7

Other key financial products

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Learning objectives

After studying this chapter, you should be able to:

- explain the other financial needs of an individual;
- explain the types of products available and their features and benefits;
- outline the tax implications for financial products;
- describe the inflation implications for financial products;
- prioritise client needs and apply other financial products to meet those needs.

Introduction

In the previous two chapters we have learnt about the various needs of an individual relating to life insurance and savings/investments and the products that address those needs. In this chapter we will cover the other financial needs an individual might have which are of equal importance as those studied in the previous two chapters.

Key terms

This chapter features explanations of the following ideas:

Health insurance	Insurance riders	Pension plan	Cashless facility
No-claim bonus	Accumulation phase	Commutation	Individual health insurance plan
Family floater	Daily hospitalisation cash benefit plan	Accidental death benefit rider	Critical illness rider
Term rider	Waiver of premium rider	Life annuity	Guaranteed period annuity
Increasing annuity	Accumulation phase	Prioritising needs	

A Other financial needs

Life expectancy in India is now well above the retirement age of 60 years and is constantly improving thanks to greater access to healthcare and the rising standards of living. The increased likelihood of a long life, however, also brings challenges.

We have already seen how insurance companies cover the risk of early death through traditional products (such as term, endowment, money-back, ULIPs etc.). However, pension/retirement products cover the risk of living too long by providing retired people with the means to pay for their continued living expenses in the absence of any regular income. We will learn about retirement pension products offered by insurance companies in this chapter.

Our vulnerability to illness and disease also increases as we grow older, and insurance companies offer healthcare products to meet the medical expenses that arise in these circumstances. We will learn about the various healthcare products provided by insurance companies in this chapter.

Before we move on, however, let's consider the following case study.

Case study

Rajesh is retired and enjoys spending time with his grandson. Unfortunately, a year ago Rajesh had an accident and had to be hospitalised for his injuries. The small amount of money Rajesh had saved for his retirement had to be spent in paying the hospital bill and wiped out his only source of income, leaving Rajesh dependant on his son for the remainder of his life.

So how and where did Rajesh get his financial planning wrong?

The fundamental point is that Rajesh had not opted for any health insurance cover. Had he bought a health insurance plan, it would have taken care of the hospitalisation expenses. Also, whatever little money Rajesh had saved for his retirement was invested in bank fixed deposits rather than a pension plan to ensure a regular monthly income.

In this section we will study the features and benefits of various health insurance plans and retirement plans.

A1 Need for health insurance

As we have already discussed, in the last few years healthcare facilities have much improved in India. However, this has come at a cost, with medical expenses soaring in recent years. Today the cost of a major operation or the need for a lengthy period of hospital treatment can be very expensive. Coupled with improved life expectancy and the corresponding vulnerability to illness and disease, the need for health insurance is now greater than ever before. A health insurance plan pays the individual and their family for expenses incurred in the event of hospitalisation. It covers doctors' fees, room rent, medicines and other related costs as specified in the policy terms and conditions.

Health insurance (also known as medical insurance or mediclaim) is needed for the following reasons:

- Life is very uncertain. A person may not stay healthy and fit throughout their life and so it is prudent to have health cover at every stage of life.
- The cost of healthcare has risen significantly in the last few years. If a major illness like heart failure, cancer or diabetes is diagnosed and the funds for treatment cannot be immediately arranged then it may lead to loss of life. If the family resorts to costly personal loans for treatment and the life of the person cannot be saved then the family could incur huge debts. Having health insurance cover can help to overcome this problem.
- The age of a person at the time of taking the health cover is relevant; the higher the age, the higher the premium will be. As these are annually renewable policies the cost will increase as the person gets older, regardless of the age of the policyholder when the policy commences. It also depends on the claims experience.

Be aware

Health insurance policies specify what they do and don't cover. The policy wordings should be read carefully.

Consider this…

Have any of your family members or friends taken out health insurance? Find out the features and benefits of the health insurance plan that they have bought.

A2 Need for insurance riders

Riders are additional benefits that can be added to insurance policies. A rider is a condition or a clause that is added to the base plan by paying extra premium, i.e. additional benefit = additional premium. If the base plan does not have some feature that an individual is looking for then it can be added through a rider (if available).

One way of explaining the concept of riders is by using the example of ice-cream scoops (flavours); the base insurance plan chosen by the individual acts as a base cone on which the individual can pick the riders they would like to add, in the same way you might choose different scoops (flavours) of ice-cream on the same cone.

