directly responsible for the death in life insurance is called Proximate Cause or ‘Causa Proxima’ and the other causes are called remote causes. When an insured loss occurs due to more than one cause, then it needs to be ascertained whether the loss had arisen directly due to the peril insured upon or due to some other cause.
Test Yourself 2

Question 2

What type of claims are investigated before a pay out?

- Maturity claims
- Early claims
- Non early claims
- Survival Benefit Payment

Learn about proof of title of claimant, claim concession and presumption of death.

[Learning Outcome c]

3.1 Proof of title of claimant

Proof of the title of claimant claiming the policy money is important so that the benefits are paid to the person legally entitled to receive payment. Otherwise, the insurer will get involved in disputes between rival claimants.

If the policyholder is alive, the claimant is the policyholder himself.

If there is a death claim, the claimant is the nominee under Section 39 of the Insurance Act.

If there is no nomination, the claimant is the legal heir, who needs to prove their identity through a succession certificate or a probate of will, if a will exists.

If the policy is assigned, the claimant is the assignee.

3.2 Nomination

The facility of nomination is provided to ensure easy and fast transfer of insurance money to the insured person’s legal heirs. However, many a times, it is seen that there are a lot of problems in determining the succession rights, and legal suits go on for a long time. Nomination is a good way to solve this problem.
The proposer can nominate somebody in his immediate family to accept all the insurance benefits after him, at the time of taking an insurance policy. It is important to note that the nominee is not the owner of the entire policy amount. He is paid the amount only as a representative of the legal heirs and it is the nominee’s duty to distribute the money properly among all the legal heirs. The policyholder can also change nominee/s if he wishes. In this case, they have to apply to the insurance company in the prescribed form and get it endorsed on the original policy.

In case there are two or more nominees, a joint discharge has to be given by all the nominees.

**Example**

Ram had nominated his son Suresh in his insurance policy. However, Suresh died, a month ago so now Ram needs to nominate some other person in his family as nominee as per Section 39 of the Insurance Act. This will ensure that there arise no disputes at the point of claim settlement.

**Assignment**

Assigning a policy transfers all the rights, title and interest on the insurance policy to the persons in whose favour the policy is assigned. It is similar to transferring the policy in the assignee’s name. Assignment could be absolute or conditional. In conditional assignment, the rights come back to the policyholder once the specified condition is fulfilled while in absolute assignment, the rights stay with the assignee absolutely till they themselves wish to assign it back to the original assignor by way of re-assignment.

**Example**

David, a policyholder, had taken a housing loan from a bank and had absolutely assigned his insurance policy in favour of the bank. However, when Aniket died of an accident, the proceeds of the death claim were paid to the bank to the extent of the outstanding loan and the balance amount was paid to the legal heir/beneficiary of the deceased life-assured (David, in this case)

### 3.3 Waiver of evidence of title

A valid nomination is adequate title. If any person challenges the nomination and makes a claim, that person is advised to obtain orders from a competent Court. In case there is no nomination, the claimant will have to prove their title. This is done through legal procedures like obtaining succession certificates. If a will has been left by the policyholder, the will has to be probated (validated) by a Court of law, before it can be acted upon. A ‘Will’ can be challenged by persons who are aggrieved. Insurers usually do not get involved in such disputes.
Procurement of succession certificate or probate of Will takes time. In case of death claims, there could be an urgent need for money. Easy liquidity is the benefit of a life insurance policy. The claimant could be in mental and financial distress. In order to facilitate the claim settlement, even when there is no nomination or assignment, insurers sometimes subject to certain conditions agree to waive strict legal proof of title and pay the claim on the strength of an indemnity bond, particularly if the sum assured is not much. While doing so, they try to confirm that:

- There is no dispute among the heirs or relatives, as regards to the title to the policy moneys.
- The deceased has not left a will or any other estate besides the insurance policy/policies, for which evidence of title may be required to be obtained from a court.
- The amount payable under all policies is not very large.

Depending upon the amount payable, the claim may be paid to all the natural heirs on the basis of a joint discharge and indemnity bond. The natural heirs vary depending upon the religion of the deceased. As far as Hindus, Sikhs or Jains are concerned, the widow, mother, sons and daughters and sons and daughters of each predeceased daughter form the natural or Class I heirs. The implications of personal laws and local custom have to be verified.

