5
Basic life insurance products

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Learning objectives

After studying this chapter, you should be able to:

- outline the various protection needs of an individual;
- explain the personal factors affecting protection needs;
- describe the basic elements of a life insurance plan;
- outline the basic life insurance products offered by the insurance industry;
- explain the different types of life insurance plans;
- describe the tax implications of life insurance products;
- explain how inflation has an impact on life insurance products;
- prioritise client needs and apply basic life insurance products to meet those needs.

Introduction

As we saw in chapter 1, protection needs arise when unpredictable events occur that can potentially result in financial disaster for individuals and/or their dependants. We also saw that **protection against unpredictable events is provided by insurances** that aim to replace much of the monetary loss produced by the occurrence of the insured event.

Even if a person knows that they would benefit from some form of insurance protection, they don't always have a real understanding of what their individual protection needs really are.

It is the role of agents to help such people to make the right choices.

In this chapter we will learn about the features and uses of various life insurance plans available in the market and – importantly – which features affect their suitability for a client. In chapters 6 and 7 we shall turn our attention to the savings needs of individuals and the range of savings products that are available to meet those needs, and also the other financial products that agents need to understand, such as health insurance.

This understanding will enable you to advise your clients to take out the right type and level of insurance cover for their **individual needs** and **circumstances**.

Key terms

This chapter features explanations of the following terms and concepts:

Protection needs	Factors affecting protection needs	Death cover	Survival benefit
Term insurance plan	Pure endowment plan	Endowment insurance plan	Whole life insurance plan
Convertible insurance plan	Single life insurance plan	Joint life insurance plan	Group insurance plan
Micro-insurance plan	ULIPs	With-profit policy	Taxation
Inflation	Prioritising needs	Child plan	Money-back plan

A Protection needs

As a life insurance agent you are concerned about the protection needs that arise as a result of a person's death or disability.

Before we move on let us take some time to consider the following case study:

Case study: Prashant's life takes a turn for the worse

Stage I

Prashant is a 35-year-old man who is well-settled in his job. His wife is a homemaker and he has a 7-year-old son, Nishant. Prashant wants Nishant to become a doctor when he grows up and has been investing Rs. 5,000 every month in a mutual fund for the past two years for Nishant's medical course. His parents are retired and are dependent on him.

Prashant has taken out an endowment policy with a cover of Rs. 2,00,000 for 10 years for which he is paying a premium of Rs. 20,000 every year. For Prashant the Rs. 2,00,000 cover is not important, it's the income tax benefits that the policy brings that attracted him.

Prashant moved into a new house last year. Previously he was staying in rented accommodation. Prashant now has a running home loan of Rs. 40 lakhs along with a car loan of Rs. 7 lakhs. He enjoys an annual vacation with his family which is paid for on his credit card. Prashant is an shining example of prospering India's rising middle class. Everything is falling into place for him and he feels that he couldn't have asked for any more from life.

Stage II

Despite his happiness, destiny has something else in store for Prashant: life takes an ugly turn which he would never have imagined. Nishant is very excited because he has been promised a new bicycle for his 8th birthday and cannot wait for his father to return from an official conference in Mumbai. Little does the young boy know that his father will never return. Prashant's flight crashes while he is returning home and he dies in the crash. Neither Nishant's father nor his bicycle arrived; the only thing that came was the news of Prashant's tragic death which dealt a severe blow to his family.

Stage III

This was not the only bad news that Prashant's family had to deal with. There was more to come. The tears of Prashant's family had not even dried when creditors had already started queuing up outside his house. First it was the credit card recovery agents and then the car loan recovery agents who repossessed the car as Prashant's family could not pay the car loan EMI. The final blow came from the bank who asked Prashant's family to vacate the house as they were unable to pay the home loan EMI.

Nishant's educational dreams fell by the wayside as there was no way the family could invest further for his education. The survival of the family itself was at stake as Prashant was the only wage earner in the family.

The endowment policy of Rs. 2,00,000 could not take care of the family's needs even for one year. This was the only insurance cover that Prashant had bought, and was only really for its income tax benefits.

For the moment, just keep this case study in mind as we move on through the rest of this chapter. We will return to it later in section D to see how different things could have been for Prashant and his family.

A1 General protection needs of an individual

There are various reasons for which a person needs financial protection in the form of insurance. These needs are as follows:

A1A Income

There is a strong need for an individual to protect the income that they are currently earning and expect to earn the future. We saw in the above case study how an untimely death combined with no income protection can lead to a family landing in a financial mess. Term insurance can help to protect the future loss of income.

A1B Medical needs

Medical emergencies strike when they are least expected. We saw in the above case study that Prashant's parents are retired and are dependent on him. If ill health strikes in old age, treatment costs can burn a big hole in the pocket of a family's income provider. Medical insurance can help protect against unexpected medical emergencies.

