LIFE INSURANCE PRODUCTS

Chapter Introduction

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

A. Overview of life insurance products

1. What is a product?

To begin with let us understand what is meant by a product. In popular terms a product is considered same as a commodity- a good brought and sold in the marketplace. The term 'product' comes from the term 'reproduce' which means 'to bring forth' or 'to create'. In other words, a product is the output or result of certain labour or efforts.

However a good's usefulness or utility derives not from the good itself but from its features. This brings us to the marketing perspective. From a marketing standpoint, a **product is a bundle of attributes**. Firms differentiate their product offerings in the marketplace by packing together different types of attributes or different bundles of the same attributes.

The difference between a product (as used in a marketing sense) and a commodity is thus that a product can be differentiated. A commodity cannot. This means that the products sold by different companies, though they may belong to the same category, may be quite different from one another in terms of their features.

A product is not an end in itself but a means to satisfy other ends. In this sense products are problem solving tools. They serve as need or want satisfiers. How appropriate a product is for the purpose would depend on the features of the product.

Products may be:

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

Life insurance is a product that is intangible. A life insurance agent has the responsibility to enable the customer to understand the features of a particular life insurance product, what it can do and how it can serve the customer's unique needs.

2. Purpose of life insurance products and needs covered

Wherever there is risk it is a cause for anxiety. However, we humans have sought to master or at least understand risk, to anticipate and be prepared for it. The instinct and desire to create security against risk has been a key reason for the creation of insurance.

We human beings are social beings who share our lives with others like us - our loved ones. We also possess an immensely valuable asset **- our human capital which is the source of our productive earning capacity.** However, there is an uncertainty about life and human well-being. Events like death and disease can destroy our productive capabilities and thus cut down or erode the value of our human capital.

Life insurance products offer protection against the loss of economic value of an individual's productive abilities, which is available to his dependents or to the self. The very word 'insurance' in 'life insurance' signifies the need to protect both oneself and one's loved ones against financial loss upon death or permanent disability.

There are other functions, such as savings and investment, but death or dread disease coverage is the most common reason for taking out life insurance. In specific terms, the potential estate value or the wealth expected to be created by the insured individual during his/her remaining earning span of work life, is sought to be replaced or compensated to one's loved ones or to self, should the income generating ability of the insured person be damaged or destroyed during the period of the contract. This is done by creating an **immediate estate** in the name of the insured life, the moment the first premium is paid by him.

So, a life insurance policy, at its core, **provides peace of mind and protection to the near and dear ones of the individual** in case something unfortunate happens to him. The other role of life insurance has been as a vehicle for saving and wealth accumulation. In this sense, it offers safety and security of investment and also a certain rate of return.

Life insurance is more than an instrument for protecting against death and disease. It is also a financial product and may be seen as one among many constituents of a portfolio of financial assets rather than as a unique stand-alone product. In the emerging financial marketplace, customers have multiple choices, not only among alternative types of life insurance products but also with numerous substitutes to life insurance that have come up, like deposits, bonds, stocks and mutual funds.

In this context, one needs to understand what the value proposition of life insurance is. **Customer value** would depend on how life insurance is perceived as a solution to a set of customer needs.

- Does it offer the right solution? or "Is it effective?"
- What does it cost? or "is it efficient?"

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

Similarly from a '**participating in profit**' traditional product, the innovations created '**market linked**' policies where the insured was invited to participate in choosing and managing his investment assets. Another dimension was added, where life insurance products evolved from being a fixed bundle (of defined benefits) to highly flexible unbundled products, wherein different benefits as well as cost components could be varied by the policy holder as per changing needs, affordability and life-stages.

3. Riders in Life Insurance Products

We have seen above, how life insurance contracts offer various benefits which serve as solutions to a host of needs of their customers. Life insurance companies have also offered a number of riders through which the value of their offerings can get enhanced.

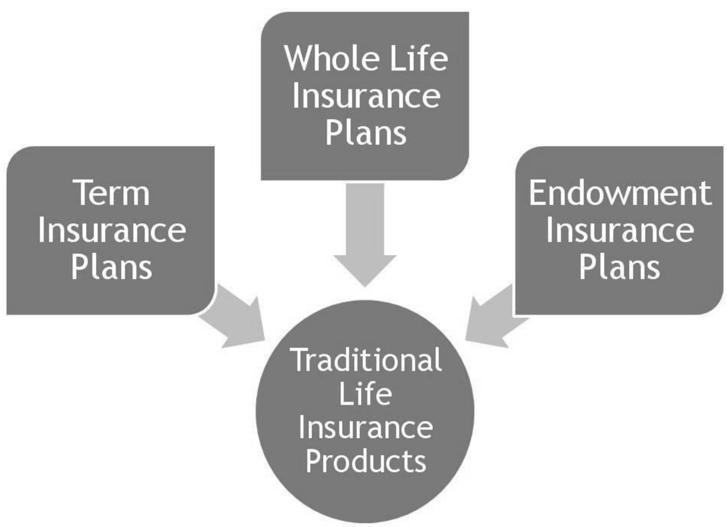
A rider is a provision typically added through an endorsement, which then becomes part of the contract. Riders are commonly used to provide some sort of supplementary benefit or to increase the amount of death benefit provided by a policy.

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 customise the pizza as per an individual's requirement. Riders help to customise different requirements of a person into a single plan.

B. Traditional life insurance products

In this chapter we shall now learn about some of the traditional types of life insurance products.

Diagram 2: Traditional Life Insurance Products



1. Term insurance plans

Term insurance is valid only during a certain time period that has been specified in the contract. The term can range from as short as it takes to complete an airplane trip to as long as forty years.

Protection may extend up to age 65 or 70. One-year term policies are quite similar to property and casualty insurance contracts. All premiums received under such a policy may be treated as earned towards the cost of mortality risk by the company. There is no savings or cash value element accruing to the insured.

2. Whole life insurance

While term assurance policies are examples of temporary assurance, where protection is available for a temporary period of time, whole life insurance is an example of a permanent life insurance policy. In other words **there is no fixed term of cover but the insurer offers to pay the agreed upon death benefit when the insured dies, no matter whenever the death might occur.** The premiums can be paid throughout one's life or for a specified period of time which is limited and is less than one's lifetime.

Whole life premiums are much higher than term premiums since a whole life policy is designed to remain in force until the death of the insured, and therefore it is designed to always pay the death benefit. After the insurance company takes the amount of money it needs from the premium, to meet the cost of term insurance, the **balance money is invested on behalf of the policyholder. This is called cash-value.** One can withdraw cash in the form of a policy loan should he require emergency funds, or he can redeem by surrendering the policy for its cash value.

