Pre-recruitment qualification for life agents

2011 Study text

Building professionalism

CII

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Pre-recruitment qualification for life agents

IC-33 Study text: 2011

Foreword

The rapid expansion of the life insurance profession in India over recent years has delivered many benefits. It has enabled families and individuals to protect themselves against some of life's most serious risks, and to plan for their financial security in retirement.

However, the sector does not have an unblemished record. There have been high profile situations where, frankly, the consumer interest has been a second-tier priority. The task of the IRDA, as Regulator, is to promote and protect the interests of policyholders.

The future success of the life insurance profession depends, above all, upon the knowledge and integrity of the people who advise customers – and are their first, and most important, point of contact. At the IRDA, our goal is to see life insurers increasingly able to attract, motivate and retain outstanding people, committed to providing a 'needs-based' approach to financial advice.

This new coursebook, and the revised qualification that agents now sit, is a vital part of our strategy. We have developed a syllabus that is challenging in its scope and depth. It does not simply encourage agents to memorise facts and figures. This is important, but insufficient. It also tests their understanding of learning, and ability to apply it in a wide range of practical real-life situations.

I am grateful to the Chartered Insurance Institute for their extensive support for this work. We have benefitted greatly from their experience in other markets. I am also thankful to many other industry practitioners who have given their time and expertise to develop this material.

Above all, I acknowledge you, the aspiring professional, for embarking on this journey, and taking seriously the need for professional study. Without you, there would be no future for this important marketplace. I trust you will find this coursebook of great value for your studies, and send my best wishes for your future as a life agent.

Mr Hari Narayan
Chairman – Insurance Regulatory and Development Authority

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The **Chartered Insurance Institute** (CII) is the premier professional organisation for those working in the insurance and financial services industry. It is dedicated to promoting higher standards of competence and integrity through the provision of relevant qualifications for employees at all levels and across all sectors, and has been at the forefront in setting professional standards for the insurance industry for over a century.

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Introduction

The aim of the syllabus for the **IC-33 Pre-recruitment qualification for life agents** is to help you attain the knowledge, skills and understanding you need to be licensed as a life insurance agent, and to offer an expert, professional service to your clients.

Specifically, it aims to develop your ability to apply, **in your clients' interests**, knowledge of the Indian insurance industry and its regulation, and knowledge and understanding of key life insurance and other financial products.

The firm proof of that achievement comes in two forms:

- the high reputation that can be established by a successful agent; and
- income earned.

As with other professions, success depends upon reliability being demonstrated over the years: careful about detail but always aware of new developments and changing circumstances; innovative but never reckless, imaginative but never careless.

As the public increasingly understand the service they should receive from a competent agent so their recognition of agents' professionalism will grow. Their expectations will rise, and their dissatisfaction if they should feel let down will be even greater. **Hence it is important to provide an outstanding service every time, for every client. This depends on being able to identify and satisfy each client's needs.**

The ability to **apply** your knowledge and understanding will determine your competence in advising your clients.

The IC-33 Pre-recruitment qualification for life agents syllabus covers the following main topics:

- **Understanding insurance**
- **Providing technical product information**
- **Providing professional advice**
- **Understanding claims**
- **Fulfilling legal and regulatory requirements**
- **Understanding customer protection and ethics**

In order to provide effective advice, a structured approach is required. The process of providing professional advice normally involves three stages:

Conducting the fact-find

Conducting the fact-find requires you to obtain all relevant information about your client before making recommendations. It also allows you to build up a clear understanding of your client's circumstances.

Assessing and satisfying client needs

The second stage of the advice process requires you to identify and understand your client's needs based on the information obtained through the fact-find. Once the needs have been assessed, you must consider the most appropriate means of satisfying those needs.

Making recommendations to the client

The third and final stage of the process of giving professional financial advice is the formulation and presentation of actual recommendations to the client. Recommendations can only be made to the client once the fact-find has been completed and the client's needs assessed.

The second aspect of professionalism that makes for success and also (sadly) exposes those who fail to maintain their professional standards, is the **ethical aspect** of the service.

The **Insurance Regulatory and Development Authority** makes **rules** for the conduct of business, sets competency standards and otherwise does its best to ensure that the high standards that are required by the law are met.

Notwithstanding these rules, ethical standards depend upon the actions – whether they are right or wrong – practiced by all those involved in the process of advising on, selling and servicing insurance products, and the ethical standards of an insurance agent will be demonstrated by his actions to achieve his desired end result, i.e. his sales target.

The section on ethics and codes of conduct in the IC-33 study text tries to help you think about how the choices you make impact on your clients as individuals. The evidence shows that client satisfaction is also good business practice: your clients will stay with you, they will recommend you to friends and colleagues, and you will become more successful.

Life insurance is a vital and growing part of the Indian economy. It helps people to plan for the future, to look after their families, and to enjoy peace of mind. Successful agents play a crucial role in enabling the insurance profession to function smoothly and support its customers. For the right people, it provides an attractive and fulfilling career. We congratulate you on taking the first step toward becoming a licensed agent. This study text is demanding but, we hope, it is also enjoyable and interesting. As you will see, as well as providing the technical information you need to know, we have included a wide range of examples to 'bring it to life' and show some of the practical applications. Using this study text alongside the mandatory fifty hours of classroom training should leave you in a good position for your forthcoming examination. Best wishes for your study and, should you pass the exam, for a long and rewarding career in our fascinating profession.

Using this study text

Welcome to the **IC-33 Pre-recruitment qualification for life agents** study text.

The study text follows the order of the examination syllabus learning outcomes. Each chapter has specific learning objectives and the syllabus learning outcomes being covered are listed on the individual chapter title pages.

Contained within the study text are a number of features which we hope will enhance your study:

Key terms introduce the main ideas covered in each chapter

Consider this – questions and points on which to think further

Examples illustrating points made in the text

Case studies will illustrate how life insurance works in practice

In text questions – quick self-test questions

Suggested activities reinforce learning through practical activities

Be aware boxes draw attention to important points or areas that may need clarification

Key points act as a memory jogger at the end of each chapter

Additionally, at the end of each chapter you will find some **self-test questions** to test your understanding of the material in this study text.

Be aware

This syllabus and study text are valid for examinations unless otherwise notified by the IRDA. You should therefore check the IRDA website at www.irda.gov.in regularly for information regarding changes to the syllabus, any changes to the law and practice and when they will be examined.

Examination syllabus

Pre-recruitment qualification for life agents

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These are the key topics that will be assessed during the examination and therefore may not reflect all of the content from the study text, which contains additional background and reading material to aid learning.

Summary of learning outcomes	Number of questions in the examination*
1. Understand how the insurance market operates	3
2. Understand risk and insurance in the context of the insurance market	3
3. Understand the principles and practices of life insurance	9
4. Understand underwriting for life insurance business	4
5. Understand basic life insurance products	2
6. Understand savings products	5
7. Understand other key financial products	4
8. Understand the key considerations when identifying client's needs	3
9. Understand the importance of completing a client fact find as part of the financial planning process	2
10. Understand what constitutes good client practice and persistency	4
11. Understand insurance procedures for life insurance claims	4
12. Understand how relevant legislation affects client advice	1
13. Understand how insurance regulation affects client advice	2
14. Understand the importance of and the process in place for customer protection	2
15. Understand the ethical considerations of a financial adviser	2

*The test specification has an in-built element of flexibility. It is designed to be used as a guide for study and is not a statement of actual number of questions that will appear in every exam. However, the number of questions testing each learning outcome will generally be within the range of plus or minus 2 of the number indicated.

Important notes

- **Method of assessment: 50 multiple choice questions (MCQs). 1 hour is allowed for this examination.**
- **This syllabus and study text are valid for examinations until otherwise notified by the IRDA. Students should therefore check the IRDA website at www.irda.gov.in regularly for information regarding changes to the syllabus, any changes to the law and practice and when they will be examined.**

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Examination syllabus

1. Understand how the insurance market operates

On completion, candidates should

1.1 Describe the basic purpose of insurance and financial services and their role in the economy

1.2 Describe the benefits of a professional insurance market

1.3 Describe the structure of the insurance market and key types of insurance organisations

1.4 Describe the distribution channels used for the selling of insurance, including e-trading

1.5 Describe the key types of insurance products

1.6 Describe the key roles of professionals in insurance

1.7 Describe the role and functions of an agent in the insurance market

2. Understand risk and insurance in the context of the insurance market

On completion, candidates should

2.1 Explain what is meant by risk as it relates to life insurance

2.2 Explain the difference between peril and hazard as they relate to life insurance

2.3 Describe the types of risk that can be insured

2.4 Describe how insurance operates as a risk transfer mechanism

2.5 Describe how insurance operates by the pooling of risk

3. Understand the principles and practices of life insurance

On completion, candidates should

3.1 Describe the essentials of a valid contract of insurance

3.2 Describe the methods of creating an agent/principal relationship and the duties of each party

3.3 Describe the principle of insurable interest and explain when insurable interest needs to exist

3.4 Describe what is meant by the principle of utmost good faith

3.5 Describe what is meant by a material fact

3.6 Describe what is meant by the duty of disclosure and explain the consequences of non-disclosure of material facts

3.7 Describe what is meant by the principle of indemnity

3.8 Explain the key terms and documents used in life insurance practice

3.9 Explain how life insurance policies are bought and written

3.10 Explain the relevance of premium payment for valid cover

3.11 Describe the procedures relating to quotations and their legal significance

3.12 Describe the procedures relating to proposal forms and their legal significance

3.13 Describe the structure, functions and content of a policy form, including the policy schedule

3.14 Describe the procedures relating to policy conditions

3.15 Describe the procedures relating to renewals and their legal significance

3.16 Explain how lapses, surrenders and paid up cancellation clauses operate

3.17 Explain the use of common policy conditions and exclusions

4. Understand underwriting for life insurance business

On completion, candidates should

4.1 Describe the methods used to obtain material facts

4.2 Explain the significance of moral and physical hazard to underwriting

4.3 Describe the key financial and medical underwriting factors used in life insurance underwriting

4.4 Describe how life insurance cover is priced

4.5 Explain the principles of how premiums are calculated

4.6 Explain the principles of how bonuses are calculated

4.7 Explain the data required and documentation used in life insurance underwriting

4.8 Explain the purpose and use of liens in life insurance

5. Understand basic life insurance products

On completion, candidates should

5.1 Know the main personal and financial details on which a client's protection requirements depend; age, dependants, income, assets and liabilities

5.2 Know the policy features of protection products which affect their suitability for a client

5.3 Understand how the tax treatment of protection products affects their suitability for a client

5.4 Understand how to prioritise and evaluate the significance of the product features to the client needs

5.5 Be able to apply the products to satisfy the client's needs in particular circumstances

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Examination syllabus

6. Understand savings products

On completion, candidates should

6.1 Know the circumstances in which there is a need for savings and investment advice

6.2 Know the main personal and financial details on which a client's savings and investment requirements depend

6.3 Know the features and benefits of savings and investment products which affect their suitability for a client

6.4 Understand how to prioritise and evaluate the significance of the product features to a given set of client circumstances

6.5 Understand how the tax treatment of savings and investment products affects their suitability for a client

6.6 Understand the relationship between risk and reward

6.7 Understand how inflation affects savings and investment products

6.8 Be able to apply the savings and investment products most appropriate to satisfy a client's needs in particular circumstances

6.9 Understand how a change in interest rates affects the future performance of savings and investment products

6.10 Understand the importance of an emergency fund and sensible debt management in managing a client's circumstances

7. Understand other key financial products

On completion, candidates should

7.1 Know the policy features and benefits of health products which affect their suitability for a client

7.2 Know the circumstances in which there is a need for health cover products

7.3 Know the policy features and benefits of annuity and pension products which affect their suitability for a client

7.4 Know the circumstances in which there is a need for annuities and pension advice

7.5 Understand how the tax treatment of other financial products affects their suitability for a client

7.6 Understand how to prioritise and evaluate the significance of other financial products to a given set of client circumstances

8. Understand the key considerations when identifying client's needs

On completion, candidates should

8.1 Know the seven typical life-stages of a client and understand the requirements and constraints at each of the life stages

8.2 Understand how the following factors can affect the life stages for individuals; age, marital and employment status, state of health, ethical preferences, divorce, separation and bereavement

8.3 Know the four main steps in identifying a client's real financial needs: distinguishing between the client's perceived and real needs, distinguishing between the client's current and future needs, quantifying the client's needs and prioritising the client's needs

8.4 Be able to apply financial planning criteria to the information collected about a client in order to identify, quantify and prioritise a client's real financial needs

8.5 Be able to apply features of different types of product to the client's needs and understand the role of the financial adviser in recommending suitable products by which the client can achieve his or her financial objectives

9. Understand the importance of completing a client fact find as part of the financial planning process

On completion, candidates should

9.1 Know what a fact find is and how to use one

9.2 Know the variety of ways a fact find can be carried out: in a structured client meeting, by telephone interview or by corresponding with the client by post