A1C Dependants

- Children's education: these days with so many children wanting to go for the same MBA/engineering/medical course and a limited number of good institutions offering quality education, the cost of education is rising at a rapid pace. As a result, parents need to plan well in advance for their child's education. In the above case study we saw how the untimely death of a parent can ruin the education plans of their child. Therefore, there is a need to protect the child's education fund. A child insurance plan (which we shall study in more detail in the next chapter) can help to address this issue in the absence of the parent.
- Children's marriage: parents will do everything it takes to provide the best quality of everything their child needs. Parents dream that their only daughter's wedding should be the best in town and should be the most talked about event for every guest. To fulfil their dream, parents will start investing for their child's wedding right from the beginning of the child's life. But the premature death of a parent can result in the wedding plan dreams going sour; hence the need for protection. A child insurance plan can help provide protection against the untimely death of the parent.

A1D Assets and liabilities

Assets such as our house, car or business are very important to us.
In building these assets – due to the huge initial investment involved – we have to apply for loans to finance them. It is the responsibility of the person who provides the family's income to make sure these loans are repaid on time. But if the income provider dies prematurely who will take care of these loans? We saw in the above case study how Prashant's family lost their car and house as they were not able to repay the EMIs in Prashant's absence. Hence there is a need for protection of these assets (loans) in the absence of the main provider of income. Home insurance or additional term insurance can provide protection in this case. Additional term insurance can provide protection against the credit card dues, personal loans, car loan and any other loans in case of the untimely death of the income provider.

A1E Family's maintenance

There is a need to protect the family in the absence of the income provider. We saw in the case study that after Prashant's death the family's survival is at stake. If there is only one income provider then the insured should make sure that they have enough life insurance to take care of their family in the case of an early death. Here a term insurance plan can provide a lump sum amount to the family, or a pension plan can provide regular income.

Be aware

Proper financial planning can ensure protection for all the above needs. A proper financial plan can provide the three benefits of protection, return on investments and tax benefits.

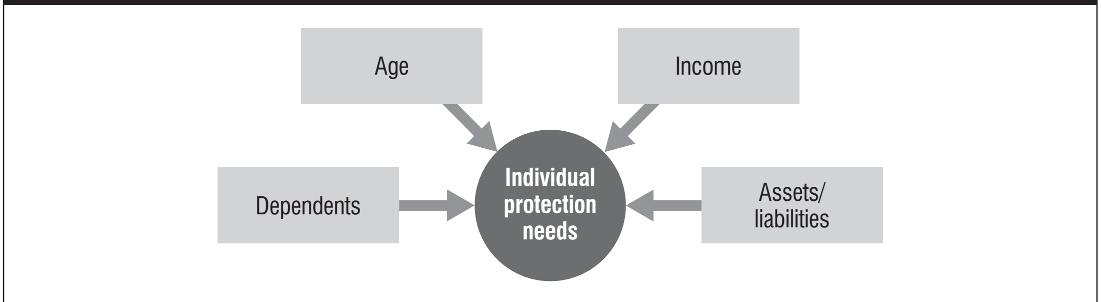
Consider this…

Now that you are aware of the common protection needs of an individual, make a list of your own personal protection needs. Do you have any other protection needs that are not mentioned above?

A2 Personal factors affecting protection needs

The precise protection needs of any client are influenced by the following personal and financial details:

Figure 5.1



Let us have a look at each of these in detail:

A2A Age

Age influences the needs of an individual in several ways. When an individual starts earning in their early twenties they are more concerned with self-protection and the protection of income. Going forward, the responsibility of an individual increases when they get married, acquire assets like a home and a retirement fund, and they start to need to take care of their parents. Age also affects the cost of buying protection. Insurance premiums for a person in the 20-25 year age group are much less than the premiums for a person in the 30-35 year age group. So it is wise to buy insurance protection as early as possible.

A2B Dependants

When an individual gets married, they will extend their family and have the responsibility of providing for their spouse and children. At a later stage in life when the individual's parents retire, they may also become dependent, thereby increasing the individual's number of dependants. Hence the greater the number of dependants, and the greater the need for a higher insurance protection cover.

A2C Income

The income of an individual has a larger role to play in meeting their financial responsibilities, like planning for their children's education, children's marriage, buying a home and building a retirement fund.

When an individual starts earning their income is generally low. At that stage the income cannot take care of requirements like buying a house and/or a car. Loans bridge this gap. Insurance protection against these loans is important in the event of anything happening to the family's main income provider. For responsibilities such as investing for a child's education and marriage and their own retirement, the individual can start with a small amount and increase their investments as their income grows.

A2D Assets and liabilities

Assets and liabilities have a considerable effect on an individual's protection needs. Assets like a house are mainly financed through loans. Income protection will enable the repayment of such loans in the event of long-term disability or the untimely death of the family income provider.

Liabilities, such as loans taken to buy a car or for vacations, can be a burden on the family members in the event of the income provider's death. It may force the family to sell other assets or dip into investments to clear these loans which can be detrimental to the interests of the family.