In case of outstanding loans the amount of loan and interest gets deducted from the payout that is made to the designated beneficiaries upon death.

A whole life policy is a good plan for one who is the main income earner of the family and wishes to protect the loved ones from any financial insecurity in case of premature death. This person must be able to afford the higher premiums of a whole life insurance policy on a consistent and long-term basis,

3. Endowment assurance

An endowment assurance contract is actually a combination of two plans:

- A term assurance plan which pays the full sum assured in case of death of the insured during the term
- A pure endowment plan which pays this amount if the insured survives at the end of the term

The product thus has both a death and a survival benefit component. From an economic point of view, the contract is a combination of decreasing term insurance and an increasing investment element. Shorter the policy term, larger the investment element.

The combination of term and investment elements is also present in whole life and other cash value contracts. It is however much more pronounced in the case of endowment assurance contracts. This makes it an effective vehicle to accumulate a specific sum of money over a period of time.
The plan is also made attractive because of the provision for deduction of premiums for tax purposes.

Yet another proposition in the Indian context has been the facility to place the policy in a trust created under the **MWPA (Married Women's Property Act), 1874** the money can only be paid to the policy beneficiary, who is thus protected against all creditors' claims on the property of the insured.

Finally many endowment policies mature at ages 55-65, when the insured is planning for his/her retirement and such policies may be a useful supplement to other sources of retirement savings.

a) Variants

Endowment assurance has certain variants that are discussed below.

i. Money back plan

A popular variant of endowment plans in India has been the Money Back policy. **It is typically an endowment plan with the provision for return of a part of the sum assured in periodic instalments during the term and balance of sum assured at the end of the term.**

ii. Par and non-par schemes

The term "Par" implies policies which are participating in the profits of the life insurer. "Non - Par" on the other hand represent policies which do not participate in the profits. Both kinds are present in traditional life insurance.

Under all traditional plans, the pooled life funds, which are made up of the proceeds of premium received from policyholders, are invested under tight

regulatory supervision, as per prescribed norms, and policyholders are either guaranteed a part of the growth or get a share of the surpluses that are generated by the insurer, under what are termed as "With Profit Plans".

Non-participating products may be offered either under a linked platform or a non-linked platform. In this chapter, we are concerned with policies which are non-linked. Typically without profit plans are those where the benefits are fixed and guaranteed at the time of the contract and the policyholder would be eligible for these benefits and no more.

ii. Participating (Par) or with profit plans

Unlike without profit or guaranteed plans, these plans have a provision for participation in profits. With profits policies have a higher premium than others. Profits are payable as bonuses or dividends. Bonuses are normally paid as reversionary bonuses. They are declared as a proportion of the sum assured (e.g. Rs. 70 per thousand sum assured) and are payable as additional benefits on a reversionary basis (at the end of the tenure of the policy, by death or maturity or surrender).

Apart from reversionary bonuses which, once attached, are guaranteed, the life insurer may also declare terminal bonuses. These are contingent upon the life insurer earning some windfall gains and are not guaranteed.

Terminal Bonuses were developed as a means to share with participating policy holders, the large windfall gains that were made through investment in capital markets in United Kingdom. They have also been adopted in India and many other developing markets.

IRDAI's new guidelines for traditional products

According to the guidelines, the product design of traditional plans would remain almost the same.

a) New traditional products will have a higher death cover.

i. For **single premium policies** it will be 125% of the single premium for those below 45 years and 110% of single premium for those above 45 years.

ii. For **regular premium policies**, the cover will be 10 times the annualised premium paid for those below 45 and seven times for others.

b) The **minimum death benefit** in case of traditional plan is at least the amount of sum assured and the additional benefits (if any).

c) In addition to the sum assured, the **bonus / additional benefits** as specific edin the policy and accrued till date of death shall become payable on death if not paid earlier.

d) These plans would continue to come in **two variants**, participating and non-participating plans.

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

Overview of non-traditional life insurance products.

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

In the previous chapters we have considered some of the traditional life insurance products which have insurance as well as a savings element in them. These products have often been considered as being part of the financial market and compared with other instruments of capital accumulation.

One of the principal purposes of saving and investing, we must note, is to **achieve inter-temporal allocation of resources, which is both efficient and effective**.

I. **Inter-temporal allocation** means allocation across time. The term **effective** here implies that sufficient funds are available to successfully satisfy various needs as they arise in different stages of the life cycle.

II. **Efficient allocation** on the other hand implies a faster rate of accumulation and more funds available in future. Higher the return for a given level of risk, the more efficient would the investment be.

A critical point of concern with respect to life insurance policies has been the issue of giving a competitive rate of return which is comparable to that of other assets in the financial market place. It would be useful to examine some of the features of the traditional cash value plans of life insurance that we discussed in the previous chapter. These have been called bundled plans because of the way their structure is bundled and presented as a single package of benefits and premium.

2. Limitations of traditional products

A critical examination would reveal the following areas of concern:

I. **Cash value component:** Firstly, the savings or cash value component in such policies is not well defined. It depends on the amount of actuarial reserve that is set up. This in turn is determined by assumptions about mortality, interest rates, expenses and other parameters that are set by the life insurer. These assumptions can be quite arbitrary.

II. **Rate of return:** Secondly it is not easy to ascertain what would be rate of return on these policies. This is because the value of the benefits under "With Profit policies" would be known for sure, only when the contract comes to an end. Again, the exact costs of the insurer are not disclosed. This lack of clarity about the rate of return makes it difficult to compare them with other alterative instruments of savings. Obviously one cannot know how efficient life insurance is as a savings instrument unless one can make such comparison.

III. **Surrender value:** A third problem is that the cash and surrender values (at any point of time), under these contracts depend on certain values (like the amount of actuarial reserve and the pro-rata asset share of the policy). These values may be determined quite arbitrarily. The method of arriving at surrender value is not visible.

IV. **Yield:** Finally there is the issue of the yield on these policies. Both because of prudential norms and tight supervision on investment and because bonuses do not immediately reflect the investment performance of the life insurer, the yields on these policies may not be as high as can be obtained from more risky investments.

Non-traditional life insurance products

1. Some non-traditional products

In the remaining paragraphs of this chapter we shall discuss some of the non-traditional products which have emerged in the Indian market and elsewhere.

a) Universal life

Universal life insurance is a policy that was introduced in the United States in 1979 and quickly grew to become very popular by the first half of the eighties.