9.3 Know the main client and family information to be collected

9.4 Know the main planning and objective categories contained in a fact-find

9.5 Know how to make suitable recommendations based on the information collected

10. Understand what constitutes good client practice and persistency

On completion, candidates should

10.1 Know that the financial adviser has a duty, at all stages of the sales process, to ensure that the client understands fully all the implications of accepting the financial adviser's recommendations, including any inherent risks

10.2 Understand why it is essential for the status of the financial adviser and the remuneration method to be disclosed to the prospective client at the outset

10.3 Know what an adviser must do when he or she does not have a product that would properly meet the needs of the client

10.4 Know what steps the adviser must take when the client rejects the adviser's recommendations

10.5 Understand why it is unethical to advise a client to switch between the financial products of different providers, unless the switch is clearly in the best interests of the client

10.6 Understand the importance of recommending the long term nature of a product to a client to avoid short term cancellations of policies

10.7 Understand the need for an effective complaints procedure to cover the sale of financial services products and know the essential features of such a procedure

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Examination syllabus

11. Understand insurance procedures for life insurance claims

On completion, candidates should

11.1 Describe the requirements for a valid life insurance claim

11.2 Explain why a life insurance claim may be invalid or only partially met

11.3 Describe the insured's duties after a loss

11.4 Describe the documentary evidence needed in relation to life insurance claims

11.5 Describe the methods by which claims can be settled

11.6 Describe the procedures commonly used to discourage and detect fraudulent claims

11.7 Explain the consequences of fraudulent claims for insurers and policyholders

11.8 Explain the difference between a policy that is void and one that is voidable

12. Understand how relevant legislation affects client advice

On completion, candidates should

12.1 Know the main legislation that currently affects financial advice and understand the main terms and conditions of those acts

12.2 Understand the implications for financial advisers of failing to comply with key legislation

13. Understand how insurance regulation affects client advice

On completion, candidates should

13.1 Understand the impact of regulation in the Indian financial services market

13.2 Describe the role of the Government in regulation, taxation, economic and industrial policy

13.3 Identify the key participants in the Indian and international markets

14. Understand the importance of and the process in place for customer protection

On completion, candidates should

14.1 Describe the importance of and need for customer protection in the financial services market

14.2 Know the internal process by which customers may seek redress against advisers

14.3 Know the process by which customers may seek redress against a company

14.4 Understand the key elements of handling customer complaints effectively

15. Understand the ethical considerations of a financial adviser

On completion, candidates should

15.1 Apply a code of ethics

15.2 Understand the professional principles and values that underline a code

15.3 Describe typical ethical behaviours

15.4 Understand the outcomes that may result from behaving ethically

15.5 Understand the outcomes that may result from not behaving ethically

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1

How the insurance market operates

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Learning objectives

After studying this chapter, you should be able to:

- explain the need for insurance;
- describe how insurance works;
- explain the role of the financial services sector and within that the role of the insurance sector in building the country's economy;
- explain the benefits brought about by a professional insurance market;
- outline the history of insurance in India together with the recent developments in the insurance industry;
- describe the structure of the insurance market, the different types of insurance organisations and the various roles in the insurance industry;
- explain how insurance products are distributed;
- outline the different types of insurance products available in the market;
- describe the role and functions of an insurance agent.

Introduction

As the first step in helping you to gain the knowledge you need to become a professional and successful life insurance agent, we are going to first take an overview of life insurance – what it is and why it is needed. In this chapter we are going to look at the insurance market in India and start to introduce some of the key concepts and ideas behind life insurance. We will continue this process in the next few chapters to give you the necessary information to help you to explain the products you will be selling to your clients and sell them the products that they really need.

In seeing how life insurance works we will need to make reference to the insurance market as a whole – insurance is available for many other things, not just for human life – but our focus will remain firmly on the life insurance part of it.

In this first section we will start by discovering what insurance is, what it is for and why people need it.

Key terms

This chapter features explanations of the following terms and concepts:

Insurance	Risk transfer	Risk retention	Reinsurance
Liberalisation	Life insurance	Non-life insurance	Insurance intermediaries
E-sales	Bancassurance	Insurance broker	Direct marketing
Non-direct marketing	Underwriters	Actuaries	Third party administrators (TPAs)
The Regulator	Individual agents	Term insurance	Endowment insurance
Money-back insurance	Unit-linked insurance plans (ULIP)	Pension plans	

Note

You will find the answers to the in-text questions at the end of the chapter.

A What is insurance?

We can define insurance as follows:

Insurance is a contract between the insurance company (insurer) and the policyholder (insured). In return for a consideration (the premium), the insurance company promises to pay a specified amount to the insured on the happening of a specific event.

That is all very well. But what does it mean? The first step in being able to answer this question is to understand **why** insurance is needed.

A1 The need for insurance

Consider the following case study to understand the need for insurance.

Case study

Ajay is 35 years old and works for a multinational corporation (MNC). He has a ten-year-old son, Vijay, whom he dreams will one day become a doctor. Ajay's spouse is a housewife, and his parents are retired and dependent on him. Ajay has a home loan and is making monthly investments for Vijay's higher studies and marriage and his own retirement. Ajay wants to ensure that Vijay gets the best of everything and that he himself is not dependent on Vijay during his retirement in the way that Ajay's parents are on him. So far everything is going well with Ajay's plans. But imagine what will happen in the following scenario.

One day while returning home from the office Ajay has an accident and dies. What will happen? Who will take care of the family, Vijay's education and marriage, the home loan etc.? What are the options available to Ajay so that his family can be taken care of in his absence?

Now put yourself in Ajay's shoes and imagine you are the family income provider and have to face the above scenario. What will you do? Relax! Our intention is not to panic or scare you. We are using this case study to try to help you realise the importance of insurance which is the solution to all the problems Ajay faces should the above scenario happen. So, let's look at the scenario again and see how insurance can provide a solution.

Life insurance provides protection to a family on the untimely death of the income provider. If Ajay has adequate life insurance cover, then should he die, the money received from the life insurance company can help to support his family. The insurance money will help to take care of the family's living expenses, Vijay's education and marriage, and the cost of the home loan etc.

Now that we have looked at the above scenario, we can see how insurance, in this case **life insurance**, can safeguard a person against unexpected events.

Consider this…

As the income provider for your family, what risks are you exposed to? Do you have any financial goals that you would like to protect?

A2 How does insurance work?

Now that you understand the need for insurance, we can move on to understanding **how** insurance works exactly.

Let us continue with our case study of Ajay. The risk of premature death described above is only one of the risks that Ajay faces. He faces many other risks – that he will need medical care at some point, that his home may burn down, for instance. Ajay can handle these risks in different ways.

- **Risk retention**: One, not very wise way, of handling these risks is to retain them, i.e. for Ajay to bear the risk that he will have to provide for these situations himself, and so do nothing about them. While times are good and none of these events happen, Ajay need not be worried. But the moment any one of them does happen, Ajay will be in trouble. So it is definitely not wise for Ajay to retain, or handle, these risks himself.
- **Risk transfer**: The other way of handling these risks is to transfer them to someone who can handle them properly. In simple words, the process of transferring risks from one person who does not have the capacity to bear them to someone who does have the capacity for them, is known as **insurance**.

At this point, it may be useful to return to our definition of insurance:

> Insurance is a contract between the insurance company (insurer) and the policyholder (insured). In return for a consideration (the premium), the insurance company promises to pay a specified amount to the insured on the happening of a specific event.

Insurance, then, is nothing but a risk transfer mechanism wherein the person taking out insurance transfers their risk to the insurance company in return for a payment (known as the premium). So in Ajay's case he can take out insurance, pay the premium and transfer his risks to the insurance company.

Insurance companies collect premiums from people like Ajay – from all those who are exposed to the same risks – and put the money into a risk pool. Not everyone will experience the happening of an insured event at the same time, but those who do are compensated from this risk pool.

So, from the above explanation we can see that insurance is:

- the process of transferring the risk from the owner (insured person);
- to another party (insurer) who can bear that risk;
- in return for a consideration (premium).

The business of insurance relates to the protection of the economic value of assets. An asset is valuable to its owner because they expect some benefits from it. The benefit can be in the form of income generated from the asset (giving a car on rent) or convenience (using the car for their own travel).

Human beings are also assets in the sense that they have the capacity to generate income themselves. Every human being has a finite life span, and death is certain. But the timing of death is uncertain. If a person dies unexpectedly early in their working life, then their family will lose the income that person would have generated in future, had they survived for their entire working life. This is where life insurance acts to fill the financial gap left behind by the early death of a person. The timing of death is uncertain for everyone, so potentially every human being needs life insurance from an early age, to protect future income.

Life insurance can protect the family from financial hardship in the event that the untimely death of an individual leads to a loss of income.

Be aware

Insurance cannot prevent the insured event from happening. It can only provide compensation for the loss that comes as a result of the insured event happening.

Question 1.1

Which is correct? The act of buying insurance is an act of:

a) risk transfer; or

b) risk retention?

Suggested activity

Speak to your family members or friends who have bought insurance. Ask them the points they considered before buying the insurance and the reason(s) they bought it.

So now we know, in the simplest of terms, how insurance works. We have seen how it can benefit the individual by providing protection against the losses that arise from life's most unhappy events. However, insurance and the insurance industry also have benefits beyond the individual, and we will look at these in the following sections.

B Role of financial services and insurance

As an employer, a producer of profit and a provider of funds for investment, the financial services industry has a huge role to play in the wider economy of the country. Insurance in particular benefits society economically and socially. Socially, it protects people from financial hardship should a disaster happen, for example a family that loses its income provider will not have to deprive its children of a higher education. Economically, it also provides employment. This is not just direct employment in the industry itself, but also, because companies no longer have to hold funds in reserve in case a disaster happens, they can invest those funds into their businesses.

The economic role is of particular importance because, according to the Government, a lot of money needs to be invested into the basic infrastructure of India if it is to continue to grow at its present rate. The Government's expenses already amount to more than its income, and so there is a role for private companies to play in developing this infrastructure and this includes insurance companies. The monies they raise from premiums can be invested into the development of the basic infrastructure needs of India: needs such as irrigation, housing, water, drainage and sanitation. In this way, insurance benefits society as a whole, not just those who hold insurance.

Life insurance is a long-term commitment for the life insured; they will need to keep paying the premium year after year for a long time. The long-term nature of this relationship means that the insurance industry is particularly well placed to meet the cost of providing infrastructure projects such as the building of airports, roads, bridges, ports and power plants etc. – projects that take a long time to develop.

We can see from all of this that a well-developed and evolved insurance sector benefits economic development and at the same time strengthens the risk-taking ability of the country.

Insurance has a role to play at the individual level too. Some of the benefits for the policyholder are shown below:

Investment option	Insurance products are an excellent investment option where the policyholder not only gets the advantage of insurance cover, but also a return on their investments based on their risk appetite.
Protection of financial security	Insurance companies provide compensation in case something happens to the assets or the individual insured, as per the terms and conditions of the policy. Life insurance protects the family against the loss of the income provider, helping to provide for the family's needs and the children's education and marriage. Hence the effect of loss is considerably reduced for an individual.
Tax benefits	Insurance offers considerable tax benefits under the **Income Tax Act 1961**. Premium paid up to Rs. 1,00,000 qualifies for deduction from taxable income under Section 80C of the Act, subject to certain terms and conditions. The death benefit or the maturity benefit received by the nominee or the policyholder is tax-free under Section 10 (10D) of the Act, as per prevailing laws, before premium paid up to Rs. 1,00,000.
Planning for life stage needs	Today the insurance products that are being offered by insurance companies are designed to suit the needs of individuals in different age groups. This allows individuals to invest in insurance policies to meet their various and changing priorities.

Example

- A young person who has just started earning can buy a term insurance plan for pure protection or an ULIP (unit-linked insurance plan) for high returns based on their risk appetite.
- An individual who is 25-30 years old and is looking to invest for their family's future, such as a child's education or a marriage, can invest in various child ULIPs or endowment plans based on their risk profile.
- An individual looking for retirement income can invest in pension plans.
- An individual can invest in a whole of life policy to provide cover over the course of their entire lifetime.

Develops the habit of saving	An individual learns to save a certain amount of money from their income in order to pay their insurance premium. This encourages the habit of saving among individuals.
Loan against insurance policy	Individuals can also take out a loan against their insurance policies, subject to the conditions and privileges of the policy, without affecting any policy benefits.
Releases capital and management	When the management of a company knows that many of the risks faced by that company are covered by insurance, they no longer need to set funds aside to cover the impact of those risks taking place. They are also free to concentrate on developing and growing their business. This makes the company more effective, which in turn helps to improve the overall economy of the country.

However, insurance can only make a positive contribution to society if people have confidence that they will only be sold a policy that meets their needs and that the policy will protect them should an insured event happen. If people don't feel this confidence, then they will not buy the insurance and all these benefits will be lost or reduced. Therefore, the insurance market needs to take a professional approach in all that it does.