B Life insurance products

B1 Basic elements of a life insurance plan

Life insurance companies offer various plans covering the risk of dying early and the risk of living too long. Most insurance plans offered by insurance companies in India have two basic elements:

- **Death cover** – this amount is paid to the nominee/beneficiary in the event of death of the life insured during the term of the policy.
- **Maturity benefit** – this amount is paid on the maturity of the policy if the life insured survives through the term of the policy. Some policies like money-back policies also make periodic payments to the life insured during the term of the policy before maturity, known as survival benefits. Money-back policies will be discussed in detail in section B2M of this chapter.

Be aware

Policies are usually taken out on what is known as a single life basis, with only one life insured. We shall look at policies that insure more than one person in sections B2G and B2I.

B2 Basic life insurance plans

The main types of life insurance plans offered by the insurance industry are discussed below.

B2A Term insurance plan

This is the most basic plan and simplest form of insurance offered by the life insurance industry. In this plan the life insurance company promises to pay a specified amount (sum insured) if the insured dies during the term of the plan. If the life insured survives the entire duration of the plan then they will not be entitled to anything, meaning that there is **no maturity benefit** with such policies.

So in short, this plan offers **only death cover** in the event of the death of the life insured during the period of the plan.

Example

Prashant takes a term insurance plan from insurance company ABC for a sum insured of Rs. 75 lakhs for 30 years. The policy document specifies that if Prashant dies at any time during the policy term of 30 years, the insurance company will pay Prashant's nominee a sum of Rs. 75 lakhs.

However, if Prashant survives for the entire policy term of 30 years then he will not get any maturity or survival benefit.

Key points:

- Term insurance plans offer only death cover.
- They are the simplest form of insurance plans offered by insurance companies.
- Term insurance plans are the cheapest insurance plans available in the market. For a small premium an individual can take out a big protection cover against their liabilities.
- **Tenure**: as the name suggests these plans offer protection only for a specified term. Normally the term starts from 5 years and runs to 10, 15, 20, 25, 30 years or any other term chosen by the insured and agreed by the insurer.
- **Protection against liabilities**: to cover larger liabilities like home loans or car loans, term insurance cover is the best solution.
- Insurance companies, under some term plans, allow the life insured to increase or decrease the death cover during the term of the plan.
- **Minimum and maximum sum insured**: for most term plans the insurance company specifies the minimum and maximum sums insured. For some insurance companies the maximum sum insured is subject to underwriting.
- **Minimum and maximum age**: most insurance companies specify the minimum and maximum age at entry and exit for term plans.

B2B Return of premium (ROP) plan

Some insurance companies also offer variants of term insurance plans in the form of **return of premium plans**. If the life insured dies during the term of the plan, the insurance company pays the specified amount (sum insured) to the nominee/beneficiary. If the life insured survives the entire policy tenure then on maturity the insurance company returns part of the premium, or the entire premium, to the life insured according to the terms of the policy.

In another variant of term insurance plans, some companies also pay some interest along with the premium on the maturity of the plan if the life insured survives until maturity.

Consider this…

If you had to choose between a term insurance plan and a return of premium plan, which one would you choose and why?

B2C Pure endowment plan

A pure endowment plan is the opposite of a term insurance plan. In this plan the life insurance company promises to pay the life insured a specified amount (sum insured) only if they survive the term of the plan. If the life insured dies during the tenure of the plan then they will not be entitled to anything.

So in short, this plan offers **only maturity benefit** in the event of the life insured surviving the entire tenure of the plan. There is no death cover.

Example

Prashant takes a pure endowment plan from insurance company ABC for a sum insured of Rs. 75 lakhs for 30 years. The policy document specifies that if Prashant survives the entire policy term of 30 years, the insurance company will pay Prashant a sum of Rs. 75 lakhs on the maturity of the policy.

However, if Prashant dies during the policy term of 30 years then he will not get any death cover.

Life is very uncertain. People like Prashant will never be able to decide whether a term insurance plan or a pure endowment plan is appropriate for their needs as they don't know how long they will survive or when they will die.

So if Prashant takes a term insurance plan for 30 years and survives for the entire duration of the plan, then at the end of 30 years he will not receive anything. At the same time, if he takes out a pure endowment plan for 30 years and then unfortunately dies during its term, then again his nominee/beneficiary will not get anything.

Situations like the one mentioned above can confuse people about which insurance plan to choose. In order to resolve the above situation, life insurance companies have combined the features of the above two plans and offer them as an **endowment insurance plan**.

B2D Endowment insurance plan

An endowment insurance plan is basically a combination of a term insurance plan and a pure endowment plan. It offers death cover if the life insured dies during the term of the policy or survival benefit if the life insured survives until the maturity of the policy.

Example

Prashant takes out an endowment insurance plan from insurance company ABC for a sum insured of Rs. 75 lakhs for 30 years. The policy document specifies that if Prashant survives the entire policy term of 30 years, the insurance company will pay him a sum of Rs. 75 lakhs and the accumulated bonus, if any, on the maturity of the policy. However, if Prashant dies during the policy term of 30 years and before the maturity of the policy, his nominee/beneficiary will get death cover of Rs. 75 Lakhs and the policy will be closed.

The above plan is a combination of:

- one term insurance plan of Rs. 75 lakhs for 30 years; and
- one pure endowment plan of Rs. 75 lakhs for 30 years.