### 3.4 Claim Concession

Strictly, if premiums are 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 a liberal and humane view in these matters. E.g.: The LIC of India allows the following privileges or concessions:

**Claims Concession:** If under a policy at least three full years’ premium is paid and if the 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 claims 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 monies will be paid after deducting the outstanding premiums with interest thereon and the premiums falling due till the next anniversary of the policy.
3.5 Presumption of death

Adequate proof of death:

Following documents are considered adequate proof of death:

<table>
<thead>
<tr>
<th>In case of natural death</th>
<th>A death certificate from the Municipality or other competent body, a certificate of cremation or burial can also be obtained</th>
</tr>
</thead>
<tbody>
<tr>
<td>In case of death by accident while travelling by air or rail or natural calamities</td>
<td>Certificate from the concerned carrier or any other organisation or authority having relevant information, if body not found</td>
</tr>
<tr>
<td>In case person is missing while on board a ship</td>
<td>Certificate of the captain of the ship / shipping company</td>
</tr>
</tbody>
</table>

Presumed to be dead

Sometimes, a person is reported missing without any information about their whereabouts. The Indian Evidence Act provides for presumption of death in case a person has not been heard of for 7 years. If a nominee or assignee or a legal heir contends that the life assured must be presumed to be dead, it would be wise to ask for a decree (an official order) from the competent court that the assured should be presumed dead. It is necessary that premiums are paid till the date of decree presuming death of the life assured.

Example

In case of maturity claims, if it is reported that the insured person had been missing for some time, the claim will continue to be a maturity claim and not a death claim till the death is proved. However, since the title is with the insured person, any other person like an heir to claim the policy proceeds, death will have to be proved. The procedure will be the same as for presuming death.

The insurer may consider payment of a claim in case of presumed death, even within 7 years, if circumstantial evidence is available to show that the life assured would not have survived a fatal accident or hazard.
The insurer may also settle the claim on getting an Indemnity Bond to protect its interest, in case the presumption of death is later found to be wrong. When the insurer takes the responsibility for such action on its own, without a decree from a court, there is a risk that some other claimant to the estate may raise a challenge later. The insurer will not be able to avoid getting involved in the dispute and having to defend its action.

**Test Yourself 3**

**Question 3**
To whom is the insurance policy assigned as financial security, when loans are taken from banks?

- Nominee
- Bank
- Policyholder
- None of the above

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**4. Understand Accidental Death Benefit, Permanent Disability Benefit and post maturity options**  
[Learning Outcome d]

### 4.1 Insurance Riders

Riders provide additional insurance cover with a basic insurance policy. A rider is an additional optional benefit with a basic insurance policy. Insurance companies offer various types of riders, which are useful in increasing insurance protection by adding a small premium on the basic policy.

The following are the characteristics of riders:

- Riders are voluntary and not compulsory.
- Riders need additional amount of premium.
- They are useful for monetary benefits in case certain untoward event occur.
- No single rider will have a premium that exceeds the basic premium of the policy selected.

Although riders call for extra premium, they are better than having different insurance policies with large premiums.
There are many types of riders, but here, we will discuss only two types of riders:

Accidental Death Benefit (ADB)
Permanent Disability Benefit

### 4.2 Accidental Death Benefit Rider

Accidents happen by chance, but there is always a possibility of them. Accidental death is all the more unfortunate due to its unexpected nature. The family members of the deceased face critical and financial crisis. In such situations, Accidental Death Benefit Rider is useful. The premium for this benefit is nominal. Accident does not only mean a road accident, it can be any sudden, unpredicted event with violent outward force resulting in an injury to body or death.

**Example**

Examples of accidents include snake bite, death in a swimming pool / river / sea, death due to lightning, electric shock etc.

**Diagram 2: Conditions when Accidental Death Benefit Rider claim will generally be paid:**
Diagram 3: Conditions when Accidental Death Benefit Rider claim generally would not be paid:

- Death due to injuries resulting from riot, civil commotion, rebellion, war, racing, hunting, mountaineering, scuba diving, bungee jumping, para gliding, river rafting, etc.
- Death is caused by intentional self-injury, attempted suicide, insanity, immorality or while under the influence of intoxicating liquor, drugs or narcotic substances.
- Death as a result of committing any breach of law.
- Death due to employment in military service, police duty.
- Death due to an accident when the life assured was engaged in aviation or aeronautics other than a fare-paying passenger in an aircraft licensed to carry passengers.
There is a maximum limit of sum assured up to which the accident death benefit is made available. Some companies have limits of up to Rs. 10 lakhs, not on each policy but on all policies put together on a single life. If there is any doubt on the circumstances of the accident, enquiries similar to those conducted in the case of early claims are made.

4.3 Permanent Disability Benefit

Accidents do not always result in death. In case of disability, the policyholder is unable to earn their normal livelihood. They become a burden on the family. In such situations, Permanent Disability Benefit is useful. It is neither a death claim nor a maturity claim. The policy does not end with the settlement.

**Example**

A series of seizures (strokes) disabled Parmeet and ended his working life. However, disability insurance came to his aid and Parmeet got some financial compensation for the disability. Although unable to work, Parmeet got the required assistance from disability insurance and was able to support himself and his family.