C Benefits of a professional insurance market

A professional insurance market is one that is open and honest in its dealings with customers and one that keeps the interests of its customers at the forefront of all that it does. There are numerous benefits of taking such a professional approach as we shall see here.

Needs-based selling

A professional market ensures that the customer gets what they are looking for rather than what the company wishes to sell them. This is called **'needs-based selling'**. A customer who is confident that they will only be sold a product that meets their needs is more likely to buy and then buy again, and recommend insurance to others. The insurance industry's Regulator (the IRDA) has been proactively trying to address concerns about mis-selling, which is where a customer has been sold a policy that does not meet their needs in some way. When this happens the public becomes wary and cynical about the value of insurance.

Disclosure

Similarly, a professional insurance market is one that is open in its dealings: where there is clear **disclosure** of all relevant information. For example, with unit-linked insurance plans (ULIPs) a break up of the premium (including all the charges) is given in the policy. The Regulator has made it mandatory for companies to disclose the commissions earned by agents on the product in the benefit illustration document. This practice makes the customer aware of how much money is going towards life cover, investments and other expenses – information they need to know.

An insurance market that operates in this professional way will bring many benefits to its customers, itself, society and the wider economy:

Higher confidence among policyholders	A professional approach to insurance selling (incorporating needs-based selling and disclosure) combined with various steps like regulation, a grievance redressal system, the Ombudsman and the IRDA grievance call centre (see section D4) have greatly helped to build the public's confidence in the system. The public can be assured that they are being treated fairly by the industry and, if they have a legitimate concern, that the Regulator will support them. Therefore they are more likely to see insurance as a practical way of meeting their needs.
Increase in insurance penetration	India has the world's second largest population and thereby the potential to be the second biggest insurance market. The addressable market is so vast that there is scope for all insurers to find new customers rather than competing with each other for the same ones. This will increase the market penetration of insurance, but will only be true if the public has confidence that they are safe to address their needs through buying insurance.
Social benefits	As insurance spreads to more parts of the Indian community, with more people seeing it as a safe and valuable option, less people will be thrown into financial hardship as a result of a family tragedy or other unforeseen event.
Employment generation	An increase in the penetration of insurance will mean more employment opportunities. Insurance companies are continuously recruiting new employees and agents to sell their products. With a dynamic market and new roles emerging, professionals can keep looking for new opportunities. An insurance market that has a reputation as a professional industry will attract good quality personnel to a career in insurance, which will also help to promote the market's professionalism.
Increase in profits for the insurance company	A company that is professional in its approach to selling insurance and is, therefore, trusted by the public will find that it is able to sell more insurance. This, combined with the spread of insurance to new customers as confidence in insurance grows, will increase the profitability of the insurance company.

We can see that these benefits of a **professional** insurance market will contribute to an increase in the overall benefits that insurance offers to the wider economy, as discussed in section B. More profitable companies, more jobs, and less financial hardship at an individual and corporate level will all enhance the overall economic success of the Indian economy and release more funds for investment in its businesses and infrastructure.

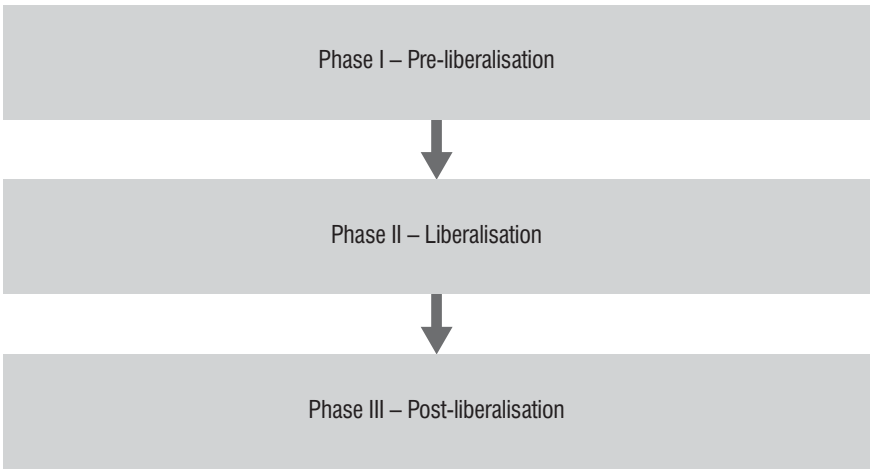
Now that we have looked at how insurance can benefit not just individuals but society as a whole, let's pause for a moment to consider how we came to be where we are today. The insurance market in India has not always been the way it is today, and we shall look at how it has developed over the years in the next section.

D History of insurance

The history of insurance in India is deep-rooted. Since the earliest times insurance has been carried out in some form or other. Insurance in India has developed over time and has taken ideas from other countries – England in particular.

The history of insurance in India can be divided into three phases as follows:

Figure 1.1



D1 Phase I – Pre-liberalisation

1818–1829	**First insurance company**: in 1818 the Oriental Life Insurance Company in Kolkata (then Calcutta) was the first company to start a life insurance business in India. However, the company failed in 1834. In 1829 the Madras Equitable had begun transacting life insurance business in the Madras Presidency.
1870	Following the enactment of the **British Insurance Act 1870**, the last three decades of the nineteenth century saw the creation of the Bombay Mutual (1871), Oriental (1874) and Empire of India (1897) in the Bombay Residency.
1912	The **Indian Life Assurance Companies Act 1912** was the first statutory measure to regulate life business.
1928	The **Indian Insurance Companies Act 1928** gave the Government the power to collect statistical information about both life and non-life business transacted in India by Indian and foreign insurers, including provident insurance societies.
1938	To protect the interest of the insuring public, the earlier legislation was consolidated and amended by the **Insurance Act 1938** which gave the Government effective control over the activities of insurers.
1950s	In the 1950s, competition in the insurance business was very high and there were allegations of unfair trade practices. The Government of India therefore decided to nationalize insurance business.
1957	Formation of the **General Insurance Council (GI Council)**: the GI Council represents the collective interests of the non-life insurance companies in India. The Council speaks out on issues of common interest, participates in discussions related to policy formation, and acts as an advocate for high standards of customer service in the insurance industry.
1972	The **General Insurance Business (Nationalisation) Act 1972 (GIBNA)** was passed. The **General Insurance Corporation of India (GIC)** was formed in pursuance of Section 9(1) of GIBNA. It was incorporated on 22 November 1972 under the **Companies Act 1956** as a private company limited by shares.

D2 Phase II – Liberalisation

The start of reform

The international payment crisis of the 1990s forced the Government to re-think its industrial policies and regulations. The Government only had enough foreign currency reserves to finance a few days of imports.

1993	**Malhotra Committee**: in 1993 the Government set up a committee under the chairmanship of R N Malhotra, the former Governor of RBI, to make recommendations for the reform of the insurance sector. In its report in 1994, the committee recommended, among other things, that the private sector and foreign companies (but only through a joint venture with an Indian partner) be permitted to enter the insurance industry.
1999	**Formation of the IRDA**: following the recommendations of the Malhotra Committee report, the **Insurance Regulatory and Development Authority (IRDA)** was constituted as an autonomous body in 1999 to regulate and develop the insurance industry. The IRDA was incorporated as a statutory body in April 2000.

D3 Phase III – Post-liberalisation

As we have seen, following the recommendations of the Malhotra Committee, the insurance sector was opened to private companies. Foreign companies were also allowed to participate in the Indian insurance market through joint ventures (JVs) with Indian companies. Under current regulations the foreign partner cannot hold more than a 26% stake in the joint venture.

The key objectives of the IRDA include the promotion of competition with a view to increasing customer satisfaction through more consumer choice and lower premiums, while ensuring the financial security of the insurance market. The IRDA has the power to make regulations under section 114A of the Insurance Act 1938. Since 2000 it has introduced various regulations ranging from the registration of companies for carrying on insurance business to the protection of policyholders' interests.

The Insurance Act 1938 and GIBNA were amended which removed the exclusive privilege of GIC and its four subsidiaries to write general insurance in India. As a result, general insurance business was opened up to the private sector.

With the **General Insurance Business (Nationalisation) Amendment Act 2002**, effective from 21 March 2003, GIC ceased to be a holding company of its four subsidiaries. Their ownership was vested with the Government of India. GIC was notified as a reinsurance company.

Question 1.2

Why did the Government think it necessary to nationalise the life insurance industry in the 1950s?

In appendix 1 we have provided lists of the life and general insurance companies that are active in India at the present time. Take a look at it now and get a feel for how many companies operate in the different sectors.

Be aware

At the time of writing (January 2011) a proposal to increase the Foreign Direct Investment (FDI) limit in the insurance sector from the current 26% to 49% is awaiting approval in Parliament.

D4 Recent developments in the insurance industry

By 2010 India was the fifth largest insurance market in the world and it is still growing rapidly.

There has been a lot of change in the decade since the market was opened up to the private sector. In this section we will look at some of the important developments of the last few years.

Growing importance of IT	All insurance companies now use information technology (IT) to benefit their business and to improve convenience for their customers. Today, customers can pay their premiums and check the status and other details of their policy using the company's website. Updates relating to the receipt of premiums or changes to their policy are sent to the customer through mobile SMS.
Bancassurance	Many banks have joined with insurance companies to cross-sell insurance products to their customers. Insurance companies benefit from the wide network and loyal customer base of banks, and the contribution that bancassurance makes to insurance sales has steadily grown over the last few years. The banks benefit through being able to provide value-added products to their customers and from the fee income they receive in return from the insurance companies. Many banks have started their own life insurance subsidiaries.

Online sales	Most of the insurance companies have now started selling insurance products online. This eliminates the need for an intermediary and reduces costs. This saving can be passed to customers in the form of reduced premiums.
Micro-insurance	Micro-insurance guidelines were issued by the IRDA in 2005. Micro-insurance products provide insurance protection to people in lower income groups, such as self-help group (SHG) members, farmers, rickshaw pullers and others against the risks that they and their assets are exposed to. The premiums for these products may be as low as Rs. 15 and are collected on a weekly basis. The minimum life insurance cover specified by the Regulator for this category is Rs. 5,000 and the maximum cover that can be provided is Rs. 50,000. People who work in agriculture and allied activities are exposed to the hazards of nature so they need protection against risks like monsoon failure, floods etc. This is where micro-insurance can come to their rescue.
Grievance redressal	Whenever any industry is experiencing fast growth there are bound to be concerns, and the insurance industry is no different. There has been an increase in complaints from customers about the settlement of their claims and customer service in general. As we saw earlier, the IRDA has taken steps to protect the interest of the policyholders. It has asked insurance companies to set up internal customer grievance redressal cells/departments, and an Insurance Ombudsman has been established. The latest initiative from the IRDA is the setting up of a call centre which an insured can contact to seek the resolution of a grievance they have against their insurer. The unhappy customer can either call a toll-free number (155255) or email complaints@irda.gov.in to register their complaint.

Question 1.3

What is bancassurance?

?

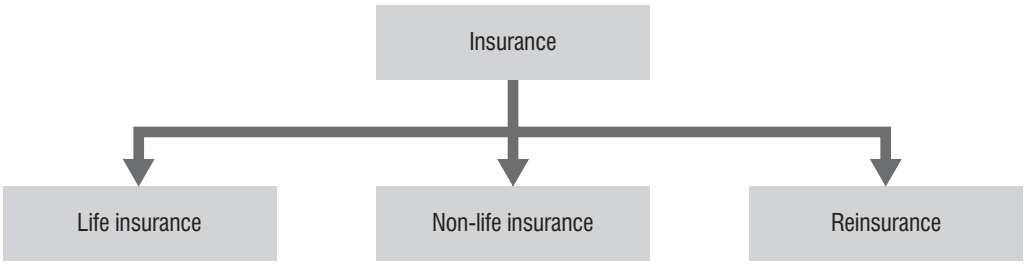
We will return to some of these topics in more detail later in this chapter. First, however, we will continue our overview of the insurance industry in India by looking at the organisations and roles that feature within it.

E Insurance organisations and roles

E1 Types of insurance organisations

Insurance organisations are divided into three main categories, as the following figure shows. We will look briefly at the various products the different types of insurance organisations offer in section G.

Figure 1.2: Types of insurance organisation



E1A Life insurance companies

Life insurance companies cover risks that relate to human lives. They offer different benefits under different types of products and cover the risk of early death, as well as the risk of living into old age. Under traditional plans, like term insurance plans, insurance companies provide death cover. If the insured person dies within the term of the policy then the nominee/beneficiary is paid a specified amount (also known as the sum insured). We saw an example of this when we looked at the case of Ajay at the start of this chapter. Under pension plans, insurance companies offer periodic monthly payments (annuities) to support the insured during their retirement.