So if Prashant dies during the policy tenure, the term insurance plan will pay out, but if he survives the entire policy tenure of 30 years then the pure endowment plan will pay out.

Beware

Most insurance plans offered by life insurance companies in India are a combination of term insurance and pure endowment plans.

Consider this…

If you had to choose between a term insurance plan, a pure endowment plan or an endowment insurance plan which one would you choose and why?

Key points

- Endowment insurance plans pay a specified amount on maturity of the plan if the life insured survives the entire term of the plan.
- **Death cover**: these plans also have a death cover element. If the life insured dies before the maturity of the plan then the death cover benefit is paid to the nominee/beneficiary.
- **Savings element**: these plans, apart from the death cover, also have a savings element. After deducting the death cover charges and administration charges from the premium, the remaining amount is invested by the insurance company on behalf of the life insured. The returns earned are later paid back to the life insured in the form of bonuses.
- **Goal-based investment**: these plans can also be bought for accumulating money for specific plans like a child's higher education or marriage etc.
- Some insurance companies also allow partial withdrawal or loans against these policies.
- This plan also comes in different variants. Some plans have a higher death cover than the maturity benefit and vice versa.
- In some plans the maturity benefit is double the death cover. This type of plan is known as a **double endowment insurance plan**.

Question 5.1

Explain the basic elements of a life insurance plan.

Participating and non-participating policies

Most endowment policies have a savings element included in the premium. This amount is invested by the insurance company on behalf of the policyholders and earns a profit on it which is again distributed back to the policyholders in the form of bonuses.

Such plans where the policyholders are entitled to participate in the profits of the insurance company are known as 'with-profits' plans or 'participating' plans. Most endowment, money-back and whole life plans are participating plans. More details on money-back and whole life plans are discussed later in this section.

Plans in which the policyholders are not entitled to participate in the profits of the insurance company are known as 'without-profits' plans or 'non-participating' plans. Pure term insurance plans are an example of without-profit plans.

Suggested activity

If you have access to the internet, visit the websites of five insurance companies and study the features of the various endowment plans offered by them. Make a comparison chart of the features of endowment plans of the five companies. Which company do you think is offering the best endowment plan and why?

B2E Whole life insurance plans

- A term insurance plan with an unspecified period is called a whole life plan. Some plans also have a savings element to them. The insurance company declares bonuses for these plans based on the returns earned on investments.
- As the name of the plan specifies, this plan covers the individual throughout their entire life.
- On the death of the life insured, the nominee/beneficiary is paid the sum insured along with the bonuses accumulated up until that point in time.
- During the individual's lifetime they can make partial withdrawals to meet emergency requirements. An individual can also take out loans against the policy.

Example

Insurance Company ABC offers a whole life insurance plan offering protection up to the age of 100.

Death cover
Should the death of the life insured occur during the policy tenure, then the sum insured, along with the accumulated bonuses up to that date, are paid to the nominee/beneficiary.

Survival benefit
If the life insured survives until age 100, then the sum insured, along with the bonuses, is paid to the life insured.

Suggested activity

So far you have studied the features of term plans, endowment plans and whole life plans. List down the scenarios/situations in which an individual should opt for each of the three plans.

B2F Convertible insurance plans

As the name suggests, this insurance plan can be converted from one type to another. For example, a term insurance plan can be converted into an endowment plan or a whole life plan or any other plan as allowed by the insurance company.

A convertible plan is useful when the life insured cannot initially afford to pay a higher premium. They can therefore start with a term insurance plan with a lower premium and then later convert it into an endowment plan or a whole life plan with a higher premium. Also, at the time of the plan conversion the life insured is not required to undergo a medical check-up.

Another advantage of convertible plans is that at the time of conversion there is no further underwriting decision to be made.

B2G Joint life insurance plans

- Joint life insurance plans offer insurance coverage for two persons under one policy. This plan is ideal for married couples or partners in a business firm.
- With some joint life insurance plans the death cover (sum insured) is payable on the death of the first joint policyholder and then again on the death of the surviving policyholder, along with the accumulated bonuses up to that date, if the death of both the policyholders happens during the tenure of the policy.

- If both the joint policyholders survive until maturity or one of the joint policyholders survives until the maturity of the policy, then the maturity benefit along with the bonuses accumulated until that date is paid.
- For some joint life policies the premiums have to be paid until the selected term or premium payment ceases on the death of the first joint policyholder.
- In the case of joint life policies each life will be underwritten separately.

Consider this…

After you marry, would you like to have separate insurance policies for your spouse and yourself or you would like to have a joint life insurance policy? What are the points that you will consider in making a decision about this?

B2H Annuities

An annuity is a series of regular payments from an annuity provider (insurance company) to an individual (called the annuitant) in return for a lump sum (purchase price) or instalment premiums for a specified number of years.

According to the manner in which the purchase price is paid, annuities can be either:

- an immediate annuity; or
- a deferred annuity.

An annuity is the reverse of a life insurance policy. In life insurance the insurance company takes on the risk, but with an annuity the annuitant takes on the risk that they won't die in a very short space of time after paying the purchase price.