Most insurers specify in product brochures or product features as to which riders are available with each product. Riders provide flexibility in the customisation of a plan to suit the needs of an individual, rather than purchasing multiple insurance plans. See section B3 for more detail on riders.

A3 Need for pension plans

With the steady increase in life expectancy, it is very important for an individual to make savings during their working years so that they can continue with a similar lifestyle during their retirement, when there will be no regular monthly income to provide for everyday living expenses.

A retirement plan is essential for anyone wishing to enjoy their post-retirement life in peace and comfort.

During an individual's working life it is possible to buy a retirement insurance plan to which a small amount can be contributed on a monthly basis. In this way a lump sum can be accumulated by the time the individual reaches retirement age, allowing them to buy a pension plan that will provide a monthly income throughout retirement.

Consider this…

Ask your parents (if retired) or your grandparents about the financial products they invested in during their working lives for their retirement.

B Types of products, their features and benefits

B1 Types of health plan

There are basically four types of health plan available in the market. Let's look at each of them in turn:

B1A Individual health insurance plan

As the name specifies this plan covers a single individual and caters for their health requirements.

Example

Ajay and Tina are a married couple. Prior to their marriage Ajay had taken out an individual health insurance policy from Company ABC for a cover of Rs. 1,00,000 which caters for his health requirements. Tina also has taken a separate individual health insurance policy from Company ABC for a cover of Rs. 1,00,000 which caters for her health requirements.

B1B Family floater health insurance plan

A family floater plan is different from an individual health plan. In this type of plan family members can be covered. An individual can cover themself, their spouse, children and parents. The insurance company may specify the number of people that can be covered. In this type of plan the insurance cover is shared among the family members covered in no fixed proportions.

Example

Ajay and Tina are a married couple and they buy a family floater health insurance plan with a cover of Rs. 2,00,000. This cover of Rs. 2,00,000 can be shared by Ajay and Tina in no fixed proportion. Regardless of whether either or both are hospitalised, the maximum payout would always be Rs. 2,00,000.

B1C Group health insurance plan

This health insurance plan provides cover to a group of people who are brought together for a common objective. For example, a group can be the employees of a company. Many employers provide health cover for their employees to protect them against medical emergencies and some extend the group health cover to the families of the employees.

Example

Ajay is working with a private company. The company provides group health insurance cover to its employees and their family members. So Ajay can also include his wife Tina in the company health insurance plan.

B1D Daily hospitalisation cash benefit plan

In this type of health plan the insurance company pays the insured a fixed amount on a daily basis in the event of hospitalisation. The daily amount is fixed at the time of taking out the policy and is paid for the number of days the insured is hospitalised, irrespective of the actual amount spent on treatment (subject to the terms and conditions of the policy). The daily amount paid is fixed and may be more or less than the cost of actual treatment.

The insurance company may pay an additional amount on a daily basis if the insured is admitted to the Intensive Care Unit (ICU). In the case of critical illness or surgery an additional lump sum amount may be paid subject to the terms and conditions of the policy. The daily amount paid under this policy can be in addition to any other medical insurance policy that the insured may have. The policy has a limit on the total number of days in a year for which the daily hospitalisation cash benefit can be used. This is specified in the policy terms and conditions.

Example

Please note: The amounts and figures mentioned below are just examples, and the actual amounts in the case of daily hospitalisation cash benefit plans may vary among insurance companies.

Ajay is working with a private company. The company provides group health insurance cover to its employees and their family members, so Ajay can also include his wife Tina in his company health insurance plan. However, Ajay feels the cover given by the company is inadequate so he decides to take out a daily hospitalisation cash benefit plan to supplement the health cover given by his company.

The daily hospitalisation cash benefit plan which Ajay has chosen promises to pay Rs. 2,000 per day in the event of hospitalisation. The insurance company also specifies that if Ajay is admitted to ICU then an additional payment of Rs. 2,000 per day will be made. However, the insurance company also specifies that there will be an annual limit of Rs. 1,20,000 that will apply for the daily hospitalisation benefit amount, and an annual limit of Rs. 1,20,000 that will apply for the ICU daily benefit amount. This effectively means that in a year Ajay can claim compensation for 60 days. The insurance company also specifies that if Ajay suffers from a critical illness then a lump sum payment of Rs. 50,000 will be made.

The above fixed payments will be made by the insurance company irrespective of the actual hospitalisation expenses incurred by Ajay, and are over and above the claim that Ajay can make under the health plan from his company.