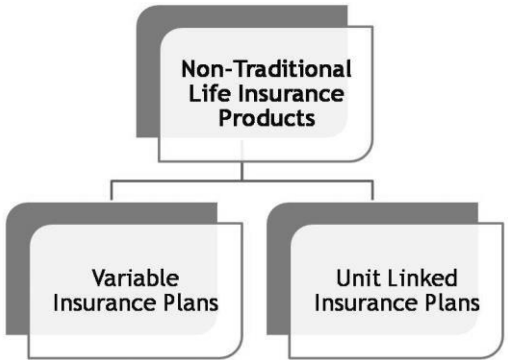
As per the IRDAI Circular of November 2010, "All Universal Life products shall be known as Variable Insurance Products (VIP)".

About Universal Life

Universal life insurance is a form of permanent life insurance characterised by ts **flexible premiums, flexible face amount and death benefit amounts, and he unbundling of its pricing factors**. While traditional cash value policies require a specific gross or office premium to be paid periodically in order to keep the contract in force, universal life policies allow the policyholder within limits, to decide the amount of premiums he or she wants to pay for the coverage. Larger the size of the premium, greater the coverage provided and greater the policy's cash value.

The major innovation of universal life insurance was the introduction of completely flexible premiums after the first policy year. One had only to ensure that premiums as a whole were enough to cover the costs of maintaining the policy. What this implied is that the policy could be deemed to be in force, so long as its cash value was sufficient to pay the mortality charges and expenses.

Diagram 1: Non-traditional life insurance products



i. **Variable life insurance**

To begin with it would be useful to know about variable life insurance as introduced in the United States and other markets.

This policy was first introduced in the United States in 1977. Variable life insurance is a kind of "Whole Life" policy where the death benefit and cash value of the policy fluctuates according to the investment performance of a special investment account into which premiums are credited. The policy thus provides no guarantees with respect to either the interest rate or minimum cash value. **Theoretically the cash value can go down to zero, in which case the policy would terminate.**

iii. **Unit linked insurance**

Unit linked plans, also known as ULIP's emerged as one of the most popular and significant products, displacing traditional plans in many markets. These plans were introduced in UK, in a situation of substantial investments that life insurance companies made in ordinary equity shares and the large capital gains and profits they made as a result. A need was felt for having both greater investment in equities nd also passing the benefits to policyholders in a more efficient and equitable manner.

Conventional with profit (participating) policies offer some linkage to the life office's investment performance. The linkage however is not direct. The policyholder's bonus depends on periodic (usually annual) valuation of assets and liabilities and resultant surplus declared, which in turn depends on assumptions and factors considered by the valuation actuary.

Unit linked policies help to overcome both the above limitations. **The benefits under these contracts are wholly or partially determined by the value of units credited to the policyholder's account at the date when payment is due**.

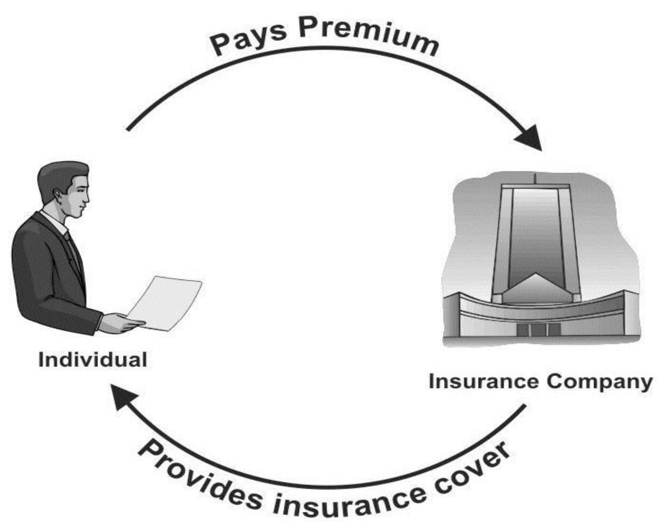
Insurance pricing - Basic elements

1. Premium

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

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

Diagram 1: Premium



The rates that are printed in these tables are known as "Office Premiums". They are typically level annual premiums which implies that the same premium needs to be paid every year during the term of the policy. They are in most cases the same throughout the term and are expressed as an annual rate.

2. Rebates

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

- For sum assured
- For mode of premium

a) Rebate for sum assured

The rebate **for sum assured** is offered to those who buy policies with higher amounts of sum assured. It is offered as a way of passing on to the customer, the gains that the insurer may make when servicing higher value policies. The reason for this is simple. Whether an insurer services a policy for Rs.50,000 or Rs.5,00,000, the amount of effort required for both, and consequently, the cost of processing these policies remain the same. But higher sum assured policies yield more premium and so more profits.

b) Rebate for mode of premium

Similarly a rebate may be offered **for the mode of premium**. Life insurance companies may allow premiums to be paid on annual, half yearly, quarterly or monthly basis. More frequent the mode, more the cost of service. Yearly and half yearly modes involve collection and accounting only once a year while quarterly and monthly modes would mean the process is more frequent. Half-yearly or yearly premiums thus enable a saving in administrative costs as compared to quarterly or monthly modes. Moreover, in the yearly mode, the insurer can utilise this amount during the entire year and earn interest on it. Insurers would hence encourage payment via yearly and half yearly modes by allowing a rebate on these. They may also charge a little extra for monthly mode of payments, to cover additional administrative expenses involved.

3. Extra charges

The tabular premium is charged for a group of insured individuals who are not subject to any significant factors that would pose an extra risk. Such individual lives are known as **standard lives** and the rates charged are known as ordinary rates.

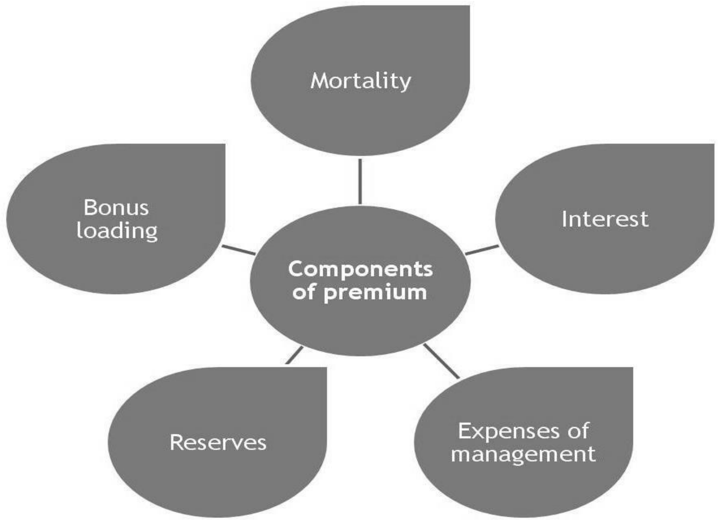
If a person proposing for insurance suffers from certain health problems like heart ailments or diabetes, it can pose a hazard to his life. Such a life is considered to be sub-standard, in relation to other standard lives. The insurer may decide to impose an extra premium by way of a health extra. Similarly an occupational extra may be imposed on those engaged in a hazardous occupation, like a circus acrobat. These extras would result in the premium being more than the tabular premium.
Again, an insurer may offer certain extra benefits under a policy, which are available on payment of an extra premium.