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**Some of the benefits available under Permanent Disability Benefit**

The following benefits are available in the case of permanent disability benefit:

- An additional sum equal to the sum assured, payable in instalments over a specified period of years, say 10 years.
- The future premiums are waived.
- In the case of death or maturity claims within the specified period, the remaining disability benefit instalments have to be paid within the specified period, along with the claim.

The maximum limit and the exclusion clauses are the same as those under accident benefit.

**Interpretation of disability**

The word ‘disability’ has different interpretations and may differ between products of one insurance company to another. Disability here means disability in **physical** terms.
Examples of permanent disability are loss of vision in both eyes, amputation of both hands at or above the wrist, amputation of both legs at or above the ankles etc.

It is necessary that disability must be total and permanent and such that the life assured would not be able to do any work to earn a livelihood. (This definition can vary from one insurer to another)

Lalit, a neuro surgeon, met with a major car accident at the age of 40. His adverse medical condition left him unable to work; inspite of long drawn treatment but disability insurance cover helped him sustain his family inspite of him unable to get back to work.

4.4 Post Maturity Option

Some insurers offer policyholders an option to collect the maturity benefit amount in instalments over a period of years. This option is also known as the settlement option. The option may be exercised at the commencement or at any time during the term of a policy. Alternatively, the policyholder can opt for part of the benefit amount being paid in monthly instalments over a selected period and a lump sum at the end thereof.
4.5 Precautions

Following are the points to be noted:

A person declared as “lunatic” is not competent to enter into any legal transactions and therefore not competent to sign a contract. If the nominee or beneficiary as per the probated Will is a lunatic, a guardian of that person has to sign on his behalf.

Payments of claims to non-residents will have to comply with the Foreign Exchange Regulations.

If the policy had been financed through an HUF (Hindu Undivided Family) fund, the money will have to be paid to the Karta of the HUF.

Furthermore, the IRDA Regulations require that:

- The insurer should ask for the requirements in case of death claim at one time, and not as piecemeal.
- The decision to admit or to repudiate a claim should be made within 30 days of receipt of all papers.
- Investigations, if necessary should be completed within 6 months.
- Interest at 2% above the saving bank interest rate will be payable for delays in settling claims.
- Interest at the bank savings account rate will be paid if there is delay on the part of the claimant.

Test Yourself 4

Question 4

In claim settlement cases, in how many months should the investigations be completed?

- 3 months
- 6 months
- 9 months
- None of the above
Summary

A demand on the insurer to fulfil its promise as per the terms and conditions of the policy is called a “policy claim”.

In an insurance company, there are three types of claims – claim by maturity, claim by periodic survival benefit payments and death claim.

A maturity claim is payable as per the terms of the contract, at the end of the term of the policy, if the life assured lives up to that date.

The payment by the insurance company of the assured amount in case the insured dies, is called death claim.

Claims arising within two years of the date of commencement or revival are termed “early death claims”.

Claims arising more than two years after the date of risk commencement or revival or reinstatement are “non-early death claims”.

Early death claims are investigated before settlement for ascertaining the genuineness of the claim pay-out.

Proof of title of the claimant claiming the policy money is important so that the benefits are paid to the person who is legally entitled to receive payment.

Claim concession is a concession given to those policyholders who keep the policy in force for at least a specified period as mentioned in the policy (3 years by LIC of India).

A missing person will be presumed to be dead after seven years subject to certain conditions as per Indian Evidence Act.

Riders are useful to help increase insurance protection by adding a small premium on the basic policy.

Insurers offer policyholders an option to collect the claim amount in instalments over a period of years.

Answers to Test Yourself

Answer to TY 1

The correct answer is C.

Submission of proof of death is needed in the case of death claim.
Answer to TY 2
The correct answer is B.

Early death claims are looked upon with suspicion.

Answer to TY 3
The correct answer is B.

When loans are taken from banks, the insurance policy is assigned to banks as financial security.

Answer to TY 4
The correct answer is B.

Investigations should be completed within 6 months.

Self-Examination Questions

Question 1
Once all the requirements are completed, how much time should an insurance company take to settle the claim?

- 60 days
- 30 days
- 120 days
- None of the above

Question 2
Who is entitled to the maturity claim?

- Nominee
- Assignee when there is no assignment registered
- Policyholder himself if there is no assignment under the policy
- Appointee
Question 3

If there are two nominees, how will the policy money be paid?

A joint discharge would be given by both the nominees
Claim proceeds will be paid jointly to all nominees
Nominees will stand invalid
A and B

Question 4

As per the Evidence Act, after how many years will a missing person be presumed dead?