E1B Non-life insurance companies

Non-life insurance companies generally cover risks other than those relating to human lives. The exceptions to this are personal accident and health insurance, which are provided by non-life insurance companies. Any asset either gives a monetary return (e.g. a house given on rent), or offers convenience (e.g. a car which can be used to travel from one place to another) can be insured. All assets are exposed to various risks: they can be damaged or destroyed by fire, earthquake, riot, theft, flooding, cyclones etc. If the asset is damaged by any of these risks, the owner will be at a disadvantage and they will lose the income or the convenience the asset provided. Non-life insurance companies offer products that cover these risks and compensate the owner should the asset be damaged by one of them. It is a product from this type of company that an individual would buy to protect their assets, for example, their home against fire etc.

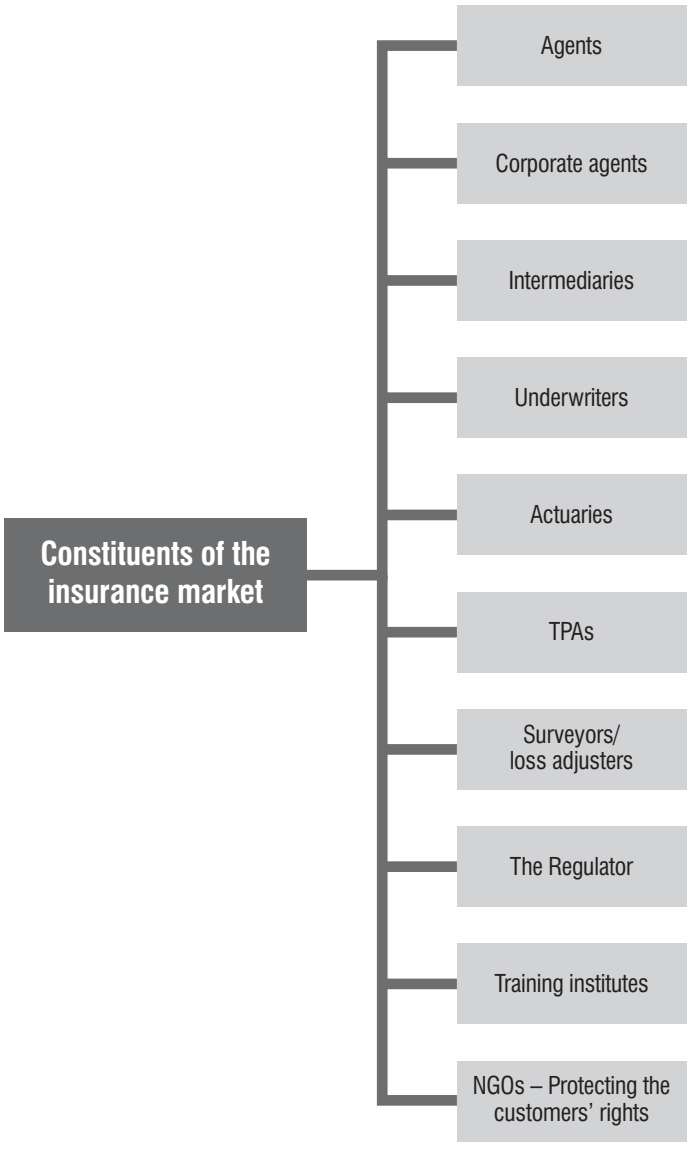
E1C Reinsurance companies

We saw in section A2 earlier that insurance is a risk transfer mechanism. Risk is transferred from those who are unable to bear it to those who can. However, insurance companies can only take on so much risk. Once that limit is reached, the insurer itself is exposed to the risk of loss. When this happens insurers look to transfer some of their risks to someone else to shield themselves from overexposure. This is where reinsurance companies come into use. A reinsurance company is an insurer for the insurance company. Reinsurance companies take on a certain percentage of the risks on the insurance company's books, in return for the payment of a consideration.

E2 Roles in the insurance industry

Apart from the insurer and the insured the other roles in the insurance industry include the following.

Figure 1.3: Roles in the insurance industry



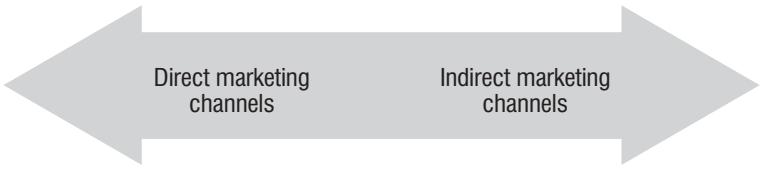
Agents	These contribute the major percentage of insurance sales in India. It is the agent's primary responsibility to meet the prospective client, understand their needs, and accordingly recommend suitable products. We shall discuss the role of agents in more detail in section H.
Corporate agents	These include banks and brokers. More details about these are included in section F2.
Intermediaries	These can be individuals as well as organisations, like firms, banks and composite brokers. Intermediaries solicit and procure business from prospective clients for the insurance company.
Underwriters	These decide whether to accept or reject the insurance proposal. If the proposal is to be accepted, then the underwriter decides at what price it should be accepted.
Actuaries	These calculate the standard price of products. They take into account statistical data and the past claims experience of the company. Apart from pricing individual products, they also do an overall financial assessment of the insurance company from time to time to make sure that the company has sufficient reserves to pay for future liabilities.
Third party administrators (TPAs)	These do the work of building hospital networks. They also help with approvals at the time of cashless admission to a hospital and with settling the bill with the insurer on discharge.
Loss adjusters/ surveyors	These do the work of assessing and certifying a loss when a claim is made on the insurance company. They have a major role to play in non-life insurance business.
The Regulator	The Regulator has the responsibility of ensuring the smooth running of the insurance sector. The Insurance Regulatory and Development Authority (IRDA) is the insurance Regulator in India. The IRDA grants licences to insurance companies and makes sure all insurance companies are in compliance with the regulations at all times. It also has a responsibility to protect the interests of the small policyholders against the mighty insurance companies.
Training institutes	These have the responsibility of supplying trained manpower to meet the ever growing need for skilled labour in the insurance industry. The Insurance Institute of India (III), Insurance Institute of Risk Management (IIRM) and the National Insurance Academy (NIA) are premier training institutes in the field of insurance.
NGOs – Protecting the customers' rights	Non-Governmental Organisations (NGOs) play an important role in spreading awareness about insurance products and protecting the rights of the customers. The role of NGOs is more important in the rural areas where they work with Self Help Groups (SHGs) and insurance companies on deeper penetration of micro-insurance products at the grassroots level.

You will see that some of these roles in the market are to do with the selling of insurance products – or insurance distribution as it is known. How do they do this? Let's take a look in this next section.

F Insurance distribution

Marketing of insurance products is done through two channels:

Figure 1.4



Consider this…

Look at the constituents of the insurance market described in section E. Of those involved in the distribution of insurance which do you think would be a direct marketing channel and which an indirect marketing channel?

F1 Direct marketing channels

A direct marketing channel may involve a sales force employed by the insurer and will certainly include the activities of the insurer's full-time staff based in the office. Advertising will focus on the target audience, whether it is done through television, email marketing, newspapers, hoardings or online advertising. The contract is concluded between the insurance company and the insured with no middleman.

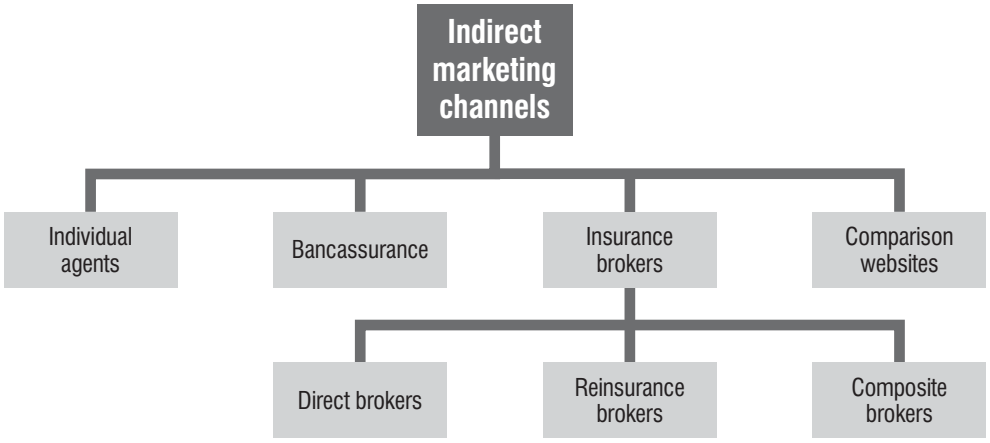
F1A E-sales

E-sales refer to sales of insurance products through the internet. This channel for the sale of insurance products is relatively new in India, but is fast catching up with more traditional methods. For some time, insurance companies have been using online payment gateways to collect renewal premiums and their websites to solicit sales inquiries for their insurance products, but it was only late in 2009 that insurance companies in India introduced products that are exclusively sold via the internet. Because these online products are being sold directly to the end customer, with no intermediaries, insurance companies can sell these products much cheaper, as the intermediary commissions are eliminated.

F2 Indirect marketing channels

Although, as we have seen, online insurance sales are increasing at a fast rate, intermediaries still make a major contribution to the sale of insurance company products. Intermediaries include the following:

Figure 1.5: Indirect marketing channels



Individual agents	These are hired by insurance companies and given the required training. After passing the prescribed examination and getting their licence, these agents seek and gain insurance business for the insurer. Agents are not on the payroll of the insurance company but are paid commission based on the sales they make. Current regulations in India mean that an individual can act as an insurance agent for only one life insurance company at a time.
Bancassurance	As we saw in section D4, insurance companies partner with banks to sell their products through them. Current regulations in India state that a bank can only act as an insurance agent for one life insurance company at a time.
Insurance brokers	These can sell the products of a number of life insurance companies. They have the advantage of being able to compare the insurance products of various insurance companies and then offer a plan that best suits the requirements of the customer. The broker represents the client: they keep in mind the customer's requirements rather than favouring any specific products of any specific insurance company.
Comparison websites	These are a recent phenomenon and use the internet to collect together and provide quotes from various life insurance companies. An individual can input their details and compare quotes from different companies. They can then choose the one that best suits their needs. However, these websites are not regulated so the customer would be wise to check with the insurance company before making a final decision on the purchase.

Consider this…

Which is better – selling insurance by direct marketing or indirect marketing? Why do you think this?

Question 1.4

Why are insurers who sell their products direct to the customer over the internet able to offer much lower premiums?

Now that we have established how we are going to sell our insurance products and who is going to do it, we need some products to sell. What sort of products are available? We will be taking the time to look at life insurance products later in this study text. For now, we will give a very brief overview of the types of insurance that are available.

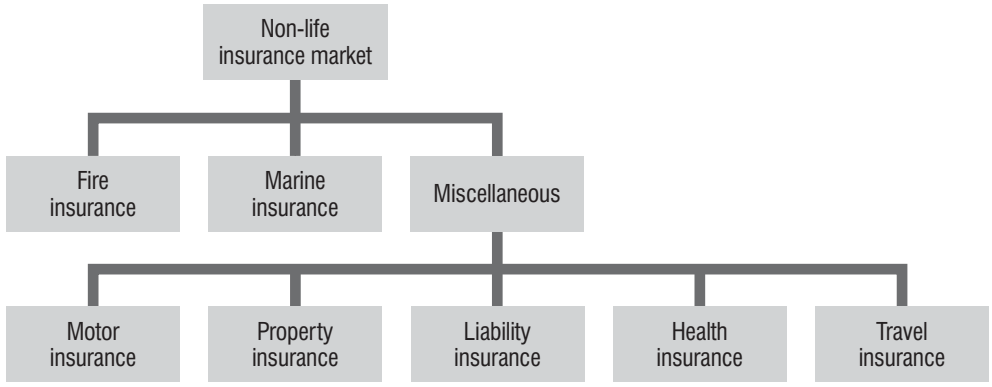
G Insurance products

As we saw in section E1, apart from reinsurance, the insurance market is broadly divided into two categories – **life insurance** and **non-life insurance**. Life insurance covers risks related to human lives. All other risks are covered under non-life insurance or **general insurance**.

G1 Non-life insurance market

The non-life insurance market is further divided into sub-categories.

Figure 1.6: Non-life insurance market

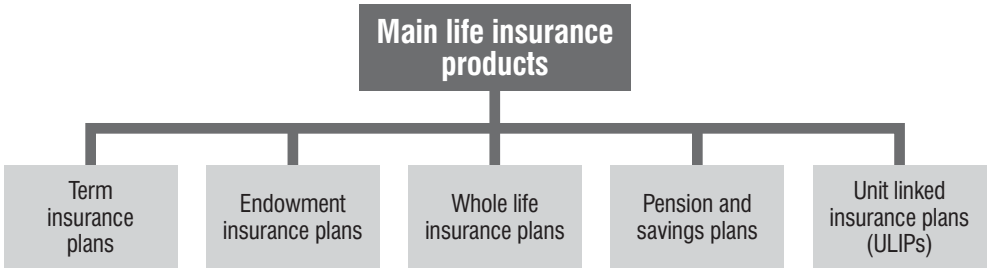


It is a continuously developing market with new products being introduced from time to time as society has a need for them.