B2 Features and benefits of health plans

Health insurance plans come with various features and benefits. Some of these include:

1. **Pricing**: the premium for a health insurance plan depends on the individual's age, fitness, habits and family medical history. If all other factors remain constant, premiums increase with the age of the policyholder. So it is always better to take out a health plan as early as possible as the premium paid at younger ages is not very significant but will increase as the policyholder gets older.

Example

Karan has bought a health insurance policy for a cover of Rs. 3,00,000 by paying an annual premium of Rs. 7,000. Karan suffers a major heart attack and has to undergo an operation. The hospital bill amounts to Rs. 2,50,000 which is taken care of by the health insurance company. So in this case the premium of Rs. 7,000 is hardly anything compared to the benefit that Karan has had by buying the policy.

2. **Cashless facility**: some health plans offer a cashless facility. In these plans the person covered under the plan is given a photo identity card. The insured needs to inform their health insurance company at the time of their admission to a network hospital. This is the group of hospitals that have contracted with a health insurance company to provide healthcare services. On approval the insured does not pay the hospital deposit amount or the treatment expenses, rather the invoices are settled directly by the insurance company as per the terms and conditions specified in the policy.

Be aware

Not all costs will be covered by the insurance company. There may be some expenses that might be excluded from the cover. These vary from company to company.

In the case of admission to a non-network hospital, the insured has to settle the hospital bill themselves and is later reimbursed by the insurance company, subject to the submission of required documents and other terms and conditions of the policy.

3. **Medical examinations**: most health insurance companies require the proposer to undergo a medical examination before the policy can be issued and, depending on the age of the proposer, a number of tests may be carried out. Based on the doctor's report, the health insurance company decides whether to accept the proposal and at what price.
4. **Pre-existing illnesses**: most health insurance policies cover pre-existing illnesses after a specified time period; commonly referred to as a 'waiting period'. Some insurance companies may exclude some pre-existing illnesses altogether and this information is specified in the policy terms and conditions; for example a pre-existing illness like diabetes may be covered after, say, three or four years. The terms and conditions relating to treatment of existing illnesses may vary from company to company.
5. **No-claim bonus**: if there is no claim in a year then, at the time of renewal, the insurance company may offer a no-claim bonus, i.e. the insurance company will give a discount in the premium due next year.
6. **Permanent exclusions**: health insurance plans have some permanent exclusions which are specified in the policy, e.g. misuse of drugs or not following medical advice.
7. **Immediate care**: treatment is available immediately and at a time convenient to the policyholder. There will be no waiting for a future appointment whilst the policyholder is suffering from a treatable medical condition.
8. **No need for lump sums from savings or loans**: the policyholder does not have to worry about how to manage when the need for medical payments arise because these will be paid by the insurance company as a result of the premiums already paid.

B3 Riders

As discussed in section A2, riders allow policyholders to customise their insurance cover with additional benefits. In this section we shall consider some examples of riders.

B3A Accidental death benefit (ADB) rider

In the event of the death of the insured due to an accident, this rider provides for an additional amount over and above the normal sum insured, as specified at the time of taking the rider. The death should be a result of an accident by external, violent, unforeseeable and visible means. The payment made under this rider is subject to terms and conditions specified in the policy.

An ADB rider has a high significance in India considering the increasing number of deaths due to accidents. The insurance company specifies the products with which this rider can be taken and also specifies the list of exclusions under which the benefit of the rider will not be payable.

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Example

Mahesh wants to take out a term insurance policy for a cover of Rs. 25,00,000 from ABC Insurance Company. He also wants to opt for an accidental death benefit (ADB) rider.

ABC Insurance Company has specified the following terms and conditions for the ADB rider:

Minimum entry age	15 years
Maximum entry age	55 years
Maximum age at maturity	60 years
Minimum sum insured	Rs. 50,000
Maximum sum insured	Rs. 10,00,000 or the base sum insured, whichever is lower
Death must occur within 180 days from the date of the accident	

Analysis of the above terms and conditions:

- Mahesh can take out this rider only at the age of 15 years and above, but not after 55 years of age.
- On Mahesh reaching 60 years of age, the rider will automatically expire even though the base policy may continue.
- Mahesh cannot opt for the rider for a sum insured of less than Rs. 50,000.
- Mahesh can opt for this rider for a maximum sum insured of Rs. 10,00,000 or the base sum insured (in this case Rs. 25,00,000), whichever is lower. So in this case Mahesh can opt for an ADB rider for a maximum sum insured of Rs. 10,00,000.
- If Mahesh meets with an accident which results in his hospitalisation and eventual death nine months after the accident then the insurance company will not pay the nominee the benefit amount under the ADB rider, although the base policy amount will be paid. For the benefit amount under this rider to be paid the insured person's death must occur within 180 days of the accident.