4. Determining the premium

Let us now examine how life insurers arrive at the rates that are presented in the premium tables. This task is performed by an actuary. The process of setting the premium in case of traditional life insurance policies like term insurance, whole life and endowment considers following elements:

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

Diagram 2: Components of Premium



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

a) Mortality and Interest

Mortality is the first element in premiums. It is the chance or likelihood that a person of a certain age would die during a given 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.

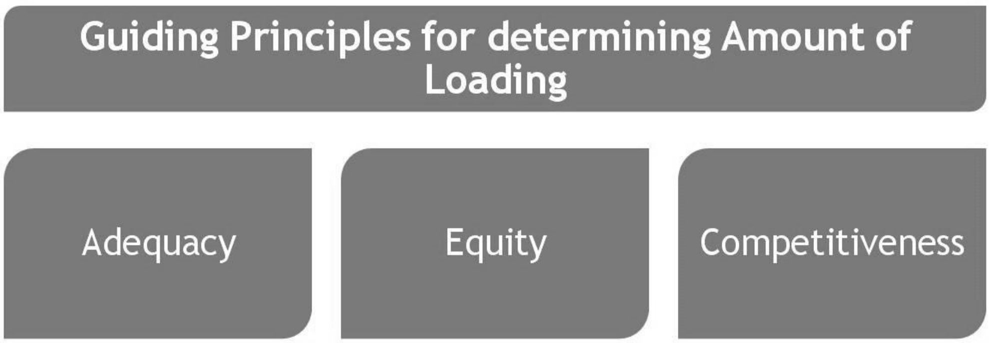
Interest is simply the discount rate we assume for arriving at the present value of future claim payments that have to be made.

Net premium

The estimates of mortality and interest give the "Net Premium" which is the estimate of present value of future claim costs.

Gross premium

Diagram 3: Guiding Principles for determining Amount of Loading



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

i. Adequacy

The total loading from all policies must be sufficient to cover the company's total operating expenses. It should also provide a margin of safety and finally it should contribute to the profits or surplus of the company.

ii. Equity

Expenses and safety margins etc. should be equitably apportioned [divided and shared] among various kinds of policies, depending on type of plan, age and term etc. The idea is that each class of policy should pay for its own costs, so that to the extent possible, one class of policy does not subsidise [pay for] another.

iii. Competitiveness

The resulting gross premiums should enable the company to improve its competitive position. If the loading is too high, it would make the policies very costly and people would not buy.

b) Expenses and reserves

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

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

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

A life insurer incurs two types of expenses:

i. The first, known as "**New Business Expenses**", are incurred at the beginning stage of the contract.
ii. The second type of expenses, known as "**Renewal Expenses,**" is incurred during subsequent years.

Initial or new business expenses can be substantial. Life insurers are also required by law to hold certain margins as reserves to ensure they can meet their obligations even in those situations when their actual experience is worse than assumed. The initial expenses along with the margins required to be maintained as reserves are typically higher than the initial premiums received by the life insurer.

c) With Profit policies and Bonus loading

During the early years of the life insurance industry, the major uncertainty faced was about the rate of mortality. Life insurers solved the problem by charging excessive premiums in advance. This would ensure that they remained solvent even in adverse situations. When, in the light of sufficient experience, it was found that the premiums were higher than what was needed, life insurers would return the excess or some of it to policyholders by way of bonus additions. This was the origin of the traditional with profit policies we find today

Participation in profits also ushered an element called "**Bonus Loading**" into premiums. The idea was to provide a margin for profits as a loading in the premium, such that it served as an added cushion against unforeseen contingencies and also paid for the policy's share of surplus distributed (as bonus).

In sum we can say that:

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

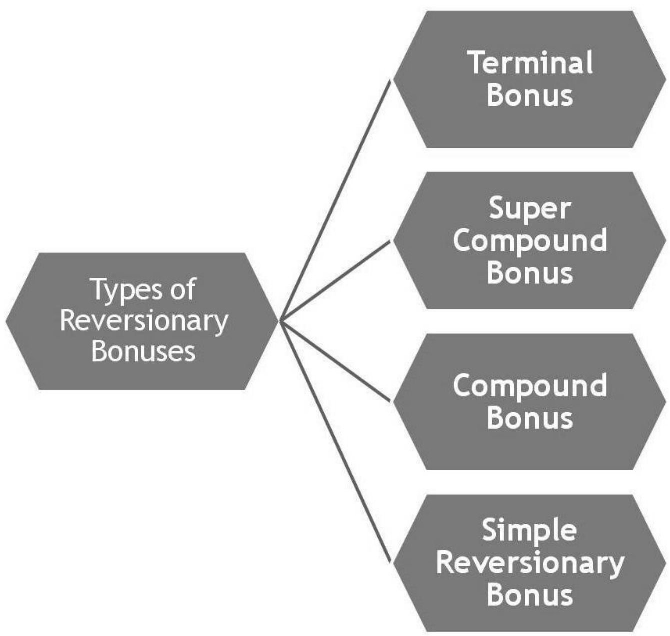
3. Bonus

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

The most common form of bonus is the **reversionary bonus**. The company is expected to declare such bonus additions each year, throughout the lifetime of the contract. Once declared, they get attached and cannot be taken away. They form part of the liabilities of the company. They are called 'Reversionary' bonuses because the policyholder only receives them when the contract becomes a claim by death or maturity.
Bonuses may also be payable on surrender. In such cases it is often stipulated that the contract should have run for a certain term (say 5 years) to become eligible.

Types of reversionary bonuses

Diagram 5: Types of Reversionary Bonuses



i) Simple Reversionary Bonus

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

ii) Compound Bonus

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

One may also have Super Compound bonus, where the bonus is arrived at as a percentage of basic benefit and applying another percentage for attached bonus. For instance it may be expressed as @8% of basic sum assured and @10% of attached bonus.

iii) Terminal Bonus

As the name suggests, this bonus attaches to the contract only on its contractual termination (by death or maturity). The bonus is declared only for claims of the ensuing year without any commitment about subsequent years (as in case of reversionary bonuses).