G2 Life insurance market

There are many products available in the life insurance market and we will consider them in detail in chapters 5, 6 and 7. However, here we will give a brief description of the main types of product so that you can start to see what sort of products you could be involved in selling. The main products offered under life insurance are show below.

Figure 1.7: Main life insurance products



A discussion of specific general insurance products is outside the scope of this book.

Suggested activity

Ask your family members or friends about the life insurance plan(s) they have. Ask them why they chose that particular plan.

We have now concluded our overview of the insurance market, the roles within it and the products it provides. Before we move on in the next chapter to look at the concepts behind insurance, let's conclude this one by looking at what it means to be an agent.

H Role and functions of an agent

H1 Becoming an agent

There are a number of steps that you as an individual need to take and a number of criteria that you will need to fulfil if you wish to become a life insurance agent. The Insurance Act requires that an insurance agent must have a licence, and the IRDA deals with all issues of licences and other matters relating to agents. There are **regulations** which must be complied with at all stages in the process. Full details of these regulations and requirements will be covered later in the study text. In this introductory chapter we shall just outline the process of becoming an agent and explain what an agent does.

H2 Role of an agent

As stated in section F2, agents are hired by insurance companies and they act as the main link between the insurance company and the insured. Their role is to recommend to clients the right products that address the clients' needs. At the same time they must act in the interests of the insurance company by using their unique position of knowing their clients well enough to protect the insurance company from any undue adverse product selection.

This makes the role of the agent in the entire insurance business very crucial.

Agents facilitate the smooth sale of insurance products by assisting their clients with completing the paperwork involved, and after the policy is sold the agent should ensure it is serviced properly until maturity or in the event of a claim. At the time of a claim, the agent should also assist the client to complete the required formalities to ensure quick settlement.

In India, life insurance agents deal with a range of insurances which are generally considered under the following headings:

- basic life insurance products, such as term insurance and whole life plans;
- savings products; and
- other financial products, such as health insurances and accidental death plans.

All these products will be looked at in later chapters.

Once licensed and appointed, the agent is an **independent professional**. At the heart of this is the need for agents to put the interests of their clients above all else.

H3 Code of Conduct for agents

In supporting agents to carry out their role in a professional manner, every licensed agent must adhere to the Code of Conduct specified by the IRDA in the **Insurance Regulatory and Development Authority (Licensing of Insurance Agents) Regulations 2000** as per Regulation 8. In the Code of Conduct the IRDA gives details as to what an agent shall and shall not do. For instance, the agent should disclose all information relating to the insurance company that they represent and the products they are recommending. They should act in the best interests of the client while at the same time making sure that there is no adverse selection against the insurance company (we will discuss adverse selection further in chapter 4).

In addition, the insurance agent needs to take steps to keep the business they have secured for their company. To do this they need to make every attempt – both orally and in writing – to ensure that the policyholder pays the premium within the required time.

We will return to the Code of Conduct for agents later.

Key points

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

Role of financial services

- The financial services sector (including the insurance sector) has a major role to play in the overall economic growth of the country.
- The insurance sector can provide investment to companies/projects thanks to the money invested in the insurer by individuals buying protection and investment products.

Benefits of professional insurance market

- A professional insurance market based on needs-based selling and proper disclosures will lead to higher confidence among policyholders, an increase in the penetration of insurance, job creation and enhancement of the overall success of the insurance company.

History of insurance

- The history of insurance in India can be divided into three phases.
- The first phase (pre-liberalisation) was dominated by private and foreign insurance companies before the Government nationalised the sector in 1956.
- In the second phase (liberalisation) reforms were initiated and the IRDA was set up as the Regulator of the insurance sector. Private participation was invited and also FDI.
- In the third phase (post-liberalisation) many private companies started insurance operations with a foreign partner in joint ventures. Currently there are 23 life insurance companies operating in India.
- In recent times insurance companies have adopted IT in a big way. Bancassurance and micro-insurance have been introduced and grievance redressal systems established.

Insurance organisations and roles

- Insurance business is classified into three main types – life, non-life and reinsurance.
- The insurance market is made up of agents, corporate agents, intermediaries, underwriters, actuaries, TPAs, surveyors, the Regulator, training institutions and NGOs.

Insurance distribution

- Insurance is sold through direct marking channels (employees and internet sales) and indirect marketing channels (agents, bancassurance, brokers).

Insurance products

- Products offered by life insurance companies include term insurance plans, endowment insurance plans, whole life plans, pension and savings plans and unit-linked insurance plans.

Becoming an agent

- To become an agent a person has to submit the necessary form and fees, have the required qualification, undergo practical training and pass the required examination.
- An agent should recommend to clients the best products that address their needs and at the same time make sure there is no adverse selection for the insurer.
- An agent should continuously strive to improve their knowledge of their own insurer's products, competing insurers' products and other competing investment products on the market.
- All licensed agents have to comply with the Code of Conduct at all times.

Question answers

1.1 The answer is a) risk transfer. You are transferring the risk you face to the insurance company to bear for you.

1.2 There was a great deal of competition and allegations of unfair practice.

1.3 Bancassurance is when banks partner with insurance companies to offer insurance products to the bank's customers.

1.4 By removing the need for a middleman and so the need to pay any commission, the insurance company can pass on the savings made to their customers.

Self-test questions

1.	Why do people need life insurance?
2.	What are the benefits of having a professional insurance market?
3.	a) What are the three phases of the development of the insurance sector in India? b) Describe what happened in the most recent phase.
4.	List the participants who make up the insurance market.
5.	What indirect marketing channels are available to insurance companies?
6.	What are the different types of products sold by life insurance companies?

You will find the answers on the next page

Self-test question answers

1.	People need life insurance to help take care of their obligations should they die prematurely. These include the: • income needs of the family; • children's education; and • children's marriage.
2.	The benefits of a professional insurance market that focuses on needs-based selling and disclosure include: • higher confidence among policyholders; • an increase in insurance penetration; • social benefits; • employment generation; • increased profits for insurance companies; • premiums available to channel into investment projects; and • an improvement in the overall growth of the economy.
3.	a) The history of insurance in India can be divided into 3 phases as follows: • Phase I – Pre-liberalisation; • Phase II – Liberalisation; and • Phase III – Post-liberalisation. b) In Phase III, following the recommendations of the Malhotra Committee, the insurance sector was opened up to private companies. Foreign companies were also allowed to participate in the Indian insurance market through joint ventures (JVs) with Indian companies. Under current regulations the foreign partner cannot hold more than a 26% stake in the joint venture. The IRDA has the power to make regulations under Section 114A of the Insurance Act 1938. Since 2000 it has introduced various regulations ranging from the registration of companies for carrying on insurance business to the protection of policyholders' interests.
4.	The constituents of the insurance market include: • agents; • corporate agents; • intermediaries; • underwriters; • actuaries; • third party administrators (TPAs); • surveyors/loss adjusters; • the Regulator; • training institutes; and • NGOs – working to protect customers' rights.
5.	The indirect marketing channels include: • individual agents; • bancassurance/corporate agents; • insurance brokers: these are further sub-classified as direct brokers, reinsurance brokers and corporate brokers; and • comparison websites (though these are not regulated).
6.	The different types of products sold by life insurance companies include: • term plans; • endowment insurance plans; • money-back plans; • whole life insurance plans; • pension and savings plans; and • unit-linked insurance plans (ULIPs).

Appendix 1.1: Insurance companies active in India (January 2011)

Table 1.1 Life insurance companies in India

Sr. No.	Name of the Life Insurance Company
1	HDFC Standard Life Insurance Co. Ltd.
2	Max New York Life Insurance Co. Ltd.
3	ICICI Prudential Life Insurance Co. Ltd.
4	Kotak Mahindra Old Mutual Life Insurance Co. Ltd.
5	Birla Sun Life Insurance Co. Ltd.
6	Tata AIG Life Insurance Co. Ltd.
7	SBI Life Insurance Co. Ltd.
8	ING Vysya Life Insurance Co. Ltd.
9	Bajaj Allianz Life Insurance Co. Ltd.
10	Met Life India Insurance Co. Ltd.
11	Reliance Life Insurance Co. Ltd. (Earlier AMP Sanmar Life Insurance Company from 3 January 2002 to 29 September 2005)
12	Aviva Life Insurance Company India Limited
13	Sahara India Life Insurance Co. Ltd.
14	Shriram Life Insurance Co. Ltd.
15	Bharti AXA Life Insurance Co. Ltd.
16	Future Generali India Life Insurance Company Ltd.
17	IDBI Federal Life Insurance Company Ltd.
18	Canara HSBC OBC Life Insurance Company Ltd.
19	Aegon Religare Life Insurance Company Ltd.
20	DLF Pramerica Life Insurance Co. Ltd.
21	Life Insurance Corporation of India
22	Star Union Dai-ichi Life Insurance Co. Ltd
23	IndiaFirst Life Insurance Company Limited

Appendix 1.1: Insurance companies active in India (January 2011)

Table 1.2 General insurance companies in India

Sr. No.	Name of the General Insurance Company
1	Bajaj Allianz General Insurance Company Limited
2	IFFCO Tokio General Insurance Company Limited
3	HDFC ERGO General Insurance Company Limited
4	ICICI Lombard General Insurance Company Limited
5	The New India Assurance Company Limited
6	The Oriental Insurance Company Limited
7	Max Bupa Health Insurance Company Limited
8	Royal Sundaram Alliance Insurance Company Limited
9	United India Insurance Company Limited
10	SBI General Insurance Company Limited
11	Tata AIG General Insurance Company Limited
12	Reliance General Insurance Company Limited
13	Cholamandalam MS General Insurance Company Limited
14	National Insurance Company Limited
15	Shriram General Insurance Company Limited
16	Bharti Axa General Insurance Company Limited
17	Future Generali India Insurance Company Limited
18	Agriculture Insurance Company of India
19	Star Health and Allied Insurance Company Limited
20	Apollo Munich Health Insurance Company Limited
21	Universal Sampo General Insurance Company Limited
22	Export Credit and Guarantee Corporation of India Limited
23	Raheja QBE General Insurance Company Limited
24	L&T General Insurance Company Limited

Table 1.3 Reinsurance companies in India

General Insurance Corporation (GIC)

Source: *IRDA website*

2
Risk and insurance

Contents	Syllabus learning outcomes
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A Concept of risk	2.1
B Components of risk	2.2
C Insurable risks	2.3
D Risk transfer	2.4
E Pooling of risks	2.5
Key points	
Question answers	
Self-test questions	

Learning objectives

After studying this chapter, you should be able to:

- explain the concept of risk in terms of insurance;
- explain the main components of risk;
- describe the risks that can be insured;
- describe the importance of insurance as a risk transfer mechanism;
- explain the concept of pooling of risks.

Introduction

In chapter 1 we explained that insurance is based on the transfer of risk and we looked briefly at some of the risks that a person might face.

In this chapter we will look at the nature of risk in more detail and the types of risks that can be insured against, in addition to explaining a little more about how risks are transferred and pooled. Of course, as a life insurance agent you are concerned with the **risks relating to human life** and we shall focus our attention on these aspects in this chapter. However, we shall also be making reference to some risks that apply to general insurances as this will help you to gain a good understanding of the concept of risk in its broadest sense.

Key terms

This chapter features explanations of the following terms and concepts:

Risk	Components of risk	Uncertainty	Hazard
Peril	Homogeneous risk	Accidental risk	Insurable risk
Financial risk	Pure risk	Risk transfer	Pooling of risks

A Concept of risk

A1 Definition of risk

The word 'risk' can be used in several different contexts. In insurance, risk is applied to certain assets that can be insured, such as a human life, a house, a car, etc.

There is no single definition of risk because of the different contexts in which it can be used.

Here are some of the definitions of risk:

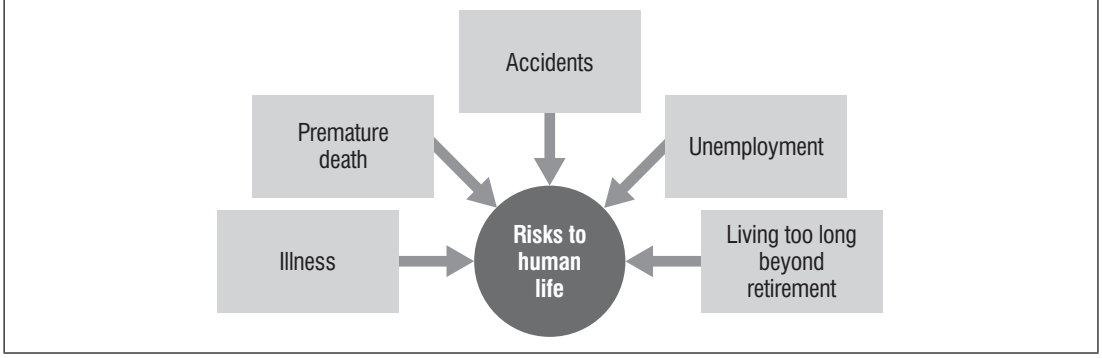
- Risk is the chance of damage or loss.
- Risk is doubt concerning the outcome of a situation.
- Risk is something or someone considered to be a potential hazard.