* **Please note** that this is just an example of one insurance company and the terms and conditions for an ADB rider may vary among insurance companies.

B3B Term rider

This rider can be used to enhance the death cover amount in a policy at a nominal cost. If an individual wants a savings policy like an endowment policy or money-back policy and at the same time wants to increase the death cover without buying a separate term insurance policy, then they can opt for this rider. The insurance company specifies the products with which this rider can be taken and also specifies the list of exclusions under which the benefit of the rider will not be payable.

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Question 7.1

List some of the features and benefits of health plans.

Chapter 7

Example

Mahesh wants to take out an endowment plan to accumulate Rs. 25,00,000 for his son's education in 20 years time. Mahesh also wants additional term insurance cover of Rs. 10,00,000, but at the same time he does not want a separate term insurance plan. So in this case Mahesh can opt for an endowment plan with a sum insured of Rs. 25,00,000 as the base policy and add a term insurance rider with a sum insured of Rs.10,00,000.

The insurance company has specified the following terms and conditions for the term insurance rider:

Minimum entry age	15 years
Maximum entry age	55 years
Maximum age at maturity	60 years
Minimum sum insured	Rs. 50,000
Maximum sum insured	Equal to the base sum insured

Analysis of the above terms and conditions:

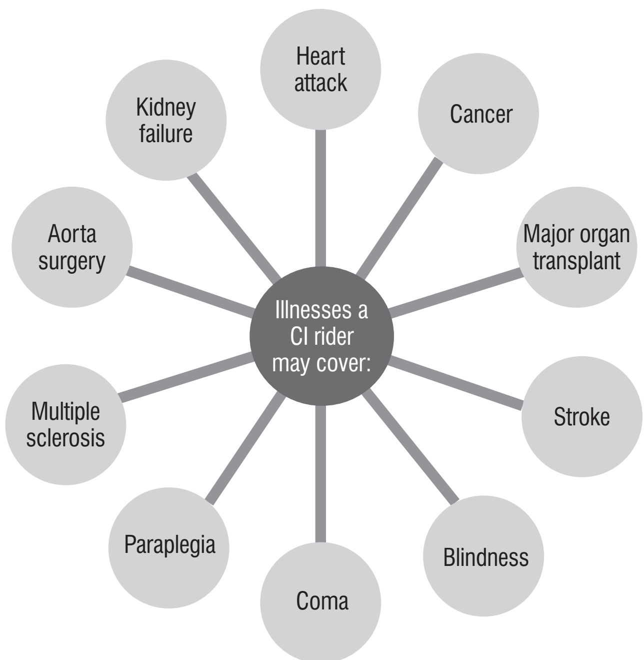
- Mahesh can take out this rider only at the age of 15 years and above, but not after 55 years of age.
- On Mahesh reaching 60 years of age the rider will automatically expire even though the base policy may continue.
- Mahesh cannot opt for this rider for a sum insured of less than Rs. 50,000.
- Mahesh can opt for this rider for a maximum amount equivalent to the base sum insured (in this case Rs. 25,00,000). So Mahesh can opt for a term rider for a maximum sum insured of Rs. 25,00,000, although his requirement is only Rs. 10,00,000.
- If Mahesh dies during the tenure of the policy then his nominee/beneficiary will get the base policy sum insured of Rs. 25,00,000 and term rider sum insured of Rs. 10,00,000 as per the policy terms and conditions.

Please note that this is just an example of one insurance company and the terms and conditions for term rider may vary among insurance companies.

B3C Critical illness (CI) rider

This rider provides payment of a specified amount on the diagnosis of a critical illness (CI). The payment can be used for any purpose including payment for medical treatment, hospital admissions or assisting with the loss of income after the diagnosis of a CI. The illness should be covered in the list of CIs specified by the insurance company for this rider. The list may differ among insurers.

Figure 7.1



Insurers specify the minimum entry age, maximum entry age, maximum maturity age and minimum and maximum sums insured for the rider. These figures vary among insurers. The insurer may also specify other terms and conditions pertaining to the rider. The insurance company specifies the products with which this rider can be taken and also specifies the list of exclusions under which the benefit of the rider will not be payable.