There are a number of different types of annuity available (such as a joint life, last survivor/life annuity with return of purchase price/increasing annuity) and we will look at these in detail in chapter 7.

B2I Group insurance plans

- A group insurance policy provides insurance protection to a group of people who are brought together for a common objective.
- The group of people can be:
  - employees of an organisation;
  - customers of a bank;
  - members of a trade union;
  - members of a professional body like an association of accountants; or
  - any other group of people who have come together with a commonality of purpose or are linked to each other for a common objective.
- In a group insurance policy the insurance company issues one master policy covering all the members of the group. For example, the insurance company will issue a master policy to an employer covering all the employees of the company. The employer would be known as the 'master policyholder'.
- The contract of insurance is between the master policyholder and the insurance company. The employees are not a direct party to the insurance contract.
- Group insurance schemes are also used by the Government as instruments of social welfare to provide insurance cover to the masses (people who are below the poverty line).
- In July 2005 the insurance industry regulator (IRDA) issued guidelines on group insurance policies.

Example

Insurance Company ABC offers a group life insurance plan that addresses the insurance requirements of the less affluent.

The company has specific eligibility criteria to identify the persons to be covered under the scheme.

Death cover

In the event of the death of a member, a sum insured of Rs. 30,000 is paid to the nominee/beneficiary. In case of death due to an accident Rs. 75,000 is paid to the nominee/beneficiary.

B2J Micro-insurance plans

- In November 2005 the IRDA issued guidelines for micro-insurance through the **IRDA (Micro-insurance) Regulations 2005**. Micro-insurance aims at providing insurance cover to low income groups.
- The IRDA has specified that the life cover provided under micro-insurance products should range from Rs. 5,000 to Rs. 50,000.
- A life insurer may offer life micro-insurance products as well as general micro-insurance products and vice versa. (This is only allowed for micro-insurance products, and no other types of general insurance products.)

B2K Unit-linked insurance plans (ULIPs)

Unit-linked policies carry a higher risk than with-profit policies and contain fewer guarantees. However, they are much more flexible. Unit-linked policies are suited to people prepared to undertake some investment risk to obtain the benefits of flexibility. Returns are subject to movements in the capital markets where investments such as equities (shares) are traded (shares will be discussed fully in chapter 6).

Consider this…

If you had to choose between a ULIP and a traditional policy (term/endowment/whole life), which one would you opt for? What are the points that you would consider in taking a decision on this?

Key points

- Unit-linked insurance plans (ULIPs) offer the benefits of both life insurance and returns on investment.
- In traditional plans the insurance company takes a decision on the investments to be made on behalf of the insured. However, in a ULIP the insured has a variety of funds to choose from like equity funds, debt funds, balanced funds and money market funds etc. for their investments.
- ULIPs give the insured the option to participate in the growth of the capital markets.
- On the death of the insured the sum insured or the market value of the investment (fund value), whichever is higher, is paid.
- On maturity of the plan the fund value is payable.
- **Settlement option**: instead of taking a lump sum amount, some plans provide the policyholder with the option to receive the maturity benefit amount as a structured payout (periodic instalments) over a period of time (say, 5 years or any time up to 5 years) after maturity. This is known as the settlement option. If the policyholder wishes to take the settlement option they need to inform the insurance company well in advance.

Question 5.2

List the features of a group insurance plan.

B2L Child plans

- Child insurance plans help parents to save for their children's future financial needs such as education, marriage etc.
- Child insurance plans offer the dual benefit of savings along with insurance.
- It is important to note that the child does not have any income of their own. Instead, they are entirely financially dependent on their parents. The parent pays the premium to the insurance company towards accumulating money for the child's future financial needs.
- The child is the beneficiary who is entitled to receive the benefit on the maturity of the policy.
- In these plans, risk on the life of the insured child will begin only when the child reaches a specified age as stated in the policy. The time gap between the policy start date and the date of commencement of risk is called the **deferment period**.
- The date on which the risk will commence at the end of the deferment period is known as the deferred date. The **deferred date** will be a policy anniversary.
- There is no insurance cover during the deferment period.
- When the child reaches the age of majority (18 years old) the title of the policy will be automatically passed on to the insured child. This process is known as **vesting**. The date on which the policy title passes to the child is known as the **vesting date**.
- After vesting the policy becomes a contract between the insurer and the insured person (the child in this case).

- Some child insurance plans come with a built-in 'waiver of premium' rider, whereas in the case of other child insurance plans the parent can opt for the waiver of premium rider for a small additional premium. In this case if the parent dies during the policy term the insurance company will continue to pay the premiums on behalf of the parent (until the child reaches the age of majority) and the policy is left intact. The child receives the benefit at the end of the policy term according to the policy terms and conditions. More details on riders will be discussed in chapter 7.
- Child insurance plans can be taken out in the form of **endowment plans, money-back plans** or **ULIPs**.