Be aware

In **life insurance** the word 'risk' is used to describe the possibility of an unfavourable event occurring, for example untimely **death** or an unforeseen **disability**.

During a lifetime an individual can be exposed to many risks, some of these are:

Figure 2.1



Insurance cannot prevent the occurrence of these risks, but it can reduce their impact should they occur. Life insurance mainly deals with two risks – premature death and living too long. The other risks relating to human life are mostly covered under non-life insurance. However, life insurance companies offer additional benefits or riders along with life insurance plans to cover the following risks – death or disability due to accidents, illness and unemployment.

Example

Rakesh Gupta is a sales executive working for a private company. His job involves frequent travelling to meet various retailers in his region in order to achieve his monthly and quarterly sales targets. Sometimes he has to travel continuously for days, without any rest.

Rakesh Gupta is exposed to the following risks, for which he should consider buying insurance:

Premature death – Rakesh's job profile is quite stressful and involves intense travelling. He is exposed to the risk of early death which could occur due to an accident or illness caused by stress. A life insurance plan can protect his family against the risk of Rakesh's early death.

Accident – Due to the frequent travelling that Rakesh has to do, he is prone to the risk of accidents that can result in either permanent or temporary disability. A life insurance plan with a disability benefit rider or a separate accidental death policy can protect his family against the risk of Rakesh becoming disabled.

Illness – Due to the stressful nature of his job, Rakesh is exposed to the risk of suffering from critical illnesses. A life insurance plan with a critical illness rider, or a health insurance policy, can help meet the hospitalisation expenses should Rakesh suffer from any critical illness.

Unemployment – If Rakesh has an accident and becomes disabled, he risks losing his job and becoming unemployed.

Living too long – Should none of the above events occur during his working life and Rakesh retires, he may be exposed to the risk of living too long beyond retirement. He is working for a private company that does not provide a monthly pension after retirement as part of his employee benefits. Hence he needs to work towards building a retirement fund during his working life by investing in a retirement pension plan. On retirement he can purchase an annuity plan from a life insurance company that will pay him regular annuity payments during his retirement years.

Note: Details about various life insurance plans, health insurance plans and riders will be discussed in later chapters.

Be aware

Insurance companies provide cover for only a specified number of risks. These risks are listed in the policy document. The insurance company will not provide protection for claims arising out of risks other than the specified risks.

Suggested activity

After studying the risks that an individual is exposed to, discuss with your family income provider which risks they are exposed to due to the nature of their job. If you are the main income provider what risks are you personally exposed to?

A2 Attitude to risk

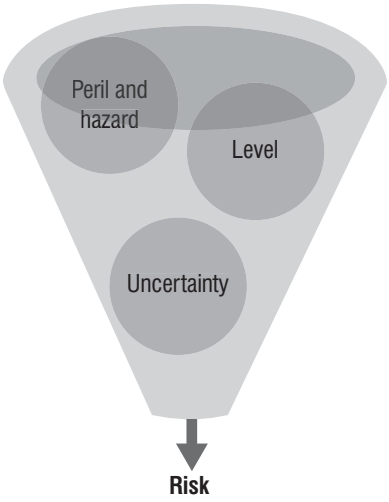
Each person's attitude to risk is different. Therefore, we all respond to risks in different ways.

Some people are willing to retain risks and carry them themselves, while others act cautiously and transfer them to an insurance company.

B Components of risk

The components of risk include:

Figure 2.2



B1 Uncertainty

Life is uncertain and so is our future. If we could know in advance that an event is going to take place we could plan to prevent it or overcome it, and thereby limit or even remove the risk involved.

As a general principle insurance is only available for risks that are uncertain. This statement raises a question: we all know that death is certain – but we also know that life insurance is available against death. So how can this statement be true?

It is true because, although we will all die one day, **when** we will die is uncertain. It is the **uncertainty about the timing of death** that makes death insurable. Once the timing of death becomes certain, when an individual is suffering from a fatal disease, for example, then an insurance company will not cover the risk. The following case studies show how this works.

Case studies

1. Rishbah Agrawal is a 40-year-old businessman who leads a healthy lifestyle. Every morning he practices yoga and abstains from smoking, tobacco and alcohol. There is a family medical history of diabetes and both his parents suffer from it. But Rishbah Agrawal himself has not been diagnosed with diabetes. Can Rishbah be provided with life insurance?

The answer is **Yes**, because Rishbah maintains a healthy lifestyle and he has not been diagnosed with any disease. The timing of his death is uncertain.

2. Rakesh Sharma has been diagnosed with a brain tumour at a very advanced stage. The doctors know that they cannot save him and sadly Rakesh's death is almost certain in the near future. Can Rakesh Sharma be provided life insurance?

The answer is **No**, life insurance companies will not take the risk of providing insurance cover for Rakesh as his death in a very short time span is almost certain.

B2 Level of risk

We know that there is a greater likelihood of some things happening than others and this affects the level of risk involved.

The level of risk is normally assessed in terms of the:

- **probability (or frequency)** of a certain event happening, and the
- **extent (or severity)** of the event if it does happen.

Frequency

The probability that a certain person will die within one year is calculated by actuaries, from the past data collected, and is made available as mortality tables. This allows insurance companies to determine the probability of a particular event, such as death, occurring under various circumstances.

The probability of risk to life for individuals will differ on the basis of their age, medical wellbeing, family medical history, lifestyle, job profile etc.

The mortality rate is the chance of dying at a specified age based on the proportion of deaths among a specific number of a sample population.

Example

Let's look at two different groups of 100 people. The first group is aged 30-39. Of these one person dies before the age of 31. The probability of death in this case is 1% – or a frequency of 1 in 100. The second group is aged 60–69. Of these 15 die people before the age of 61 (15%). The frequency of death in the second group is therefore greater than in the first group.

Severity

Insurance companies attempt to determine the amount of claims they would experience if the insured events were to actually occur based on the likely severity of the losses.

Be aware

Life insurance companies determine the level of risk based on past data (claims experience). If the past data indicates that individuals within a certain age group (say, 60–70) are more prone to heart attacks, then the level of risk will be considered to be higher for that age group.

Case study

On 22 May 2010 Air India Express Flight 812 (Dubai – Mangalore) crashed. 158 passengers were killed. The total insurance claim for Air India is expected to run into crores of rupees for the plane crash victims.

The nature of airline insurance can be categorised as low frequency but high severity (impact) since the probability of an air crash is low, but when it does occur, the extent of the loss is very high.

B3 Peril and hazard

This is the final aspect of risk and relates to the cause of losses.

Peril refers to a specific event which might cause a loss. This loss can be loss of life or loss of property. Natural disasters such as earthquakes, storms, floods etc. are all perils which cause loss of life and damage to assets.

Perils are the risk being insured against, e.g. the risk that an individual will die during the term of their policy. A **hazard**, on the other hand, is a condition that either increases the chance that a peril will happen or may cause its effect to be worse if it does.

Be aware

A hazard influences the operation of the peril.

Example

If lung cancer is a peril then smoking can be a hazard that may increase the chance that the peril (lung cancer) will occur.

Case study

On 26 January 2001 one of the worst earthquakes in India's history hit Gujarat. Thousands of people lost their lives in this tragic event. Lakhs of people were injured and property worth thousands of crores of rupees was destroyed. The epicentre of the earthquake was located northeast of Bhuj Town in Western Gujarat.

In this case the earthquake was the peril and the poorly constructed houses and schools which were not earthquake resistant and easily collapsed were a hazard.

Similarly in the event of a tsunami (such as the one that happened on 26 December 2004) leading to widespread loss of life and property, the tsunami will be the peril and flimsy houses and buildings constructed near the seashore which are washed away causing their occupants to drown will be a hazard.

Remember that while insurance cannot prevent the peril from happening, the resulting loss from the occurrence of the peril can be insured against.

Types of hazard

Hazards can be categorised into one of the following types:

Physical hazards	Moral hazards
Refer to the dimensions and physical characteristics of the risk.	Refer to the habits and activities of the individual that increase risks. They may also arise from a state of mind, i.e. the attitude and behaviour of the individual.
Example: a family history of heart disease, high blood pressure etc. is a physical hazard.	Example: consumption of alcohol, smoking etc.

In the case of life insurance, companies take account of hazard by categorising policyholders as high or low risk individuals based on their risk exposure. This categorisation also extends to the assets owned by the policyholder if they wish to insure them as well. Some of the hazards that would cause an individual to be categorised as **high risk** are:

- **Risky job profile**: if the job profile of the individual requires them to work in dangerous situations then the exposure to risk increases. For example, a person working in a chemicals factory, explosives factory, underground mine etc. will be considered more at risk than someone working in an IT company or a bank.
- **Existing medical conditions**: if the individual has already been diagnosed with a medical condition such as high blood pressure or diabetes, they will be considered to be a greater risk than those who are not suffering from an illness.
- **Lifestyle of the individual**: if an individual maintains a healthy lifestyle and abstains from smoking and drinking, the risk reduces. In contrast, an individual who is a heavy smoker or drinker has a higher exposure to risk.
- **Age group of the individual**: an older individual seeking insurance will be considered a greater risk than a younger person.

If the individual is categorised as high risk, insurance companies can either accept or reject the proposal. High risk proposals can be accepted on other than standard terms such as charging a higher premium, imposing restrictions on the sum insured, term or a lien etc. We will look at this topic in more detail in chapter 4.

Think

Identify any three perils that can happen in an individual's life. What are the hazards that might give rise to these perils?

Question 2.1

Distinguish between perils and hazards.

C Insurable risks

The following types of risk can be insured against:

- financial risks;
- pure risks; and
- particular risks.

C1 Financial risks

The outcomes of risks that can be measured in monetary terms are known as financial risks. Some of the financial risks for which an individual needs to plan are as follows:

Loss of life – this refers to risk of death of the income provider of the family with unfulfilled financial liabilities.	• To provide a steady source of income to dependants after death. • To help dependants in fulfilling various financial liabilities such as a home loan, car loan etc. in the event of their death.
Disease/disability – these include medical expenses and loss of earnings.	• To provide for any medical expenses that might arise. • To provide financial security in the event of being unable to work due to disease/disability.
Savings accumulation	• To provide for children's higher education. • To provide for children's marriage expenses. • To provide initial capital for a business etc.
Retirement – this refers to the risk of insufficient income following retirement.	• To accumulate sufficient capital to live comfortably post-retirement. • To provide a steady source of income post-retirement.

Example

Raghav Mishra is an accountant who works with a local firm. He is married with two children. His wife Kavya is a housewife. His elderly father, Suhas, also lives with them. Suhas Mishra is a farmer and owns a small piece of farmland. However, income from the farmland is not sufficient to help him meet his expenses, hence he is reliant on Raghav.

Being the main earning member of the family, Raghav has a considerable responsibility to provide for different contingencies in the future, such as:

- **Loss of life** – Raghav needs to make sure that his wife, children and father are able to have a steady source of income in case something happens to him. This income should be sufficient to meet liabilities such as daily living expenses, children's school fees, managing his father's medical expenses etc.
- **Disease/disability** – there is a risk that Raghav may have an accident and become physically disabled so that he cannot work. To protect against this, he should have sufficient funds for meeting medical expenses and also routine living expenses.
- **Savings accumulation** – Raghav should make sure that his children's education is not affected due to a shortage of funds. He therefore needs to save for his children's higher education and marriage expenses.
- **Retirement** – Raghav needs to make sure that he receives a steady source of income post-retirement which should be sufficient to meet his medical and other living expenses.

Question 2.2

What are the main financial risks for which an individual needs to plan?

C2 Pure risks

Pure risks are those risks where there is no possibility of making a profit. In pure risks there can be a loss and the best possible outcome is one of breaking even.

With a pure risk the possibility of any benefit occurring as a result of the insured event taking place is nil. This type of risk is associated with those events which are totally out of the control of an individual.

C3 Particular risks

Particular risks are personal or local in their effect. The consequences of these risks occurring affect specific individuals or local communities.

D Risk transfer

As we saw in chapter 1, the primary function of insurance is to transfer the risk from an individual to an insurance company. The insurance company which bears the risk is known as the **insurer** and the individual who transfers his risk is known as the **insured**.

Risk transfer provides a sense of financial security to the insured in that if anything happens to them or their financial assets, the losses would be compensated for by the insurance company as per the policy terms and conditions. Against this transferred risk, the insured will have to pay a certain amount (consideration) to the insurer, which is known as the premium.

E Pooling of risks

Pooling of risks is one of the fundamental principles of insurance.

With pooling of risks an insurance company pools the premium collected from several individuals to insure them against similar risks. The insurance company maintains different sets of pools for different risks.

Example

Separate pools will be maintained by insurance companies for:

- life insurance;
- car insurance;
- home insurance; and
- travel insurance.