Be aware

Insurance companies normally pay a lump sum amount under this rider when the policyholder is diagnosed with the CI (payable under the rider) and the rider benefit ceases. Hence subsequent claims under this rider will not be allowed by the insurance company.

Question 7.2

Name five common CIs covered under a CI rider.

B3D Waiver of premium (WOP) rider

This rider waives future premiums in the event of the disability of the policyholder due to illness or accident resulting in their inability to work. The insurance company continues paying the premiums on behalf of the policyholder and the policy continues normally.

This rider is ideal for helping to prevent a policy lapsing due to non-payment of premiums arising from the disability or death of the policyholder.

In the case of some child plans the WOP rider comes built-in, while for others it is an optional benefit. The WOP rider ensures that in the event of the death of the premium-paying parent the policy continues normally and the child's future does not suffer. In such cases, the premium is waived until the intended benefit, as per the policy terms, reaches the child.

Insurers specify the minimum entry age, maximum entry age, maximum maturity age and the minimum and maximum sums insured to which the WOP applies for the rider. These figures vary among insurers. The insurer may also specify other terms and conditions pertaining to the rider. The insurance company specifies the products with which this rider can be taken and also specifies the list of exclusions under which the benefit of the rider will not be payable.

B3E Other riders offered by insurance companies

Some other riders offered by insurance companies include:

Surgical care rider	This rider pays the treatment costs for surgery involving the insured's brain, heart, lungs, liver etc. subject to the terms and conditions specified at the time of opting for the rider.
Hospital care rider	This rider pays the treatment costs in the event of hospitalisation of the policyholder, subject to the terms and conditions specified at the time of opting for the rider. Under this rider payment may be made in two ways. An insurance company may pay the actual cost for the treatment (subject to what is covered in the rider terms) or it may pay a specified amount on a per day basis for the number of days the policyholder is hospitalised. The insurance company may also pay an additional amount on a per day basis if the policyholder is admitted to ICU. The practice among insurance companies varies. This rider is similar to the individual policies mentioned in section B1.
Guaranteed insurability rider	This rider gives the insured the right to increase their cover in response to different life events, such as marriage, child birth, buying a house etc.

B4 Features and benefits of riders

Features and benefits of riders are listed below:

- **Additional cover**: by adding riders the insured can purchase extra protection. Riders help to enhance the quality and scope of cover.
- **Nominal cost**: riders come at a nominal cost compared to buying a new plan. For example if a person buying an endowment plan wants to enhance the death cover, then instead of buying a separate term insurance plan they can add a term rider and enhance the cover at a nominal cost.
- **Customisation**: riders help in customisation of the health plan according to the preference of the customer. Insurers also find it convenient to have a small number of basic plans with riders as options to help the client have a number of options to choose from. Each plan can be taken with one or more riders. Five basic plans and seven riders, effectively provide 35 or more options.
- **Flexibility**: many riders can be added or removed at the will of the policyholder, thus providing a high degree of flexibility.
- **Tax benefits**: premium paid for riders qualifies for deduction from taxable income under relevant sections of the Income Tax Act.

IRDA regulations for riders

As per the IRDA regulations issued in April 2002 and amended in October 2002:

- the premium on all riders relating to health or critical illnesses, in case of term or group insurance products shall not exceed 100% of the premium of the base policy;
- the premium on all the other riders put together should not exceed 30% of the premium on the base policy; and
- the benefits arising under each of the riders shall not exceed the sum insured under the base policy.

By these regulations the IRDA has put a limit on the number of riders that can be offered with any policy. It is possible that these limits may be amended from time to time.

B5 Annuities

Annuities are often described as the 'reverse' of life insurance; under a life insurance contract the insurer starts paying upon the death of the insured, but under an annuity contract the insurer usually stops paying upon the death of the annuitant.

Annuities are bought from life insurance companies. They may be purchased by a single lump sum payment or by a series of regular contributions spread over, possibly, many years. Payment may be made by the person who is to be the annuitant or another annuity purchaser such as the annuitant's employer, other personal benefactor or a pension scheme.

An annuity is a series of regular payments from an annuity provider to an individual, referred to as the annuitant.

Annuities can be either immediate or deferred annuities:

- **Immediate annuities** vest (become payable) immediately after they have been purchased with a lump sum. The annuity payments commence at the end of the month, quarter, half-year or year as per the features of the policy/option exercised by the policyholder.
- **Deferred annuities** are paid for in advance. The annuity purchase price may be a lump sum paid at commencement before the annuity is due to vest (be paid). Alternatively, deferred annuities may be bought by paying instalments over a series of years before vesting date.