Two years
Five years
Seven years
Ten years

Question 5

If the policy holder dies after the due date of survival benefit claim but before the settlement of the claim, the rights for that survival benefit would vest in ______

The legal heirs of the policyholder
Nominee under the policy
Appointee under the policy
The money will be retained by the insurance company

Answers to Self Examination Questions

Answer to SEQ 1

The correct answer is B.

According to the IRDA regulations, an insurance company should settle a claim within 30 days from the day the formalities are completed and all requirements submitted by the claimant.
Answer to SEQ 2

The correct answer is C.

The policyholder himself is entitled to the maturity claim. This is correct only when the policy is not assigned.

Answer to SEQ 3

The correct answer is D.

If there were two nominees, a joint discharge would be given by the nominees and claim proceeds would be paid jointly to all nominees.

Answer to SEQ 4

The correct answer is C.

A missing person will be presumed to be dead after seven years.

Answer to SEQ 5

The correct answer is A.

If the policy holder dies after the due date of the survival claim but before settlement of claim; then rights for that survival benefit are payable to the legal heirs of the policy holder.
ANNEXURE 1

Cir. No. IRDA/ACT/CIR/ULIP/102/06/2010 June 28, 2010

To

CEOs of All Life Insurance Companies

Sub: Unit Linked Insurance Products (ULIPs)

Please refer following circulars:

1. IRDA/Actl/032/ Dec 2005 dated December 21, 2005 and subsequent clarifications issued
2. 061/IRDA/ACTL/March-2008 dated 12 March, 2008
3. IRDA/Actl/ULIP/055/2009-10 dated 24 September, 2009,
4. IRDA/Actl/CIR/ULIP/071/066/04/2010 dated 27 April, 2010 and
5. IRDA/ACTL/CIR/ULIP/071/05/2010 dated 3 May, 2010

In order to meet the emerging needs of prospective insurance policyholders, this circular specifies certain elements which shall be incorporated in all ULIPs which may be offered for sale to the public commencing from September 1, 2010.

The three year lock-in period for all Unit Linked Products will be increased to a period of five years, including top-up premiums. During this period, no residuary payments on policies which are lapsed / surrendered / discontinued will be made. The residuary payments for policies arising out of policies which stand lapsed/surrendered/discontinued during the lock-in period shall be payable on the expiry of the lock in period and in accordance with the relevant Regulations of IRDA.

All regular premium / limited premium ULIPs shall have uniform / level paying premiums. Any additional payments shall be treated as single premium for the purpose of insurance cover.

All limited premium unit linked insurance products, other than single premium products, shall have premium paying term of at least 5 years.
The insurers shall distribute the overall charges, in ULIPs in an even fashion during the lock-in period.

All unit linked products, other than pension and annuity products shall provide a minimum mortality cover or a health cover, as indicated below:

(i) Minimum mortality cover should be as follows:

<table>
<thead>
<tr>
<th>Minimum Sum assured for age at entry of below 45 years</th>
<th>Minimum Sum assured for age at entry of 45 years and above</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single Premium (SP) contracts: 125 percent of single premium.</td>
<td>Single Premium (SP) contracts: 110 percent of single premium</td>
</tr>
<tr>
<td>Regular Premium (RP) including limited premium paying (LPP) contracts: 10 times the annualized premiums or (0.5 X T X annualized premium) whichever is higher. At no time the death benefit shall be less than 105 percent of the total premiums (including top-ups) paid.</td>
<td>Regular Premium (RP) including limited premium paying (LPP) contracts: 7 times the annualized premiums or (0.25 X T X annualized premium) whichever is higher. At no time the death benefit shall be less than 105 percent of the total premiums (including top-ups) paid.</td>
</tr>
</tbody>
</table>

(In case of whole life contracts, term (T) shall be taken as 70 minus age at entry)

(ii) The minimum health cover per annum should be as follows:

<table>
<thead>
<tr>
<th>Minimum annual health cover for age at entry of below 45 years</th>
<th>Minimum annual health cover for age at entry of 45 years and above</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regular Premium (RP) contracts: 5 times the annualized premiums or Rs. 100,000 per annum whichever is higher. At no time the annual health cover shall be less than 105 percent of the total premiums paid.</td>
<td>Regular Premium (RP) contracts: 5 times the annualized premiums or Rs. 75,000 per annum whichever is higher. At no time the annual health cover shall be less than 105 percent of the total premiums paid.</td>
</tr>
</tbody>
</table>
All top-up premiums made during the currency of the contract, except for pension/annuity products, must have insurance cover treating them as single premium, as per above table.

The accumulated fund value of unit linked pension / annuity products is the fund value as on the maturity date. All ULIP pension / annuity products shall offer a minimum guaranteed return of 4.5 per cent per annum or as specified by IRDA from time to time, on the maturity date. This guaranteed return is applicable on the maturity date, for policies where all due premiums are paid. Mortality and / or health cover could be offered along with the pension/annuity products as riders, giving enough flexibility for the policyholders to select covers of their choice.