In the life insurance industry we deal with a large number of forms and documents. These are required for the purpose of bringing clarity in the relationship between the insured and the insurer. In this chapter, we shall deal with the various documents that are involved at the proposal stage and their significance. The documents we shall consider include

- Prospectus
- Proposal form
- Agent's report
- Medical examiner's report
- Moral hazard report
- Age proof
- Know Your Customer (KYC) documents

Life insurance - Proposal stage documentation

1. Prospectus

A prospectus is a formal legal document used by insurance companies that provides details about the product.

The prospectus used by a life insurance company should state the following, under each of its plans of insurance:

I. The terms and conditions
II. Scope of benefits - guaranteed and non-guaranteed
III. The entitlements
IV. The exceptions
V. Whether the plan is participative or non-participative

2. Proposal form

The insurance policy is a legal contract between insurer and the policyholder. As is required for any contract, it has a proposal and its acceptance. The application document used for making the proposal is commonly known as the 'proposal form'. All the facts stated in the proposal form become binding on both the parties and failure to appreciate its contents can lead to adverse consequences in the event of claim settlement.

3. Agent's report

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

4 Medical examiner's report

In many cases, the life to be insured has to be medically examined by a doctor who is empaneled by the insurance company. Details pertaining to physical features like height, weight, blood pressure, cardiac status etc. are recorded and mentioned by the doctor in his report called the medical examiner's report.

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

The underwriter of the insurance company thereby gets an account of the current health position of the life to be insured.

5. Moral hazard report

Life insurance is a contract between an individual and an insurance company that pays a stated amount of money if the covered person passes away during the term of the policy. When you purchase life insurance, you must go through several underwriting procedures including filling out an application and submitting to a physical exam. One factor impacting the risk, which underwriters look out for, is termed as moral hazard.

6. Age Proof

We have already seen that the risk of mortality in life insurance increases with age. Hence age is a factor that insurance companies use to determine the risk profile of the life to be insured. Accordingly a premium is charged for each age group. Verification of correct age by examination of an appropriate document of evidence of age thus assumes significance in life insurance.

Valid age proofs may be standard or non-standard.

a) Standard age proofs

Some documents considered as standard age proofs are:

i. School or college certificate
ii. Birth certificate extracted from municipal records
iii. Passport
iv. PAN card
v. Service register
vi. Certificate of baptism
vii. Certified extract from a family bible if it contains the date of birth
viii. Identity card in case of defence personnel
ix. Marriage certificate issued by a Roman Catholic church

b) Non-standard age proofs

When standard age proofs like the above are not available, the life insurer may allow submission of a non-standard age proof. Some documents considered as non-standard age proofs are:

I. Horoscope
II. Ration card
III. An affidavit by way of self-declaration
IV. Certificate from village panchayat

7. Anti-Money Laundering (AML)

Money laundering is the process of bringing illegal money into an economy by hiding its illegal origin so that it appears to be legally acquired. The Government of India launched the PMLA ,2002 to rein in money-laundering activities.

The Prevention of Money Laundering Act (PMLA), 2002 came into effect from 2005 to control money laundering activities and to provide for confiscation of property derived from money-laundering. It mentions money laundering as an offense which is punishable by rigorous imprisonment from three to seven years and fine up to Rs. 5 lakhs.

Each insurer is required to have an AML policy and accordingly file a copy with IRDAI. The AML program should include:

i. Internal policies, procedures and controls
ii. Appointment of a principal compliance officer
iii. Recruitment and training of agents on AML measures
iv. Internal audit/control

8. Know Your Customer (KYC)

Know your customer is the process used by a business to verify the identity of their clients. Banks and insurers are increasingly demanding their customers provide detailed information to prevent identity theft, financial fraud and money laundering.

The objective of KYC guidelines is to prevent financial institutions from being used by criminal elements for money laundering activities.

Insurers, hence, need to determine the true identity of their customers. Agents should ensure that proposers submit the proposal form along with the following as part of the KYC procedure:

1. Photographs
2. Age proof
3. Proof of address - driving license, passport, telephone bill, electricity bill, bank passbook etc.
4. Proof of identity - driving license, passport, voter ID card, PAN card, etc.
5. Income proof documents in case of high-value transactions

DOCUMENTATION - POLICY CONDITION - II

A. Policy conditions and privileges

1. Grace period

Every life insurance contract undertakes to pay the death benefit on the condition that the premiums have been paid up to date and the policy is in force. The "Grace Period" clause grants the policyholder an additional period of time to pay the premium after it has become due.

The standard length of the grace period is one month or 31 days. The days of grace may be computed from the next day after the due date fixed for payment of the premium. The provision enables a policy that would otherwise have lapsed for non-payment of premium, to continue in force during the grace period.

The premium however remains due and if the policyholder dies during this period, the insurer may deduct the premium from the death benefit. If premiums remain unpaid even after the grace period is over, the policy would then be considered lapsed and the company is not under obligation to pay the death benefit. The only amount payable would be whatever is applicable under the non-forfeiture provisions. In a sense the insured may thus be said to have received free insurance during the grace period.

2. Lapse and Reinstatement / Revival

We have already seen that a policy may be said to be in lapse condition if premium has not been paid even during the days of grace. The good news is that practically all the permanent life insurance contracts permit reinstatement (revival) of a lapsed policy.

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

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

i. **No increase in risk for insurer:** Revival of a policy cannot result in an increase in risk for the insurance company

ii. **Creation of reserve:** The policyholder must pay such amount of premiums with interest, as would lead to creation of the same reserve it would have accumulated if the policy had not lapsed.

iii. **Revival application within specific time period:** The policy owner must complete the revival application within the time frame stated in the provision for such reinstatement. In India revival must be affected within a specific time period, say five years, from the date of lapse.

iv. **Satisfactory evidence of continued insurability:** The insured mustpresent to the insurance company satisfactory evidence of continued insurability of the insured. Not only must her health be satisfactory but other factors such as financial income and morals must not have deteriorated substantially.

v. **Payment of overdue premiums with interest:** The policy owner is required to make payment of all overdue premiums with interest from due date of each premium.

vi. **Payment of outstanding loan:** The insured must also pay any outstanding policy loan or reinstate any indebtedness that may have existed.

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

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

i. One is where the grace period has expired since long and the policy is in a lapsed condition for say, nearly a year.

ii. Another situation is where the insurer has reason to suspect that a health or other problem may be present. Fresh medical examination may also be required if the sum assured or face amount of the policy is large.