Example

Vesting

- At the age of 40 Ajay purchases a retirement plan by paying a lump sum amount of Rs. 10 lakhs to the insurance company.
- Ajay wants to start receiving the annuity payments after his retirement, i.e. at the age of 60. The time from when the annuity will become payable is known as vesting.
- For the in-between 20 years the insurance company will invest the lump sum amount on behalf of Ajay and earn returns on it. On Ajay's retirement the accumulated money will be used to pay a regular annuity to him.
- The retirement date is normally the vesting date as the annuity payments will start from that date.
- At the time of vesting Ajay can decide whether to buy the pension plan from the same insurance company or some other life insurer of his choice. This option to choose the pension provider is known as the open market option.
- At the time of vesting Ajay will have the choice of selecting the type of annuity plan that he would like from the annuity options available to him.
- The annuity payout will depend on the type of annuity chosen and the rates prevailing at the time of vesting.

In practice there are many variations available. Here are some examples:

B5A Life annuity

As the name suggests, in this type of annuity the annuitant keeps receiving annuity payments from the insurance company throughout their lifetime. The annuity payments cease on their death.

For example, if Sanjay buys a life annuity plan then he will keep getting regular annuity payments from the insurance company until he dies.

Be aware

Life annuities (immediate and deferred) are often bought with money that is tied to pension purchase and which cannot be used for any other purpose (see section B6 below on pension plans for more detail).

B5B Guaranteed period annuity

In this type of annuity the annuitant can choose to receive the annuity payment for a minimum fixed number of years such as 5, 10, 15, and 20 or 25 years regardless of whether the annuitant is still alive. If the annuitant dies during the selected term, annuity instalments for the remaining part of the selected term will be paid to the beneficiaries. If the annuitant is still alive after the guaranteed period has elapsed the payments are continued until his death.

B5C Joint life, last survivor annuity

In this type of annuity there are usually two annuitants, e.g. husband and wife. After the first death, regardless of who dies first, the remaining spouse continues to receive the same level of annuity payment throughout their lifetime, i.e. 100% of the level paid whilst they were both alive.

Another variant of this type of annuity is when the annuitant gets annuity payments during their lifetime, and after the death of their spouse (for example) gets annuity payments at a reduced percentage during their lifetime, e.g. 25%, 50% or 75% of the original amount of annuity. With this type of annuity the payments are made at the 100% level as long as the first named annuitant is still alive. If on their death the first named annuitant's spouse is still alive, they will receive the reduced percentage, as stated in the policy, until they die.

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Example

For example, Sanjay and his wife Sheetal opt for a joint annuity. In this case Sanjay will keep getting regular annuity payments from the insurance company during his lifetime. On Sanjay's death, Sheetal will keep getting the reduced annuity payments during her lifetime. After Sheetal's death the annuity payments will stop. If Sheetal dies before Sanjay, then the annuity payments will stop after Sanjay's death.

B5D Life annuity with return of purchase price

In this type of annuity the annuitant receives regular annuity payments during their lifetime. On their death, the original purchase price is returned to the nominee/beneficiary. The purchase price refers to the value of the investment at the end of the accumulation phase (with which the annuity was purchased) or the lump sum amount paid at the time of purchasing the annuity, depending on the circumstances.

B5E Increasing annuity

With this type of annuity the terms can be similar to any of the above, but the annuity increases every year by a fixed percentage or in line with an agreed inflation index.

B6 Pension plans

Pension plans are savings and investment plans tied to the provision of pension benefits for individuals and their dependants. Once contributions are paid into a pension scheme they are locked in the scheme until retirement or earlier death. They cannot be withdrawn to pay debts or buy a new car for example. Pension plans may be provided by employers or by private individuals (for their own benefit).

A retirement pension plan is, in effect, a life annuity starting at retirement.

Features and benefits of pension plans	
Accumulation phase	In a pension plan there are two phases: the accumulation/investment phase and the regular annuity phase. In the accumulation phase, during their working life the individual makes regular contributions or a lump sum contribution which is invested by the insurance company on the client's behalf.
Regular annuity phase	On retirement the individual can use the fund accumulated during the accumulation phase to buy an annuity plan from the same insurance company or from another insurance company. Apart from the accumulated fund the individual can also use the money received as part of retirement benefits such as provident fund money, gratuity, superannuation etc. or maturity money received from investments like a Public Provident Fund or from other investments to buy the annuity scheme. During the regular annuity phase the insurance company invests the lump sum amount on behalf of the individual and starts making regular/periodic annuity payments to the individual (annuitant).
Commutation	Before receiving regular/periodic annuity payments the individual can make a lump sum withdrawal. This is known as commutation. Insurance companies normally permit the individual to make withdrawals of up to a third of the accumulated fund. The remaining two thirds must be used to buy the annuity payments for the individual.