In the case of unit linked pension / annuity products, no partial withdrawal shall be allowed during the accumulation phase and the insurer shall convert the accumulated fund value into an annuity at the vesting date. However, the insured will have an option to commute up to a maximum of one-third of the accumulated value as lump sum at the time of vesting. In the case of surrender, only a maximum of one-third of the surrender value can be commuted after the lock-in period. The remaining amount must be used to purchase an annuity, subject to the provisions of Section 4 of Insurance Act, 1938.

Vide circular 3rd cited above, caps on charges were fixed on Unit Linked contracts with a tenor of 10 years or less and for those with tenor above 10 years. However, taking into account the discontinuance/lapse/surrender behavior and with a view to smoothen the cap on charges, the following limits are prescribed starting from the 5th policy anniversary:

<table>
<thead>
<tr>
<th>Annualized Premiums Paid</th>
<th>Maximum reduction in yield</th>
</tr>
</thead>
<tbody>
<tr>
<td>5</td>
<td>4.00%</td>
</tr>
<tr>
<td>6</td>
<td>3.75%</td>
</tr>
<tr>
<td>7</td>
<td>3.50%</td>
</tr>
<tr>
<td>8</td>
<td>3.30%</td>
</tr>
<tr>
<td>9</td>
<td>3.15%</td>
</tr>
<tr>
<td>10</td>
<td>3.00%</td>
</tr>
<tr>
<td>11 and 12</td>
<td>2.75 %</td>
</tr>
<tr>
<td>13 and 14</td>
<td>2.50 %</td>
</tr>
<tr>
<td>15 and thereafter</td>
<td>2.25 %</td>
</tr>
</tbody>
</table>

The net reduction in yield for policies with term less than or equal to 10 years shall not be more than 3.00% at maturity. For policies with term above 10 years, the net reduction in yield at maturity shall not be more than 2.25%.
The maximum loan amount that can be sanctioned under any ULIP policy shall not exceed 40% of the net asset value in those products where equity accounts for more than 60% of the total share and shall not exceed 50% of the net asset value of those products where debt instruments accounts for more than 60% of the total share.

Circular No: 2 cited above will stand superseded by this circular and circular numbers 1, 3, 4 and 5 will stand modified to the extent prescribed in this circular.

All insurers are directed to conform to these features so that they can introduce the products with due approval from IRDA. From September 1, 2010 all unit linked products offered for sale shall conform to this circular,

(R. Kannan)

Member (Actuary)
ANNEXURE II

Dr. R. Kannan
Member (Actuary)

To
All Life Insurers

Sub: Cap on Charges

Please refer our Circular No. 20/IRDA/Act/ULIP/09-10 dated 22nd July, 2009 and 29/IRDA/Act/ULIP/2009-10 dated 20th August, 2009. Taking into account the various issues discussed in the ‘Appointed Actuaries’ meet held on 9th September, 2009, the following clarifications are issued in this regard:

1. The Cap on annual Fund Management Charge in respect of each of the segregated funds shall be 135 basis points.

2. Surrender penalty should be zero after completion of five policy years and thereafter, irrespective of the number of premiums paid (e.g. if DOC is 01.01.2003 then no surrender penalty w.e.f 01.01.2008).

3. The above circulars are not applicable in case of unit linked health insurance products or any other product which does not offer maturity benefit.

4. In respect of whole life products, the net yield calculation should be demonstrated assuming the duration of (X - entry age) or 30 years whichever is lower, where ‘X’ is the cover ceasing age as defined in the product, otherwise ‘X’ should be taken as 100.

5. In respect of 100% allocation charge products, the total charge should be treated as a normal charge and not a charge towards investment guarantee. The ‘Benefit Illustration’ of such products should clearly reflect the 100% allocation charge as a normal allocation charge and ‘Fund available for Investment’ should be shown as zero in the first policy year. In fact, any allocation charge should be considered as normal allocation charge and should be shown in the benefit illustration along with funds available for investment. Any statement referring allocation charge as charge towards any benefit guaranteed should be deleted from the sales literature and benefit illustration.