B2M Money-back policies

- Money-back policies combine the dual benefits of savings and insurance, and are somewhat similar to endowment plans in terms of features.
- In an endowment plan, the policyholder receives the maturity benefit at the end of the policy term. However, in money-back policies '**partial survival benefits**' are paid to the policyholder during the term of the policy at specific intervals.
- The policyholder may receive the survival benefits in fixed proportions or variable proportions during the policy term as per the terms and conditions of the policy.
- The benefits received by the policyholder at specific intervals are tax-free according to prevailing tax laws.
- If the policyholder dies during the policy term, the nominee or beneficiary receives the entire sum insured along with the accrued bonus (if any) without the deduction of survival benefits that have already been paid to the insured.

Example

Chetan Mishra has taken out a 20 year money-back policy from ABC insurance company. The sum insured is Rs. 20,00,000. He chose to take out a money-back policy as he wanted to enjoy a return on his savings while he is alive. He has nominated his wife Sumedha to be the beneficiary of the policy. Under the money-back policy that he has taken out he will receive 25% of the survival benefit after 5, 10 and 15 years and the remaining balance of 25% of the survival benefit will be payable in the 20th year.

However, tragedy strikes the family. Chetan dies in a car accident. Sumedha is a housewife and was financially dependent on Chetan.

Chetan's death occurred in the 11th year after he took out the policy. He had already received a percentage of the survival benefit (Rs. 10,00,000) in the 5th and 10th years.

In this case Sumedha will receive the entire Rs. 20,00,000 as the sum insured, even though a percentage (Rs. 10,00,000) of the sum insured has already been paid to Chetan in the 5th and 10th years of the policy.

B2N Salary saving schemes (SSS)

- Salary saving schemes (SSS) are intended to cater to the needs of the working classes.
- In these schemes the insurance company has an arrangement with the employer, whereby the employer deducts the premium from the employee's salary and passes it on to the insurance company every month.
- As the premium is deducted from their salary before it reaches the employee they do not need to worry about defaulting on the premium.
- The insurance company also benefits as it receives the consolidated premium from the employer for all the employees who have enrolled on the scheme.

Consider this…

What benefit do you think this might have for the insurance company?

- The employer makes the deduction for the premium from the employee's salary based on an authority letter signed by the employee, which is collected with the proposal form and is sent to the employer by the insurer, when the policy is accepted.
- A demand list containing the list of employees, their designation along with the amount to be deducted is sent to the organisation periodically by the insurance company.
- A salary saving scheme is not a specific insurance plan. It is just a convenient arrangement to collect the premium. It can be used for a term plan, an endowment plan or any other plan as offered by the insurer under the SSS arrangement.

C Taxation and inflation

C1 Tax implications on insurance products

Life insurance products are eligible for income tax benefits under the **Income Tax Act 1961**. Insurance products qualify for income tax benefits at the time of investing as well as at the time of maturity.

(a) **Investment stage**: the premium paid for life insurance plans qualifies for deduction from taxable income under section 80C of the Income Tax Act. The Act specifies certain conditions for tax benefits to be granted. The following condition should be fulfilled:

- as per current tax laws the premium paid should be 20%, or less than 20%, of the sum insured; or
- the sum insured should be five times, or more than five times, the premium paid.

Example

Prashant buys an ULIP policy for Rs. 4 lakhs cover. To make use of tax benefits on this policy, the premium paid should be less than 20% of the insurance cover of Rs. 4 lakhs. So in this case the premium paid should be Rs. 80,000 or less to gain the tax benefits.

If the premium is more than 20% of the sum insured, i.e. if the premium paid is more than Rs. 80,000 (say, Rs. 100,000), then the income tax deduction will be restricted to 20% of the premium paid. In this case it will be restricted to Rs. 80,000.

Now, let's look at this the other way round:

Prashant wants to invest Rs. 80,000 to obtain a deduction of this amount from his taxable income. So he decides to purchase a ULIP policy by paying a premium of Rs. 80,000. If he wants to obtain income tax benefits on the entire amount of Rs. 80,000 then he should make sure that the insurance cover he gets should be at least five times, or more than five times, the premium paid (Rs. 80,000). So in this case Prashant should make sure the insurance cover is at least Rs. 4 lakhs or above.

Be aware

The current income tax provisions can be reviewed at any point by the Income Tax Department and are subject to change.

A new Direct Tax Code (DTC) has been drafted by the Ministry of Finance and will be implemented with effect from 1 April 2012 and consequently there will be changes to the existing income tax laws at that time.

Under section 80C the maximum tax deduction that can be gained for premium paid is Rs. 1,00,000 in a financial year.

(b) **Maturity stage**: as per current tax laws the maturity benefit amount received by the life insured or the death cover amount received by the nominee/beneficiary is tax-free under section 10 (10D) of the Income Tax Act. However, the condition of premium not exceeding 20% of sum insured also applies to maturity benefits.

Suggested activity

Under section 80C of the Income Tax Act, an individual can benefit from income tax benefits of up to Rs. 1,00,000 by investing in various instruments. Life insurance is one of the investment instruments. Find out about the other investment instruments and list them.