The premium collected from the individuals is deposited in the pool accounts. When there is a claim to be settled it is paid out of this pool. The insurance company has to make sure that the premium that is collected is enough to meet the claim payments. The premium that is charged by the insurance company should also be sufficient to meet the administrative and other expenses for maintaining the pool. The insurance company includes a certain percentage of the profit in the premium as well.

Question 2.3

What is pooling of risk in insurance? Can the same pool be used for car insurance and life insurance for claims payment?

E1 Law of large numbers

Insurance companies apply the 'law of large numbers' to determine the cost of total annual claims. Insurance companies determine the probability that a certain amount of claims will have to be paid by them if a large number of people are insured for a similar risk.

Example

Out of the 1,000 individuals insured by an insurance company, if the probability of death is 1% then the company will have to pay claims for 10 people.

An insurance company will set the rates of its premiums according to the number of claims it will expect to pay over the term of the policy.

Key points

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

Concept of risk

- In insurance, risk is used in the context of certain assets that can be insured, such as a human life, house, car, etc.
- Risk is the likely chance of loss that an individual might have to incur on the occurrence of a specified event.

Components of risk

- Components of risk include uncertainty, level of risk, peril and hazard.
- As a general principle, insurance is only available for risks that are uncertain.
- Level of risk is determined by two criteria: the probability of the occurrence of a certain event and the extent of losses suffered due to the occurrence of that event.
- Peril refers to a specific event which might cause a loss. A hazard is a condition that influences the operation of a peril.
- Hazards are classified as physical hazards and moral hazards.

Insurable risks

- Risks, the outcome of which can be measured in monetary terms are known as financial risks.
- Pure risks are those risks where there is no possibility of making a profit. In pure risks there can be a loss and the best possible outcome is one of breaking even.
- Particular risks are personal or local in their effect.

Pooling of risks

- An insurance company pools the premium collected from several individuals to insure them against similar risks.
- Insurance companies apply the law of large numbers to determine the cost of total claims.

Question answers

2.1 Peril refers to a specific event which might cause a loss. This loss can be loss of life or loss of property. Natural disasters such as earthquakes, storms, floods etc. are all perils which cause damage to assets and loss of life. Perils are the risks being insured against, e.g. the risk that an individual will die during the term of their policy.

A hazard, on the other hand, is a condition that either increases the chance that a peril will happen or may cause its effect to be worse if it does.

A hazard influences the operation of the peril.

2.2 The main financial risks for which an individual needs to plan are:

1) Loss of life – this refers to the risk of death of the income earner of the family with unfulfilled financial liabilities.
   - To provide a steady source of income to their dependants after death.
   - To help the dependants in fulfilling various financial liabilities such as home loan, car loan etc. in case of their death.

2) Disease/disability – includes medical expenses and loss of earnings.
   - To provide for any medical expenses that might arise.
   - To secure the individual financially, in case they are unable to work due to illness/disability.

3) Savings accumulation
   - To provide for children's higher education.
   - To provide for children's marriage expenses.
   - To provide initial capital for setting up a business etc.

4) Retirement – this refers to the risk of insufficient income after retirement.
   - To provide a steady source of income post-retirement.
   - To accumulate sufficient capital to live comfortably post-retirement.

2.3 In pooling of risk, an insurance company pools the premium collected from several individuals to insure them against similar risks. The insurance company maintains different sets of pools for different types of risks.

The pool account for life insurance will be maintained separately from the pool account for car insurance.

The pool account for one risk cannot be used to settle the claim for another type of risk.

Self-test questions

1.	List the main components of risk.
2.	List the types of risks that can be insured.

You will find the answers on the next page

Self-test question answers

1.	The main components of risk are: • uncertainty; • level of risk; and • peril and hazard.
2.	The following types of risks can be insured: • financial risks; • pure risks; and • particular risks.

3
Life insurance principles and practices

Contents

3
Part 1: Insurance principles

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Learning objectives

After studying this chapter, you should be able to:

- explain the essential features of a valid contract;
- explain the concept of insurable interest and state when insurable interest needs to exist;
- explain the importance of utmost good faith;
- outline the insurer's and insured's duty of disclosure;
- explain the importance of material facts;
- describe the facts which need not be disclosed;
- explain the concept of indemnity and its relevance to life insurance.

Introduction

An insurance policy is a legal contract between the insurance company and the insured person and it must satisfy certain conditions to ensure that it is a valid contract.

In this chapter we will learn what the essential features of a valid contract are, including some unique principles that apply only to contracts of insurance.

Key terms

This chapter features explanations of the following terms and concepts:

Offer and acceptance	Consideration	*Consensus ad idem*	Insurable interest
Key person insurance	Utmost good faith	Duty of disclosure	Material facts
Ab initio	Indisputability clause	Indemnity	Capacity to contract
Contract of indemnity	Value contracts		

A Essentials of a valid contract of insurance

An insurance contract is an agreement, enforceable by law, between the insurance company and the insured person; the insured person agrees to pay a premium to the insurance company and the insurance company agrees to pay a sum of money, on the happening of a specified event, to the insured person.

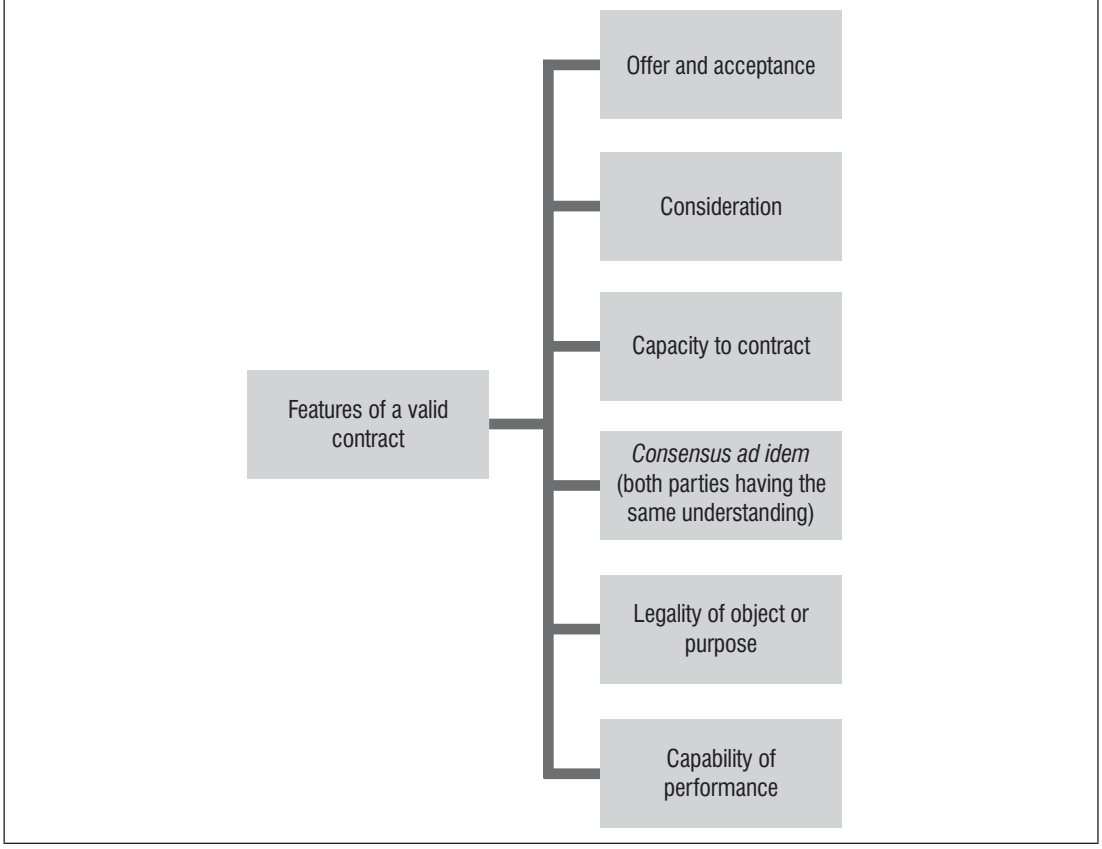
How do both parties enter into this legally binding agreement and what conditions must be satisfied by both parties to ensure that the contract is a valid one?

To answer these questions, we will first look at the essential features of a valid contract, and then we will move on to see how an insurance contract differs from other contracts.

A1 Features of a valid contract

The following features are essential if a legal contract is to be valid:

Figure 3.1



The most important features are **offer and acceptance** and **consideration**.

A1A Offer and acceptance

A contract comes into existence when one party makes an offer which the other party accepts unconditionally. It is easier to see how unconditional acceptance works by looking at an example. Let's consider the following conversation:

Example

ABC insurance company: 'On the basis of your proposal form we can offer you cover, with a sum insured of Rs. XXXXX.'

Ganesh, the proposer (the person who wants to take out the insurance): 'I accept.'

In this example, Ganesh's acceptance does not alter any of the terms of ABC's offer and the acceptance is said to be unconditional. A contract is formed, subject to the other essential elements being present.

Now, consider an alternative response by Ganesh:

Example

ABC insurance company: 'On the basis of your proposal form we can offer you cover, with a sum insured of Rs. XXXXX.'

Ganesh, the proposer (the person who wants to take out the insurance): 'I accept, but I would like to increase the sum insured to Rs. YYYYY.'

In this case, a contract has not been formed as Ganesh has not unconditionally accepted the offer. Not until ABC accepts Ganesh's counter-offer, without further conditions, is a contract formed.

A1B Consideration

A contract must be supported by consideration in order to be valid. Consideration may be described as each person's side of the bargain which supports the contract. Consideration in contract law is merely something of value that is provided and which acts as the inducement to enter into the agreement. The payment of money is a common form of consideration, although not the only form. In terms of insurance policies, we refer to the premium as the insured's consideration.

A1C Capacity to contract

Persons entering into contracts should be competent to do so. An individual is said to be competent to enter into a contract if they are:

- of the age of majority (age 18);
- of sound mind; and
- not disqualified, by law, from entering into contracts

According to this provision therefore, minors (those under the age of 18) cannot enter into insurance agreements. In addition, people who are legally considered to be of unsound mind and any person who has been barred by law cannot enter into an insurance contract. Any contracts entered into by the above people will be null and void.

A1D *Consensus ad idem*

In simple terms this means both the parties to the contract must understand and agree upon the same thing, in the same sense. The proposer should have understood the features of the insurance policy in the same sense (manner) in which it was explained to them by the agent.

A1E Legality of object or purpose

The objective of both the parties to the contract should be to create a legal relationship. The purpose of the contract should also be legal.

Example

It is illegal for a husband to insure his wife's life, and then to kill her and present it as a case of accidental death in order to benefit from the claim amount that he will receive as the legal beneficiary. Insurance cannot be used for illegal purposes or to derive monetary benefits from it.

Another example of an illegal act is a person who is heavily in debt, taking out life insurance for a large amount and then committing suicide so that their family can benefit from the claim money. Claims for death due to suicide in the first year are excluded by most life insurance companies.

A1F Capability of performance

The contract must be capable of being performed by both the parties. For example, a person requesting life insurance for a very high amount should be capable of paying the premium required.

The agreement and its term must be certain and capable of performance and in a form that complies with the requirements of the laws of the land.

Consider this…

Jigar makes a proposal to an insurance company for life insurance cover of Rs. 75 lakhs with a premium payment of Rs.12,000. During the medical check-up the company finds out that Jigar is suffering from a disease and considers that he presents a higher than normal risk. The insurance company therefore tells him that the premium chargeable will be Rs.15,000 instead of Rs.12,000.

How will you treat the above scenario in terms of offer and acceptance?

Question 3.1

What are the essential features of a valid contract?

A2 The policy document

In order that both the insured person and the insurance company are clear as to the terms that have been agreed between them, a policy is issued. The policy contains all the details of cover, period of cover, exceptions, conditions, the premium and other relevant information. The policy is not the contract of insurance in itself; rather, it is evidence of the contract.

The contract of insurance comes into effect once the insurance company has accepted the insurance proposal, terms have been agreed and the premium has been paid or agreed to be paid. Thus, the contract exists irrespective of the existence of an actual policy document. The absence or loss of the policy does not invalidate the contract, but the policy is useful as proof in the event of a dispute over the terms agreed. We will examine the structure and contents of the policy in detail in Part 2 of this chapter.

A3 The role of insurance agents in insurance contracts

In the eyes of the law, anyone who acts on behalf of another person is an 'agent'. If we allow someone to act for us, we probably have to accept responsibility for whatever is done by them on our behalf within the terms of the arrangement. This is true in insurance, and whenever there is the involvement of an intermediary, legal relationships are set up.

We saw in chapter 1 that there are different types of intermediaries involved in the insurance industry and that the term 'agent' is applied to a licensed intermediary hired by an insurance company to sell that company's products on its behalf. In doing so the intermediary becomes the legal 'agent' and is deemed to be acting on behalf of the 'principal' (in this case, the insurance company). They are authorised by the principal to bring the principal into a contractual relationship with a third party (in this case the proposer/ person wanting to take out insurance).