Since a revival may require the policyholder to pay a sizeable sum of money (past arrears of premium and interest) for the purpose, each policyholder must decide whether it would be more advantageous to revive the original policy or purchase a new policy. **Revival is often more advantageous because buying a new policy would call for a higher premium rate based on the age the insured has attained on date of revival.**

a) Policy revival measures

Let us now look at some of the ways through which policy revival can be accomplished. In general one can revive a lapsed policy if the revival is within a certain period (say 5 years) from the date of first unpaid premium.

i. Ordinary revival

The simplest form of revival is one that involves payment of arrears of premium with interest. This has been termed as ordinary revival and is affected when the policy has acquired surrender value. The insurer would also call for a declaration of good health or some other evidence of insurability like a medical examination.

iii. Special revival

What do we do when the policy has run for less than three years and has not acquired minimum surrender value (i.e. the accumulated reserves or cash value is insignificant) but the period of lapse is large?, say the policy is coming up for revival after a period of one year or more since the date of first unpaid premium.

One way to revive it is through a scheme known as special revival (which is for instance prevalent in LIC of India). Here it is as though a new policy has been written, whose date of commencement is within two years of the original date of commencement of the lapsed policy. The maturity date shall not exceed the original stipulated period as applicable to certain lives at the time of taking the policy.

iv. **Loan cum revival**

Yet a third approach to revival also available with LIC and other companies is that of loan cum revival. This is not a revival alone but involves two transactions:

- the simultaneous granting of a loan and
- revival of the policy

Arrears of premium and interest are calculated as under ordinary revival. The loan that one is eligible to get under the policy as on date of revival is also determined. This loan may be utilised as consideration amount for revival purposes. If there is any balance amount subsisting after loan adjustment towards arrears of premium and interest, it is payable to the policyholder. Obviously, the facility of loan cum revival would be allowed only for policies that have acquired surrender value as on date of revival.

v. **Instalment revival**

Finally we have instalment revival which is allowed when the policyholder is not in a position to pay arrears of premium in a lump sum and neither can the policy be revived under special revival scheme. The arrears of premium in such case would be calculated in the usual manner as under an ordinary revival scheme.

Depending on the mode of payment (quarterly or half yearly) the life assured may be required to pay one half yearly or two quarterly premiums. The balance of arrears to be paid would then be spread so as to be paid with future premiums on premium due dates, during a period of two years or more, including the current policy anniversary year and two full policy anniversaries thereafter. A condition may be imposed that there should be no outstanding loan under the policy at the time of revival.

3. Non-forfeiture provisions

One of the important provisions under the Indian Insurance Act (Section 113) was that which allowed for accrual of certain benefits to policyholders even when they are unable to keep their policies in full force by payment of further premiums. The logic, which applies here, is that the policyholder has a claim to the cash value accumulated under the policy.

The law in India thus provided that if premiums have been paid for at least three consecutive years there shall be a guaranteed surrender value.

Recently this provision is amended saying it (GSV) will be specified by R egulations. If the policy has not been surrendered it shall subsist as a policy with a reduced paid up value. The policy provisions usually provide for a more liberal surrender value than that required by law.

a) Surrender values

Life insurers normally have a chart that lists the surrender values at various times and also the method that will be used for calculating the surrender values. The formula takes into account the type and plan of insurance, age of the policy and the length of the policy premium-paying period. The actual amount of cash one gets in hand on surrender may be different from the surrender value amount prescribed in the policy.

This is because paid up additions, bonuses or dividend accumulations, advance premium payments or gaps in premiums, policy loans etc. may result in additions or subtractions from the cash surrender value accrued. What the policyholder ultimately receives is a net surrender value. Surrender Value is a percentage of paid-up value.

Surrender Value arrived as a percentage of premiums paid is called Guaranteed Surrender Value.

b) Policy loans

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

In that case however the insurance would also have been terminated. By instead taking a loan on the policy, a policyholder is able to keep the cake and eat it too. A loan provides access to liquid funds while keeping the insurance alive. A loan is what you would recommend to a client in need of urgent funds but you would like to keep him or her as your client.

4. Special policy provisions and endorsements

a) Nomination

I. **Nomination** is where the life assured proposes the name of the person(s) to whom the sum assured should be paid by the insurance company after their death.
II. The life assured can **nominate one or more than one person** as nominees.
III. Nominees are entitled for **valid discharge** and have to **hold the money as a trustee** on behalf of those entitled to it.
IV. Nomination can be done either **at the time the policy is bought or later**.
V. Under Section39 of the Insurance Act 1938, the holder of a policy on their own life may nominate the person or persons to whom the money secured by the policy shall be paid in the event of their death.

Nomination can be changed by making another endorsement in the policy.

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

Where more than one nominee is appointed, the death claim will be payable to them jointly, or to the survivor or survivors. **No specific share for each nominee can be made.** Nominations made after the commencement of the policy have to be intimated to the insurers to be effective.

Provisions related to nomination

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

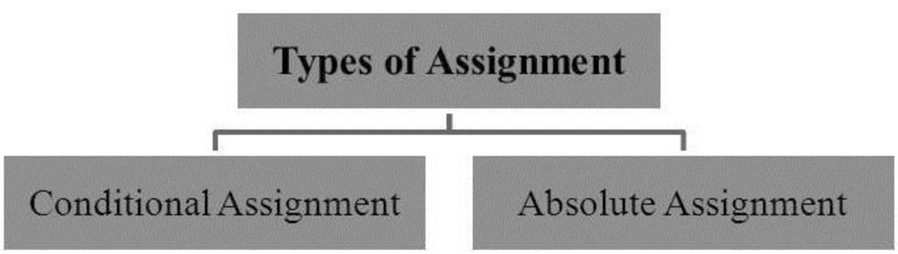
Assignment

The term assignment ordinarily refers to transfer of property by writing as distinguished from transfer by delivery. The ownership of property consists of various rights in respect of such property, which are vested in one or more persons.

On assignment, nomination is cancelled, except when assignment is made to insurance company for a policy loan.

The assignment of a life insurance policy implies the act of transferring the rights right, title and interest in the policy (as property) from one person to another. The person who transfers the rights is called **assignor** and the person to whom property is transferred is called **assignee**.

There are two types of assignments



Conditional assignment provides that the policy shall revert back to the life assured on his or her surviving the date of maturity or on death of the assignee.

Absolute assignment provides that all rights, title and interest which the assignor has in the policy are transferred to the assignee without reversion to the former or his/her estate in any event. The policy thus vests absolutely with the assignee. The latter can deal with the policy in whatever manner he or she likes without the consent of the assignor.

The assignment has to be in writing and must be signed and attested by at least one witness. The fact of transfer of title has to be specifically set forth in the form of an endorsement on the policy. It is also necessary that the policyholder must give notice of the assignment to the insurer. **Unless such notice in writing is received by the insurer, the assignee would not have any right of title to the policy.**

Provisions related to assignment of insurance policies

As per recent amendment in the Insurance Act, a life insurance policy can be assigned wholly or partially. In case of a partial assignment, liability of an insurer shall be limited to the amount secured by partial assignment. The policy holder can not further assign the residual amount under the policy.