Payment frequency	During the accumulation phase the individual can make contributions on a monthly/quarterly/biannual/annual basis towards the retirement fund. An individual can also make a single lump sum investment towards the retirement fund. At the time of buying the annuity the individual can also choose to receive annuity payments monthly/quarterly/biannually/annually. Most people choose the monthly annuity mode.
Insurance cover	Annuity plans or pension plans do not provide any insurance cover during the regular annuity phase, and on the death of the annuitant the payments stop unless there is a guaranteed period. Refer to section B5B for further information.
Tax implications	As per the prevailing tax laws, annual investments of up to a specified amount made in pension plans during the accumulation phase qualify for deduction from taxable income under the Income Tax Act. A third of the accumulated fund can be withdrawn as a tax-free lump sum. Regular annuity or pension received by the individual is taxable as per the tax slab and tax rate applicable to them.
Frequency of payment	An individual can pay the insurance company a lump sum amount or choose to make a series of payments during the accumulation phase.
Traditional/unit-linked	During the accumulation phase the individual can choose to invest in a traditional pension plan or a unit-linked pension plan, based on their risk appetite. A traditional pension plan invests most of the funds in Government securities, whereas in a unit-linked retirement plan the individual can choose to invest the funds in an equity fund, a debt fund, a balanced fund or any other fund from the available options.
Type of pay outs	During the regular annuity phase some annuities make fixed payments to the annuitant while some increase the annuity payments by a certain percentage or amount related to an inflation index.

As per IRDA norms which came into effect from 1 September 2010, all unit-linked pension plans require insurers to guarantee minimum 4.5% returns (if all premiums are paid), and no partial withdrawals will be allowed during the accumulation period.

C Tax and inflation implications for financial products

Be aware

Note that in the Finance Bill 2011 a decision has been taken to implement the new direct tax code (DTC) from 1 April 2012. This may bring in modifications in the existing tax treatment on all life insurance policies, at which time it will be necessary to be conversant with such changes before being licensed as an agent.

C1 Tax implications for financial products

- **Health insurance plans**: as per the prevailing tax laws, the premium paid up to a specified limit for health insurance plans qualifies for deduction from taxable income under the relevant section of the Income Tax Act. If the individual is a senior citizen (65 years or above) then the deduction allowed is higher than other individuals. An individual can pay the premium for themself, their spouse, children and parents and make use of the tax benefits applicable.
- **Riders**: premium paid for insurance riders qualifies for deduction from taxable income under relevant sections of the Income Tax Act.
- **Pension plan**: the premium paid for pension plans (up to specified limits) during the accumulation phase qualifies for deduction from taxable income under the Income Tax Act. During commutation the individual can withdraw a lump sum amount of up to a third of the accumulated funds tax free. The regular annuity received by an individual will be deemed as income and is taxable in the hands of the annuitant as per the tax slabs and tax rates applicable to them.

C2 Inflation implications for financial products

We have seen in chapters 5 and 6 how inflation can have severe implications for insurance and other financial products. Similarly inflation has an impact on the costs of healthcare which have risen sharply in the past few years meaning that the health insurance cover taken out today may not be adequate in a decade's time. However, some health insurance plans allow an increase in the health cover and an individual needs to review their health cover regularly, keeping in mind the effects of inflation. Some health plans and life insurance plans allow the insured to add the critical illness rider. This comes in very useful if the individual is diagnosed with some form of CI.

Inflation has severe implications for the cost of living. During their retirement years an individual does not have any other source of income to fall back on, so when choosing a retirement plan clients must take into consideration that their expenses will go up year after year due to inflation. Some retirement plans increase the annuity payment every year by a fixed percentage rate or agreed inflation index to allow for the effects of inflation.

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Question 7.3

Explain the meaning of commutation.