C2 Inflation

Over a period of time, inflation can have a big impact on the insurance cover that has been taken out. In simple words, inflation is the rise in the price of goods and services in the economy and means an increase in the cost of living.

Example

Until a few years ago a litre of petrol used to cost Rs. 40. Today a litre of petrol costs Rs. 60 – that's a 50% rise in the price. So until a few years ago a Rs. 100 currency note could buy 2.5 litres of petrol. Today the same Rs. 100 currency note can buy only 1.67 litres of petrol.

So a Rs. 100 currency note which could buy us a certain amount of goods some years back, buys us a lot less today. If prices continue to rise in future, the same Rs. 100 currency note will buy even less.

That is the impact of inflation: money loses its value.

Inflation has the same impact on insurance cover. Today we have decided that our insurance requirement is, say, Rs. 50 lakhs and we take out an insurance cover of Rs. 50 lakhs for 30 years. But the same insurance cover 15–20 years in the future will be worth a lot less because of inflation. Insurance cover requirements also increase with the increase in inflation. So clients (and their insurance agents) need to review their insurance cover from time to time keeping in mind the effect of inflation.

There are some insurance plans provided by insurance companies that allow the insured to increase/ decrease insurance cover at fixed/regular intervals.

Example

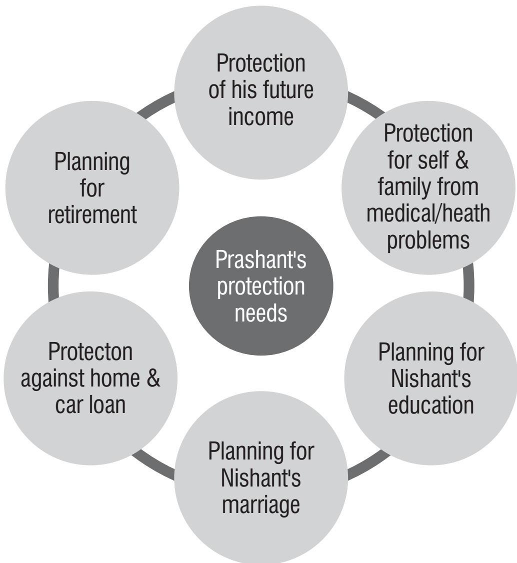
Some companies allow an increase/decrease in the sum insured by 5–10% every year. In this way with a higher insurance cover every year, the life insured can protect themselves from inflation.

D Prioritising protection needs

D1 Why is it necessary to prioritise needs?

An individual can have various protection needs in life. Let us take the example of Prashant again and identify his various protection needs:

Figure 5.2



Does Prashant have enough money to finance all these needs? If not, how does he decide which ones are most important?

A person who has adequate financial resources at their disposal can provide money for all their protection needs. But a person who has limited financial resources cannot provide money for all their protection needs at the same time. This is where the concept of prioritising needs comes into consideration.

D2 How to prioritise needs

Let‘s assume that Prashant does not have sufficient resources to buy protection for all his needs. So let’s see how the insurance agent can help him go about prioritising them. Let ‘s consider them one by one.

Protection of future income:	• This need assumes significant importance as providing financial resources for all other needs/goals comes from prashant’s income. Therefore Prashant should prioritise this need and buy protection for it. He can start with a term insurance plan and later when he has more resources he can opt for savings/ investment plans. The other option can be starting with a convertible term plan and later converting it into an endowment plan or a whole life plan.
Protection of self and family from medical/health problems:	• This need also assumes significant importance as medical emergencies can occur at any time. Prashant could take out a family health insurance plan. In the case of many salaried individuals, employers provide health insurance for their employee as well as their family. In these circumstances the person can postpone buying health insurance for some time if resources are limited.
Planning for Nishant’s education:	• This need is a priority for a married person with children. In this case Prashant can begin with a child insurance plan investing a small amount to start with and later, when he has adequate resources, he can step up investments for this goal.
Planning for Nishant’s marriage:	• This need can be postponed for some time for those persons who are unable to finance all their protection needs, whereas people who have adequate financial resources can start investing towards this goal alongside their other goals.
Protection against home loan and car loan:	• Buying protection for this need is very important. If something happens to the family income provider and if the family is not able to pay the EMIs then the creditors can repossess the asset and sell it to recover their money. For the home loan the individual can buy a home loan protection insurance policy from the bank and for the car loan the individual can enhance the term insurance cover.
Planning for retirement:	• This is an important need. However, an individual who does not have adequate financial resources can start contributing a small amount towards this need and later step up the investments for this goal as and when they have more financial resources at their disposal. We shall look at pensions in more detail in the next two chapters.

A prudent approach towards protection needs will be to:

Figure 5.3

Prioritise them and immediately start with protection for critical and high priority needs.

↓

Start with smaller investments for medium priority needs and increase investments later.

↓

Postpone the low priority needs for some time and take them up later when additional financial resources are available.

Suggested activity

List down your own protection needs. After that prioritise them into critical, high, medium and low priority categories.

Let’s now go back to how ‘Prashant’s life took a turn for the worse’ and see how Prashant should have prioritised his and his family’s needs to provide them with the correct insurance protection.