An insurer may accept or refuse the assignment and communicate the reasons for refusal within 30 days from the date of notice of assignment by the policy holder. Any person aggrieved by the decision of the insurer may appeal to the Authority.

The rights of an assignee existing prior to the current amendment shall not be affected by the current provision under section 38.

Nomination Vs. Assignment

Basis of Difference	**Nomination**	**Assignment**
What is Nomination or Assignment?	Nomination is theprocess ofappointment of aperson to receive thedeath claim	Assignment is the process of transferring the title of the insurance policy to another person or institution.
When can the nomination or assignment be done?	Nomination can be done either at the time of proposal or after the commencement of the policy.	Assignment can be done only after commencement of the policy.
Who can make the nomination or assignment?	Nomination can be made only by the life-assured on the policy of his own life.	Assignment can be done by owner of the policy either by the life assured if he is the policyholder or the assignee
Where is it applicable?	It is applicable only where the Insurance Act, 1938 is applicable.	It is applicable all over the world, according to the law of the respective country relating to transfer of property.
Does the policyholder retain control over the policy?	The policyholder retains title and control over the policy and the nominee has no right to sue under the policy	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.
Is a witness required?	Witness is not required.	Witness is mandatory.
Do they get any rights?	Nominee has no rights over the policy.	Assignee gets full rights over the policy, and can even sue under the policy.

Can it be revoked?	Nomination can be revoked or cancelled at any time during the policy term.	The assignment once done cannot be cancelled, but can be re-assigned.
In case of minor:	In case the nominee is a minor, appointee has to be appointed.	In case the assignee is a minor, a guardian has to be appointed.
What happens in case of the nominee's or assignee's death?	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	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?	Creditors can attachthe insurance policywhich has a nomination in it.	Creditors cannot attach the policy unless the assignment is shown to have been made to defraud the creditors.

Duplicate Policy

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

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

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

Alteration

Policyholders may seek to effect alterations in policy terms and conditions. There is provision to make such changes subject to consent of both the insurer and assured.

Normally alterations may not be permitted during the first year of the policy, except for change in the mode of premium or alterations which are of a compulsory nature - like

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

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

Some of the main types of alterations that are permitted are:

I. Change in certain classes of insurance or term (where risk is not increased)
II. Reduction in the sum assured
III. Change in the mode of payment of premium
IV. Change in the date of commencement of the policy
V. Splitting up of the policy into two or more policies
VI. Removal of an extra premium or restrictive clause
VII. Change from without profits to with profits plan
VIII. Correction in name
IX. Settlement option for payment of claim and grant of double accident benefit

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

Insurance companies everywhere are generally allowed to select the actual wording of their policy documents, but these may need to be submitted to the regulator for approval

UNDERWRITING

Underwriting - Basic concepts

1. Underwriting purpose

We begin with examining the purpose of underwriting. There are two purposes

i) To prevent anti-selection or selection against the insurer
ii) To classify risks and ensure equity among risks

Definition

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

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

2. Equity among risks

Let us now consider equity among risks. The term "Equity" means that applicants who are exposed to similar degrees of risk must be placed in the same premium class. We have already seen how life insurers use a mortality table to determine the premiums to be charged. The table represents the mortality experience of standard lives or average risks. They include the vast majority of individuals who propose to take life insurance.

a) Risk classification

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

i. Standard lives

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

ii. Preferred risks

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

iii. Substandard lives

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

iv. **Declined lives**

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

2. **Selection process**

Underwriting or the selection process may be said to take place at two levels:

- At field level
- At underwriting department level

Field or Primary level

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

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

A similar kind of report, which has been called as **Moral Hazard report**, may also be sought from an official of the life insurance company. These reports typically cover the occupation, income and financial standing and reputation of the proposed life.

Underwriting department level

The second level of underwriting is at the department or office level. It involves specialists and persons who are proficient in such work and who

consider all the relevant data on the case to decide whether to accept a proposal for life insurance and on what terms.

Underwriting decisions

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

a) **Acceptance at ordinary rates (OR)** is the most common decision. This rating indicates that the risk is accepted at the same rate of premium as would apply to an ordinary or standard life.
b) **Acceptance with an extra:** This is the most common way of dealing with the large majority of sub-standard risks. It involves charging an extra over the tabular rate of premium.
c) **Acceptance with a lien on the sum assured:** A lien is a kind of hold which the life insurance company can exercise (in part or whole) on the amount of benefit it has to pay in the event of a claim.

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

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

Non-medical underwriting

Non-medical underwriting

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

The case for non-medical underwriting lies in the finding that medical examinations bring out adverse features only in a small proportion (say one tenth) of the cases. The rest can be found out from the answers given in the proposal or the proposed life's leave records and other documents.

Conducting a medical examination by a qualified doctor would require that fees be paid to the doctor. The cost that can be saved by not conducting such examination is found to be much more than the loss that the life insurer may suffer on account of extra death claims arising as a result of bypassing a medical test. Life insurers have hence adopted the practice of granting insurance without insisting on a medical examination.

Conditions for non-medical underwriting

However non-medical underwriting calls for certain conditions to be followed.

i. Firstly **only certain categories** of females, like working women, may be eligible.

ii. **Upper limits on sum insured** may be imposed. For example, any case having a sum assured beyond five lakhs may need to be subjected to a medical examination.

iii. **Age at entry limits** may be imposed - for example, anyone above 40 or45 years of age has to compulsorily get a medical examination done.

iv. Restriction being imposed with regard to **certain plans of insurance** -term insurance for example may not be allowed under non-medical category.

v. **Maximum term of insurance** may be limited to twenty years /up to age 60.

vi. **Class of lives:** Non-medical insurance may also be allowed to certain specific categories of individuals, for instance, non-medical special is provided to employees of reputed firms - having one year service. These companies have proper leave records and may also have periodic medical examinations so that the employee's medical status can be easily verified.

3. Rating factors in underwriting

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

Let us understand how the characteristics of an individual life have an impact on the risk. Broadly these may be divided into two - those which contribute to moral hazard and those which contribute to physical [medical] hazards. Life insurance companies often divide their underwriting into categories accordingly. Factors like income, occupation, lifestyle and habits, which contribute to moral hazard, are assessed as part of **financial underwriting**, while medical aspects of health are appraised as part of **medical underwriting**.

a. Female insurance

Women generally have greater longevity than men. However they may face some problems with respect to moral hazard. This is because many women in Indian society are still vulnerable to male domination and social exploitation. Evils like dowry deaths are prevalent even today. Another factor which can affect longevity of women can arise from problems connected with pregnancy.