6. Service Tax and any charge towards guarantees are to be disclosed explicitly in the ‘Benefit Illustration’ (A revised format is enclosed in Annexure-I).
7. Computation of net yield:

a) As per the aforesaid circulars, certain charges are excluded from the calculation of net yield. This implies that the net yield shall be calculated based on the projection of end fund on monthly basis at a specified gross rate of return assuming these charges as zero throughout the term of the contract and premiums are paid as and when due. The equation of value concerning the gross premiums paid by the policyholder and the maturity fund value shall give the effective net yield per annum expected to be earned on the contract at the point of sale.

b) As the policyholders' behavior with regard to options, for example, partial withdrawals, premium redirection etc. affect the net yield, such options may be ignored throughout the term of the contract in demonstrating the net yield.

c) A sample calculation of net yield is given in Annexure - II.

d) The customized ‘Benefit Illustration’ should include all charges as applicable and fund values should accordingly be derived without relating to the projections used for net yield calculation as pointed out under (a) above.

e) The net yield and hence reduction in yield as calculated, shall be disclosed in the benefit illustration indicating the corresponding gross yield figures.

f) As per the current practice, the benefit illustration should be shown at Gross investment return of 6% and 10% p.a. but the net yield may be demonstrated only with respect to gross investment return of 10% p.a.

8. The following are to be complied with regard to ‘F&U’ application:

a) Compliance of the above circulars is to be demonstrated at the ‘F&U’ stage by constructing model points viz. min/max (SA, policy term, FMC, Premium Paying Term, Mode, Size of premium), considering various combinations of limiting values of model points, including extreme scenarios.

b) The following declaration is to be added as an additional paragraph in the declaration section of the ‘F&U’ application:

'It is hereby certified that the product has been analyzed by taking into account various model points comprising of every possible combination of variables like policy term, premium paying term, premium amount, sum assured, entry age, frequency of premium payment etc. as per features of the product and confirm that the product completely complies with the IRDA
9. In respect of products which do not conform with the above circulars, the insurers shall comply with the following:
   
a) Products are to be either closed or modified.
b) All such products (new/modified) should reach the Authority’s office by 1st December, 2009.
c) List of products which are on shelf should be sent by 25th September, 2009.
d) Soft copy of the F&U application with track changes shall have to be submitted along with the hard copy highlighting the changes made and also a tabular format showing a comparison of the existing and revised structures.
e) User-friendly soft copy of the yield calculation sheets in excel format along with formulae should be submitted to enable the Authority to expedite the clearing process.

10. If the compliance is achieved through modification route and the Fund Management Charge (FMC) of the existing funds are revised, the revised FMC should be applicable to all policyholders - both new and existing. If the insurer wants to close the existing funds to new policyholders and offer new funds an option should be offered to the existing policyholders (includes all policyholders whether policies are in force or not as on 01.10.2009) to shift to the new funds without any penalty within a specified time period. A copy of such option letter which will be sent to the existing policyholder is to be submitted to the Authority.

   Where insurer wants to close the existing product, it should be closed for new business before 01.01.2010. Insurer should inform IRDA the withdrawal of the products as per file & use procedure.

   Names of new segregated funds should not be identical with the names of the old segregated funds which are either in closed status or in existence. However, product names of the existing products can continue to be used in case of modification, with different Unique Identification number.

11. Please note that if the same segregated fund is offered under more than one product then such fund should have same NAV and FMC.

Yours faithfully

(R. Kannan)
Member (Actuary)
Cir. No. IRDA/Actl/Cir/ULIP/ 124/08/2010

4th August, 2010

To
CEOs of All Life Insurance Companies

Sub: Unit Linked Insurance Products (ULIPs)

This has reference to the Authority’s Circular IRDA/ACT/CIR/ULIP/102/06/2010 dated June 28, 2010. As requested by many life insurance companies, we issue the following clarifications to ensure that the objectives of the Authority are clearly understood by the industry.

1. ‘Top-up’ premiums once paid cannot be withdrawn from the fund for a period of 5 years from the date of payment of the ‘Top-up’ premium. Top-up premiums are not permitted during the last 5 years of the contract.

2. The contractual premium payable by the policyholder shall not be altered during the term of the policy.

3. The term “even fashion” does not mean “equal”. However, premium allocation charge and policy administrative charge shall be spread evenly during the first 5 years of the policy contract, without wide fluctuations. The charges could change from year to year in a reasonably orderly manner so that the difference between the maximum and minimum charges shall not vary by more than 1.5 times.

4. The life cover on top-up premium will be based on the age at payment of top-up premium but not on entry age.

5. The maturity date, under individual pension/deferred annuity policy, is the contractual vesting date agreed at inception of the policy.

6. With regard to group pension ULIP the following shall be applicable:
   i. The guaranteed return is applicable to individual contribution made to Group Unit linked Defined contribution Pension products if the contract has been in force for a continuous period of five years.
   ii. For defined benefit schemes, the guaranteed return shall apply to the entire contribution if the contract has been in force for a continuous period of five years.
iii. In case of termination of group pension schemes, the guaranteed yield shall be applicable, if the contract has been in force for a continuous period of five years.

iv. Cap on charges shall be applicable to

a. all other group schemes at individual member levels, if individual accounts are maintained separately
b. to the entire fund if individual accounts are not maintained

v. The premium with respect to group schemes may be altered as per the certificate submitted by the employer in accordance with the AS 15 (Revised)

7. The guarantee shall be applicable on gross premiums and not on net premiums.

8. The minimum guaranteed rate of 4.5% per annum is applicable to all contributions/premiums received up to March 31, 2011.