Case study: Prashant's life is back on track

While the first half of the case study paints a rosy picture of 'shining India', the second half talks about the harsh reality of life. It highlights how life can surprise you and if you are not prepared it is your family who will bear the consequences.

We will now analyse how Prashant got his planning wrong and how insurance could have met his needs.

- **Term insurance**: Prashant is the only earning member of the family, so he should have made sure that the income that he was going to earn during the remainder of his working years was protected. In short, irrespective of whether Prashant is there or not, his family should not suffer. Insurance cannot fill the emotional gap left behind by the absence of a person, but it can at least address the financial gap. Prashant should have taken term insurance for an amount that would have taken into consideration the salary he would have earned until his retirement. Instead Prashant chose to buy an endowment plan which could not help his family even for a year. Also, Prashant bought this plan for income tax benefits and not for protection. Had Prashant bought a term insurance plan instead of an endowment plan, then for the same premium of Rs. 20,000 he would have got a much bigger insurance cover which would have taken care of the home loan, car loan and some other requirements of his family in his absence.
- **Child insurance**: Prashant did not have adequate insurance protection for himself. At the same time he was investing in a mutual fund for Nishant's education. The moment Prashant died the mutual fund investments stopped and with that Nishant's education plans were in jeopardy. Prashant should have chosen a child education plan for Nishant's education planning. This plan would have ensured that in the event of Prashant's death, the insurance company would have continued to pay the premium and Nishant's education plans would not have been compromised.
- **Home loan and car loan**: When Prashant's responsibilities increased, he should have stepped up his term insurance to cover his additional responsibilities. In this scenario adequate insurance would have made sure that in Prashant's absence the insurance money could have been used to clear the car and home loans, and Prashant's family could then have retained the car and continued living in the same house.
- **Retirement plans**: Instead of an endowment plan, Prashant should have chosen a term plan with an enhanced cover which would have diverted the remaining money towards a retirement insurance plan.

Summary

In this chapter we have seen how proper planning and having the right life insurance products in place can protect a person's family in the event of their death or disability, and that life can be led without worry should things 'take a turn for the worse'.

As a professional life insurance agent you:

- need to know the features of the range of life insurance products available;
- should be able to analyse the protection needs of an individual; and
- should be able to identify how life insurance products can best be used to address those needs.

Key points

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

Protection needs

- The various needs for which an individual requires protection can be: income protection; medical expenses needs; children's education; children's marriage; loans on various assets; and their family's survival.
- Factors affecting protection needs include: age; dependants; income; assets; and liabilities.

Insurance products

- The two basic elements of most life insurance plans are death cover and maturity benefit.
- A term insurance plan provides only death cover in the event of the death of the life insured during the term of the policy.
- A pure endowment plan provides maturity benefit/survival benefit if the life insured survives the entire term of the plan.
- An endowment insurance plan is a combination of a term plan and a pure endowment plan. It provides the nominee/beneficiary with a specified death cover amount in the event of the death of the life insured during the term of the policy or provides a maturity benefit/survival benefit to the life insured if the life insured survives the entire tenure of the plan.
- Endowment plans also have a savings element. Insurance companies declare bonuses on the returns earned on investment.
- A whole life plan covers the individual throughout their entire life.
- Convertible insurance plans allow conversion from one life insurance plan to another life insurance plan.
- Joint life insurance plans offer insurance cover for two persons under one policy.
- Annuities are regular payments received by an individual from the insurance company in return for a lump sum (purchase price) or instalment premiums for a specified number of years.
- Group insurance plans provide insurance protection to a group of people who are brought together for a common objective.
- Micro-insurance plans provide insurance cover to people with low incomes.
- Unit-linked insurance plans (ULIPs) provide the life insured with an opportunity to participate in the growth of the capital markets.
- In ULIPs the investment risk is borne by the insured and not the insurance company as in traditional plans.
- Child insurance plans help parents to save for their children's future financial needs, such as education, marriage, etc.
- In money-back policies 'partial survival benefits' are paid to the policyholder during the term of the policy at specific intervals.
- A salary saving scheme (SSS) is not a specific insurance plan. It is a convenient arrangement to collect the premium. In these schemes the insurance company has an arrangement with the employer, whereby the employer deducts the premium from the employee's salary and passes it on to the insurance company every month.

Taxation and inflation

- Under section 80C of the Income Tax Act, premium paid for life insurance plans qualifies for deduction from taxable income up to Rs. 1,00,000 in a financial year.
- For income tax benefits, the premium should not be more than 20% of the sum insured or the sum insured should be at least 5 times the premium or more.
- Under section 10 (10D) of the Income Tax Act, the maturity benefit or the death cover amount received from a life insurance company is tax-free.
- The effects of inflation erode the value of insurance cover over the long term.
- Some insurance companies offer the benefit of increasing the insurance cover at regular intervals to keep pace with inflation.
- Some insurance companies offer the benefit of decreasing insurance cover at regular intervals which is useful in the case of loans which reduce over a period of time.