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

b. Minors

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

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

i. **Whether they have a properly developed physique**
   Poor growth of physique can arise as a result of malnutrition or other health problems posing grave risks.

Ii. **Proper family history and personal history**
   If there are adverse indicators here, it may pose risks.

iii. **Whether the family is adequately insured**
   Insurance of minors is generally pursued by families having a culture of insurance. One would thus need to be alert when receiving a proposal on a child's life where the parents have not been insured. The underwriter would need to ascertain why such insurance has not been taken. Amount of insurance is also linked to that of parents.

c. Large sums assured

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

d. Age

As we have seen elsewhere in this course, the mortality risk is closely related to age. The underwriter needs to be careful when considering insurance for people who are of advanced ages.

An important part of the underwriting process is admission of age, after verifying the proof of age. There are two types of age proofs

- ✓ Standard
- ✓ Non-standard

Standard age proofs are normally issued by a public authority. Instances are

- the birth certificate which is issued by a municipality or other government body;
- the school leaving certificate;
- the passport; and
- the employers' certificate

Where such proofs are not available, the proposer may be asked to bring a **non-standard age proof**. Examples of the latter are the horoscope; a self-declaration

When a standard age proof is not available, non-standard age proof should not be accepted readily. Often, life insurers would impose certain restrictions with respect to plan of insurance, term of assurance; maximum maturity age and maximum sum assured.

e. Moral hazard

Moral hazard may be said to exist when certain circumstances or characteristics of an individual's financial situation, lifestyle and habits, reputation and mental health indicate that he or she may intentionally engage in actions that increase the risk. There may be a number of factors which may suggest such moral hazard.

f. Occupation

Occupational hazards can emanate from any of three sources:

- Accident
- Health hazard
- Moral hazard

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

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

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

g) **Lifestyle and habits** Lifestyle and habits are terms, which cover a wide range of individual characteristics. Generally the agents' confidential reports and moral hazard reports are expected to mention if any of these characteristics are present in the individual's lifestyles, which suggest exposure to risk. In particular three features are important:

i. **Smoking and tobacco use**: It has now been well recognised that use of tobacco is not only a risk in itself but also contributes to increasing other medical risks. Companies charge differential rates today for smokers and non-smokers with the former having to pay much higher premiums. Other forms of tobacco usage like gutkha and paan masala may also attract adverse mortality ratings.

ii. **Alcohol:** Drinking alcohol in modest quantities and occasionally is not a hazard. It is even an accepted part of social life in many countries. However when it is regularly consumed in excess for a long time it can have a significant impact on mortality risk. Long term heavy drinking can impair liver functioning and affect the digestive system. It can also lead to mental disorders.

Alcoholism is also linked with accidents, violence and family abuse, depression and suicides. Where the proposal form indicates use of alcohol, the underwriter may call for further details and decide on the case depending on the extent of usage and any complications that are indicated to have been caused as a result.

iii. **Substance abuse**: Substance abuse refers to the use of various kinds of substances like drugs or narcotics, sedatives and other similar stimulants. Some of these are even illegal and their use indicates criminal disposition and moral hazard. Where substance abuse is suspected, the underwriter may need to call for a number of tests to check the abuse. Insurance is often declined in such cases.

Medical underwriting

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

a. **Family history**

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

i. **Heredity**: Certain diseases can be transmitted from one generation to another, say from parents to children.

ii. **Average longevity of the family**: When the parents have died early on account of certain diseases like heart trouble or cancer, it may be a pointer that the offspring may also not live long.

iii. **Family environment**: Thirdly, the environment in which the family lives can cause exposure to infection and other risks.

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

b) Personal history

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

c) Personal characteristics

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

i. Build

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

ii. Blood pressure

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

- ✓ Systolic
- ✓ Diastolic

iii. Urine - Specific gravity

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

Types of claims and claims procedure

Concept of claims

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

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

Claims can be of two types:

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

While a **death claim** arises only upon the death of the life assured, **survival claims** can be caused by one or more events.

A **maturity or death claim** or a surrender leads to termination of the insurance cover under the contract and no further insurance cover is available. This is irrespective of whether the claim is actually paid or not. Non-payment of a claim does not assure the continuity of insurance cover under the contract.

Types of claims

The following payments may occur during the policy term:

a) Survival Benefit Payments

Periodical payments are made by the insurer to the insured at specified times during the term of the policy. The policy bond is returned to the policyholder bearing an endorsement of payments made after each survival benefit instalment.

b) Surrender of Policy

The policyholder opts for a premature closure of his policy. This is a voluntary termination of the policy contract. A policy can be surrendered only if it has acquired paid-up value. The amount payable to the insured is the **surrender value** which is usually a percentage of the premiums paid. There is also a minimum guaranteed surrender value (GSV), but the actual surrender value paid to the insured is more than the GSV.

d) Rider Benefit

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

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

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

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

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

e) Maturity Claim

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

i. **Participating Plan:** The amount payable under a maturity claim, if participating, is the sum assured plus accumulated bonuses less dues such as outstanding premium and policy loans and interests thereon.
ii. **Return of Premium (ROP) Plan:** In some cases premiums paid over the term period are returned when the policy matures.

iii. Unit Linked Insurance Plan (ULIP): In case of ULIPs, the insurer pays the fund value as the maturity claim.

iv. Money-back Plan: In case of money-back policy, the insurer pays the maturity claim minus the survival benefits received during the term of the policy.

The insurance contact terminates after the claim is paid.

e) Death Claim

If the insured expires during the term of his / her policy, accidentally or otherwise, the insurer pays the sum assured plus accumulated bonuses, if participating, less dues like outstanding policy loan and premia plus interest there on respectively. This is the **death claim**, which is paid to the nominee or assignee or legal whatever the situation may be. A death claim marks the end of the contract as a result of death.

A death claim may be:

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

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

i. Forms to be submitted for death claim

The following forms are to be submitted by the beneficiary with the insurer to facilitate processing of the claim:

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

ii. Repudiation of death claim

The death claim may be paid or repudiated. While processing the claim, if it is detected by the insurer that the proposer had made any incorrect statements or had suppressed material facts relevant to the policy, the contract becomes void. All benefits under the policy are forfeited.

iii. Section 45: Indisputability Clause

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

Section 45 states:

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

iv. Presumption of Death

Sometimes a person is reported missing without any information about his whereabouts. The Indian Evidence Act provides for presumption of death in such cases, if he has not been heard of for seven years. If the nominee or heirs claim that the life insured is missing and must be presumed to be dead, insurers insist on a decree from a competent court. It is necessary that premiums should be paid till the court decrees presumption of death. Insurers may, as a matter of concession, waive the premiums during the seven year period.

Role of an agent

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

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