From 1st April of every year starting from 2011, the guaranteed interest rate shall be 50 basis points above the average of the reverse repo rate prevailing as on the last working day of June, September, December and March of the preceding year. Thus the guaranteed interest rate may vary depending upon the variation in the reverse repo rates. However, the guaranteed interest rate shall be subject to a maximum of 6 per cent and a minimum of 3 per cent.

9. The “net asset value” and “products” under para 11 of the said circular shall be read as “surrender value” and “policies”.

10. The first column of the table given in item no. 9 of the said circular “annualized premiums paid” shall be read as “number of years elapsed since inception”.

11. The insurer is not obliged to offer loans, but may choose to do so. The insurer is allowed to charge interest on such loans. However, any top-up premiums paid shall first be adjusted towards outstanding loan, if any, and the balance available shall be invested in the segregated funds chosen by the policyholder subject to recovery of applicable charges. This shall form part of the terms and conditions of the contract.

12. The charges during lock-in period shall be so structured that the cap on net reduction in yield is achieved without any further additions to fund value at any time during first five years of the contract.

13. We reiterate our earlier stand that the effective date of the said circular is 1st Sep’10 and all the unit-linked products offered from 1st Sep’10, shall conform to the above circular.

(R. Kannan)
Member (Actuary)
ANNEXURE III
INSURANCE REGULATORY AND DEVELOPMENT AUTHORITY

(Standardization of terms & conditions of ULIP Products and treatment of lapsed policies) REGULATIONS, 2010

In exercise of the powers conferred by clause (zd) of sub-section 114A of the Insurance Act, 1938 (4 of 1938) read with sections 14 and 26 of the Insurance Regulatory and Development Authority Act, 1999 (4 of 1999), the Authority in consultation with the Insurance Advisory Committee, hereby makes the following regulations

Short title and commencement

(1) These regulations may be called the Insurance Regulatory and Development Authority (Standardization of terms & conditions of ULIP Products and treatment of lapsed policies) Regulations, 2010

(2) They shall come into force on the date of their publication in the Official Gazette and shall apply to all contract of Linked Life Insurance affected thereafter. These regulations supercede the provisions of circular/ guidelines if any issued by the Authority and will be applicable to the existing products also.

These regulations apply to all life insurers, insurance agents, insurance intermediaries and policyholders.

Definitions:

(1) Unless the context otherwise requires,-a)

“Act” means the Insurance Act, 1938

“Authority” means the Insurance Regulatory and Development Authority established under sub-section (1) of section 3 of the Insurance Regulatory and Development Authority Act, 1999 (41 of 1999)

“Grace Period”: The additional period of time given / allowed by the insurer from the date of premium falling due to insured to make payment of premium without any interest or penalty. The risk will be covered without interruption in case payment is effected by the insured during the grace period.

“Lapsation”: discontinuation of premium payment by the policy holder during the period of operation of the policy, due to any reason other than the death of the policy holder. If policy has lapsed due to non-payment of premiums, the terms and conditions of the policy contract are rendered void, till the policy is revived.
“Date of payment”: Date of payment in all cases shall be the date on which payment in cash is received by the insurance company or the date on which the cheque or postal order is posted to the insurer as set out in Section 64 VB (2) of the Insurance Act, 1938 provided the cheque is honored by the bank.

“Revival of a policy”: A lapsed policy has to be revived by payment of the accumulated premiums with interest as well as the cost of medical tests etc. as under the terms of the policy.

“Surrender Value”: The surrender value of the policy is the amount remaining in the fund account less applicable surrender charges which is refundable to the policyholder. However, the surrender charges shall not exceed the charges provided in regulation 6.a.

“Surrender charge” : means the maximum permissible charges as defined in regulation 6.a below. Surrender charges as applicable on lapsation date and on the fund value as on date of lapsation to be recovered at the time of pay out to the policyholder.

(2) Words and expression used and not defined in these regulations but defined in the Insurance Act, 1938 (4 of 1938), or the Life Insurance Corporation Act, 1956 (31 of 1956) or the General Insurance Business (Nationalization) Act, 1972 (57 of 1972), or Insurance Regulatory and Development Authority Act, 1999 (42 of 1999) shall have the meanings respectively assigned to them in those Acts or the rules and regulations made there under, as the case may be.