D Prioritising needs and applying financial products to needs

If a family income provider suffers from a major illness and is hospitalised for a number of days it can affect the family's financial position in two ways – firstly, the hospital bill may force the family to divert money reserved for other financial goals, and secondly the income provider's hospitalisation will result in a loss of income to the family. In the worst case scenario the family may even have to borrow money in the form of personal loans to clear the hospital bills. This may leave the family with large debts and no income to repay them. This is where health insurance plans can come to the rescue in helping the family take care of the hospital bills, with some health plans also paying the insured a daily amount for loss of income. This is why health insurance should be a priority for all individuals.

Once the family income provider has taken out personal life insurance they should consider arranging health insurance for themselves and their entire family. The individual could also add an accidental death benefit rider and a disability rider to their life insurance plans to enhance the cover, or they can buy a separate personal accident insurance. When arranging health insurance for their family an individual should consider buying a family floater plan rather than individual health plans for all the family members. In a family floater all family members can share the cover in no fixed proportions.

As we have previously stated, many people give more priority to goals like children's education planning and children's marriage planning over retirement planning. A professional life insurance agent should do their best to encourage their clients to start contributing to a pension plan as soon as possible, even if they start with a very small amount and gradually increase their contributions over time.

Summary

We have now concluded our study of the range of products that life insurance agents need to know about and understand. In this chapter we have considered the importance of addressing the needs of old age as early as possible in order to ensure a comfortable and enjoyable retirement. As a result you will now understand the role and variety of health plans, riders and annuities available to individuals as they become more vulnerable to ill health, as well as the financial consequences of illness when there is no longer the security of a regular income.

Before moving on, take some time to revisit chapter 5, section D and chapter 6 section G to see how the topics we have covered in this chapter fit into the overall picture of the potential needs of clients, and how you should aim to use this knowledge and understanding to help them identify the life insurance and savings products that are suitable for their particular circumstances.

In the next chapter we will stay with the topic of prioritising client needs, placing particular emphasis on how you might achieve this within the context of your client's current life stage and the various factors that will influence the advice you will provide.

Key points

The main ideas covered by this chapter can be summarised as follows:

Other financial needs

- Other financial needs of an individual include the need for health insurance, insurance riders, retirement plans etc.
- Health insurance plans protect the family against hospitalisation expenses which may include doctors' fees, medicines, room rent and other medical expenses.
- Insurance riders bring additional benefits at a nominal cost. Riders help in the customisation of an insurance policy.
- Retirement plans help the individual maintain a similar lifestyle post-retirement as they enjoyed pre-retirement.

Features and benefits of other key products

- Assuming other factors remain constant, the premium in a health insurance plan increases with age.
- Health plans offer cashless treatment in network hospitals and on a reimbursement basis in non-network hospitals.
- Riders help enhance the quality and extent of cover.
- Pension plans have two phases: the accumulation phase wherein the individual makes regular or lump sum contributions, and the annuity phase where the insurance company makes regular payments to the annuitant.
- An individual can commute a third of the accumulated fund tax-free and must use the remaining two thirds to buy an annuity.
- Contributions made in a retirement plan qualify for deduction from taxable income under the relevant section of the Income Tax Act. The regular annuity received by the annuitant is taxable.
- Annuities can be classified on the basis of frequency of payment, type of pay-outs, time the pay-outs start, the number of people benefitting etc.

Different types of financial products

- There are four main types of health insurance plan: individual health plans, family floater health plans, group health insurance plans, daily hospitalisation cash benefit plans.
- An accidental death benefit rider provides extra payment over and above the normal sum insured in the event of death due to an accident.
- A term rider can be used to enhance the death cover in a policy.
- A critical illness rider comes in very handy in the event that the insured is diagnosed with one of the critical illnesses covered under the rider.
- A waiver of premium rider waives the payment of future premiums in the event of the disability of the insured.
- Variants of an annuity plan include: life annuity, guaranteed period annuity, joint life last survivor annuity, life annuity with return of the balance of the purchase price, increasing annuity.

Tax and inflation implications for financial products

- Premium paid up to a specified limit for health insurance plans qualifies for deduction from taxable income under the relevant section of the Income Tax Act.
- Contributions made towards a retirement plan qualify for tax benefits under the relevant section of the Income Tax Act. However, the regular pension received by an individual is taxable.
- Due to inflation, the health insurance cover which seems adequate today will not, for example, be adequate in a decade's time.

Prioritising needs and applying financial products to needs

- Health plans provide for the costs incurred in the event of hospitalisation of the family income provider or any other family member.
- Even though retirement is further from other financial goals, the individual should not give less priority to this goal; they can start with a lower amount and increase contributions over a period of time.