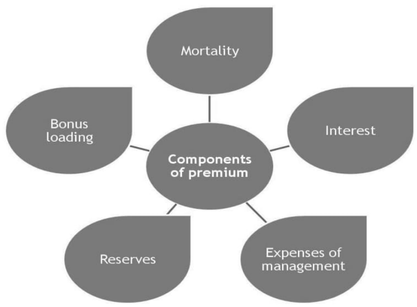
Diagram 2: Components of Premium



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

a) Mortality and Interest

Mortality is the first element in premiums. It is the chance or likelihood that a person of a certain age would die during a given period, of typically one year. To find out the expected Mortality of a person, we use a "Mortality Table", which gives us an estimate of the rate of mortality for different ages

Consider a person aged 35. If he wants to take life insurance cover for a term of twenty years [age 35 to 55], the insurance company must have sufficient money available to meet the cost of claims that can arise if he dies at any time during this period. This cost can be ound out by summing up the individual risk premiums for different ages from age 35 to 55.

The total cost of these claims, as summed up above, would give us the future liabilities under a policy. In other words it tells us how much money is needed by an insurer to pay claims that may arise in future.

Since Life insurers collect premiums at the beginning of a given term, these premiums earn interest. While estimating the amount money that would be needed at hand to pay claims that may arise in future [future liabilities], it is necessary to take this factor of interest into account.

Interest is simply the discount rate we assume for arriving at the present value of future claim payments that have to be made.