Grace Period

The Grace period for payment of the premium will be as under for all types of linked products
a. where the premium payment mode selected is monthly : 15 days
b. in all other cases : 30 days

Lapsation of the Policy

Where policies lapse: the policy holder is entitled to one of the following options:-

a. to revive the policy;
b. to continue with the policy only to the extent of risk cover and
c. to continue with the policy with risk cover and as part of the Fund; d. to withdraw completely from the Fund without any risk cover

In order to exercise the options available by a policy holder as mentioned in regulation 4 above, the insurance company shall take the following steps in all cases where a policy has lapsed:

a. A notice shall be issued to such a policy holder asking him/her to exercise the said options within a period of 30 days of receipt of such notice.
b. In case no option is exercised within 30 days, the option at regulation 4 (c) above, i.e., to continue in the Fund with risk cover will be deemed to have been exercised and the risk charges and fund management charge will be recovered.

In case he does not opt to be in the fund, the fund value will be credited to “Lapsed Policy Fund” invested in a fixed income instrument earning at least the saving deposit interest rate. The interest on the fund so set aside will be apportioned to the Lapsed Policy fund only and will not be available to the shareholders.

In all cases, foreclosure has to be notified and policyholder must be given an opportunity of three months for revival of the policy.

**Surrender Charges**

It is observed that Insurers apply different surrender charges while paying the surrender value to the insured. After due consideration of various practices, the Authority orders that the surrender charges (as percentage of fund value) shall not exceed the limits specified below:-

<table>
<thead>
<tr>
<th>Year</th>
<th>Policy Period</th>
<th>Less than 10 years</th>
<th>More than 10 years</th>
</tr>
</thead>
<tbody>
<tr>
<td>1st year</td>
<td>12.50%</td>
<td>15%</td>
<td></td>
</tr>
<tr>
<td>2nd year</td>
<td>10.00%</td>
<td>12.50%</td>
<td></td>
</tr>
<tr>
<td>3rd year</td>
<td>7.50%</td>
<td>10%</td>
<td></td>
</tr>
<tr>
<td>4th year</td>
<td>5.00%</td>
<td>7.50%</td>
<td></td>
</tr>
<tr>
<td>5th year</td>
<td>2.50%</td>
<td>5%</td>
<td></td>
</tr>
<tr>
<td>6th year</td>
<td>NIL</td>
<td>2.50%</td>
<td></td>
</tr>
<tr>
<td>7th year &amp; onwards</td>
<td>NIL</td>
<td>NIL</td>
<td></td>
</tr>
</tbody>
</table>

However, insurers shall not impose surrender charges on Single Premium Policy and on Top up premiums.

9. **Revival of a lapsed policy**

Policy holder must be given an option within a period of 5 years from the date on which premium fell due to revive/reinstate the policy. However, Insurer will have the right to decline revival of the policy based on the grounds of moral hazard and/or medical conditions.

**Treatment of Proceeds of the Lapsed Policies**

Here the “proceeds of the lapsed policies” means

a) The fund value on the date of the lapsed reduced by the following charges

i. Charges for risks to be covered if agreed to by the insured or in terms of provision of regulation 5.b

ii. Charges for the fund maintenance after lapse of the policy provided the same has been agreed by the insured.

b) The fund value for the policyholder will be after
Adjustment of the fund as per NAV if the insured has agreed to be in the fund (OR)

Addition of Interest at saving deposit rate of interest (currently 3.50% p.a. calculated daily) in case the policyholder has not exercised his option to be in the fund.

The proceeds of the lapsed policies shall invariably be refunded to the policyholder after the expiry of the revival period or at any time after completion of 3 years term as and when demanded by the policyholder. In case there is no demand from the policyholder for refund, insurance company shall refund the amount on its own by means of a cheque / demand draft to be delivered to the insured/ nominee at his last known address. However, Insurer may deduct charges on account of pre-closure and lapsation which should, in any case, not exceed the charges stated in regulation 8 above.

i. The provision made for the same will be shown as a separate line item in the Balance Sheet
   a. Provision / Funds for Lapsed Policies
   b. Provision / Funds for Surrendered Policies
      As a part of the fund
      As a part of the segregated fund

   The amount refunded to the policyholders during the financial year will be shown as a separate line item.

   Disclosure giving the following will be made in the notes of the accounts – separately for surrendered and lapsed policies
   a. number and percentage surrendered/ lapsed during the year
   b. Number and percentage of policyholders opted for surrender out of lapsed policies
   c. number and percentage of the policies revived during the year
   d. number of the policyholders opted for mortality and fund
   e. Amount charged on account on surrendered and lapsed policies.

Any breaches of the obligations cast on an insurer / insurers in terms of these regulations may enable the Authority to initiate action against each or all of them jointly or severally, under the Act and / or the Insurance Regulatory and Development Authority Act, 1999.

Removal of Difficulties

Where doubt or difficult arises in giving effect to the provisions of any of these regulations, the same may be referred to the Authority, whose decision thereon shall be binding on the parties concerned.