Be aware

You will also remember from chapter 1 that certain intermediaries called composite brokers are independant advisers. Their legal status is complicated because they do some things on behalf of their client and some on behalf of the insurer, and so they can be deemed to be both the agent of the insured and the agent of the insurer (depending upon the nature of the function they are performing).

Be aware

Insurance contracts are specialised contracts and are subject to additional principles as well as the essentials of a valid contract described above.

We will now look at these additional principles in the following section.

B Insurable interest

Insurable interest is one of the elements necessary to create a valid insurance contract.

B1 What is insurable interest?

The following case study will help you to understand the meaning of insurable interest:

Case study

Ganesh is a 30-year-old man working for a multinational company (MNC). Ganesh's wife works for a domestic firm and she is a co-applicant in the loan on their home together with Ganesh. Whilst Ganesh has a well-paid job, as well as managing the monthly living expenses he has a running home loan and a car loan to take care of. Ganesh has worked hard to build these assets. So far everything has been going as Ganesh has planned. Imagine, however, the following scenarios:

Scenario 1: Ganesh meets with an accident and is hospitalised for a month.

Scenario 2: Ganesh's wife dies unexpectedly.

Let us have a closer look at the above scenarios and the possible solutions.

Scenario 1: Ganesh will not be able to work for at least a month. He will not receive a salary for that time and will also have to pay his hospital bills which could be very costly. To avoid this situation Ganesh should ensure that he has adequate health insurance to cover him against unexpected medical emergencies and to cover him against loss of pay if he is absent from work due to medical reasons.

Scenario 2: Ganesh's wife, apart from contributing to the family income, also takes care of the family. Following her unexpected death, Ganesh will face financial difficulties in repaying the home loan and meeting other financial commitments. To protect against the above scenario Ganesh can take out life insurance on his wife's life which will pay out in the event of her unexpected death, thus ensuring that the family's finances are not put in jeopardy. Ganesh's wife can also take out life insurance on Ganesh's life which would pay out on his unexpected death.

You will see from these scenarios that if either of the events happen, Ganesh and his family's **financial position will be adversely affected unless he has taken out insurance**.

Consider this…

How do these scenarios help us to understand insurable interest?

Insurable interest is said to exist when an individual stands to gain or benefit from the continued existence or well-being of another individual(s) or property, and at the same time the individual would suffer a financial loss or inconvenience if there is damage to the other individual(s) or property.

We can see from the case study that Ganesh has insurable interest in his own good health and the life of his wife because he benefits from the well-being of them, and he would be **financially adversely affected** should there be damage to either or both of them.

B2 Relevance of insurable interest

Now that you know the meaning of insurable interest, you must be wondering what is the relevance or importance of insurable interest in insurance? **Insurable interest is a very important principle of insurance**. In order to take out any kind of insurance, an individual has to have insurable interest in the subject matter they wish to insure. The subject matter is the item or event insured and can be a person's own life, the life of others or property. Insurable interest forms the legal basis for deciding whether insurance can be taken out or not.

To summarise: Insurable interest is the legal right of the person to insure the subject matter with which they have a legal relationship recognised by law.

B3 Circumstances in which insurable interest exists

Court judgements have established the circumstances in which insurable interest is deemed to exist.

By common law, insurance interest is deemed to exist in the following circumstances:

- **Own life:** a person has unlimited insurable interest in their own life.

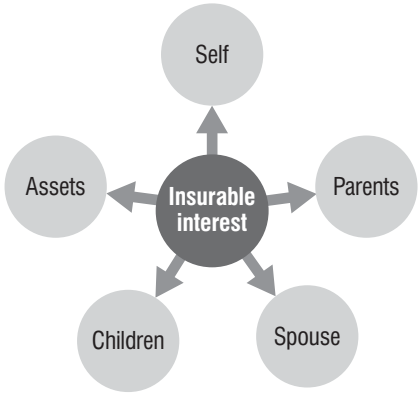
Example

Ganesh can take out life insurance for an amount equal to the present value of his future earnings. Alternatively, he might assess how much would be needed to take care of all his liabilities in his absence – such as the home loan, car loan, his family's living expenses etc.

Another method that can be used to calculate the amount of life insurance needed is to use a multiple of annual income, say, 15 times annual income or even 20 times annual income.

- **Spouse:** a husband has insurable interest in the life of his wife and, similarly, a wife has insurable interest in the life of her husband. Both benefit from the well-being of each other and each would be adversely affected if something were to happen to the other. So a husband can take out life insurance cover for his wife and vice versa.
- **Children:** parents can take insurance for their children when the children are dependants. Children can also take out insurance for their parents when the parents are dependent upon them. Ganesh can, therefore, take out life insurance for his children. Similarly Ganesh's children can take out health insurance for Ganesh in his old age when he may be dependent on his children.
- **Assets:** a person has insurable interest in the assets they own because they benefit from their use and they would be adversely affected if the assets were to be damaged.

Figure 3.2



Other circumstances where insurable interest is deemed to exist include:

- **Creditor:** a creditor has insurable interest in the life of the debtor to the extent they have lent money to the debtor.

Example

If Ganesh has borrowed Rs.10,000 from Kailash, Kailash will then have insurable interest in the life of Ganesh to the extent of the loan amount lent, i.e. Rs.10,000.

This is because if something happens to Ganesh then Kailash will not be able to recover his Rs.10,000 and he will have incurred a loss. So in this case Kailash can take out life insurance on Ganesh's life for up to the loan amount of Rs.10,000.

- **Surety:** a surety has insurable interest in the life of the principal debtor and also in the life of the co-surety to the extent of the debt.
- **Employee – employer:** an employee has insurable interest in the life of their employer to the extent of their monthly salary.
- **Employer – employee:** employers have insurable interest in the well-being of all their employees to the extent of the value of their services, for example if an employee falls sick and remains absent from duty for a long time then it can hamper the delivery of the projects that they are working on.
- **Keyman insurance:** a company has insurable interest in the lives of certain important people. The company can take out **keyman insurance** on the lives of such people.
- **Partners:** partners in a business have insurable interests in the lives of each other.

Be aware

In **life insurance**, insurable interest needs to exist (be proven) at the time of taking out the policy, i.e. at the inception of the policy. In the event of a claim, insurable interest may or may not exist and is not required to be proved.

In the case of **general insurance**, insurable interest must exist at the time of inception of the policy **and also** at the time of making a claim.

Different rules apply to marine insurance where insurable interest need only exist at the time of the claim.

C Utmost good faith

Utmost good faith must also exist for a contract of insurance to be valid.

C1 Importance of utmost good faith

The following scenario will help you to understand the principle of utmost good faith:

Scenario

Rajesh had taken out a term insurance policy of Rs. 50 lakhs for 20 years.

While returning home from the office one day, Rajesh had a road accident and sadly died.

Rajesh's wife Komal (as the policy nominee) made a claim with the insurance company. To Komal's surprise the insurance company rejected the insurance claim. Komal was obviously very distressed and asked for an explanation for the rejection of the claim. The insurance company had found out in its investigation that Rajesh had manipulated his proof of age documents and, in order to benefit from a lower premium, declared his age to be five years younger than he actually was. Rajesh had deliberately misled the insurance company to obtain the insurance policy at better terms. Due to this the insurance company declared the policy null and void and rejected the claim made by Rajesh's wife.

The proposer knows all the facts about themselves and has the moral responsibility to disclose all true information at the time of completing the insurance proposal form and submitting proper documents.

The age of a person is a vital criterion in deciding the premium pricing of a life insurance policy which is what Rajesh manipulated.

In many contracts for the purchase of a tangible product, each party can examine the item. Provided that one party does not mislead the other party and answers questions truthfully, there is no question of the other party avoiding the contract. In the case of buying a refrigerator, its features can be examined and switched on to check that it works properly. The rule governing the sale and purchase of goods and services is *caveat emptor*, or 'let the buyer beware'.

But insurance cannot work like this. We can read the policy but the only point at which we will find out how it works is when a claim is made. There is nothing to touch or see. Equally the insurance company is relying entirely upon the proposer for much of the information that it will use to decide whether it wants to accept the risk, and if it does, on what terms.

The above scenario shows that the intentional suppression of a material fact is not permissible. That is why a different set of rules apply to insurance contracts and a higher duty is required called utmost good faith.

C2 Definition of utmost good faith

We can define 'utmost good faith' as:

> A positive duty voluntarily to disclose, accurately and fully, all facts material to the risk being proposed, whether requested or not.

This means that the parties to a contract must volunteer material information before the contract is concluded. The principle applies equally to both the proposer and the insurer throughout the contract negotiations, but the law sees the proposer as the main supplier of material facts to the contract. We shall be explaining what material facts are in section D.

Breach of the duty of utmost good faith
Breaches of the duty of utmost good faith can be categorised as:

- **Non-disclosure**, or the omission to disclose a material fact, either inadvertently or because the proposer thought it was immaterial.

For example, Ajay, while applying for life insurance with Company ABC, does not disclose that he had undergone surgery during his childhood. He feels it is immaterial to disclose this information to the insurance company as the surgery was done during his childhood, some 15 years ago, and he had completely recovered from the incident a long time ago.

- **Concealment** of a material fact.

For example, Ajay consumes alcohol regularly. However, before applying for life insurance he does not consume alcohol for a month, thinking that by doing so it will not be detected during the medical test and he will get insurance at better terms.

- **Fraudulent misrepresentation** or statements made with the intention of deceiving the insurer.

For example, Ajay declares his age to be five years less than he actually is. To support this he forges the proof of age documents and submits them to the insurance company to get insurance at better terms.

- **Innocent misrepresentation** or inaccurate statements which are believed to be true.

Question 3.2

List some practical circumstances in which insurable interest is deemed to exist for an individual.

C3 Duty of disclosure

As we have explained, there is a duty to disclose material facts implicit in all insurance negotiations; this is particularly important at the proposal stage, before the contract comes into existence. The duty of disclosure is revived at each renewal date.

Insured's duty of disclosure

It is important that the proposer makes full and complete disclosure of all the material facts relating to the contract since, in the vast majority of cases, the full circumstances of the subject matter are only known to the proposer. The insured should also act towards the insurer in good faith throughout the duration of the insurance contract.

Examples

- The proposer should mention all facts relating to their health. If they are suffering from any illness which may affect the insurer's decision, it must be disclosed at the time of the proposal itself.
- The proposer must declare their correct age and support it with proper proof of age documents.
- If the proposer smokes tobacco or consumes alcohol, then this should be mentioned on the proposal form.
- If the proposer has been denied insurance in the past by any company or a proposal has been accepted at a higher premium than normal, then this should be mentioned along with the reason for it, on the proposal form.

Insurer's duty of disclosure

The insurer also has a duty of disclosure to the insured. In order to fulfil this duty, the insurer must also behave with utmost good faith.

Examples

- The insurer should make sure that it discloses all information related to the insurance product in all its literature, such as pamphlets, brochures, website etc.
- Insurance companies, for example, charge a lower premium for non-smokers compared to those for smokers.
- In the case of health insurance, at the time of renewal some companies offer a discount on the premium or increase the cover by a certain percentage keeping the premium the same, if there has been no claim made by the insured in the entire year.

Suggested activity

We have mentioned above some instances where the insurer has a duty of disclosure to the proposer/insured person. Think about some other instances where there might be a duty of disclosure on the insurer towards the insured.

Or

Search the internet for some cases or examples where the insured has not followed the duty of disclosure and their claims have been rejected by the insurer on the grounds of non-disclosure. Study the reasons for such a rejection of claims.

D Material facts

D1 Importance of material facts

Material facts can be defined as those which:

> would influence the judgment of a prudent insurer in fixing the premium or determining whether it will take the risk.

From the above definition we can see that material facts are important because they help the insurance company's underwriter to decide two things:

- whether to accept the risk proposal or to reject it; and
- if the proposal is to be accepted, then at what price (premium) it should be accepted.

If the proposer is in any doubt about facts which may be considered material, they should disclose them, regardless of whether there is a specific question on the proposal form. This is because the proposer alone is in possession of the full facts and these must be presented to the insurer when the insurer is underwriting the business.

Any facts which render the risk greater than normal are clearly material, as are those that explain the exceptional nature of a risk, or suggest some special motive for insurance.

D2 Consequences of non-disclosure

If the insured is in material breach of the duty of disclosure, the insurer may avoid the contract entirely, *ab initio* (from the beginning). In other words, no claims are payable. If the non-disclosure is fraudulent (often termed 'concealment') the insurer may keep the premium. The legal rule is that non-disclosure arises and gives grounds for avoidance by the second party to the contract (the insurer) where a fact is:

- within the **knowledge** of the first party (the insured);
- **not known** to the second party (insurer); or
- **calculated**, if disclosed, **to induce** the second party to enter the contract at terms they consider to be better, or not to enter the contract at all.

D3 Indisputability clause (section 45)

As specified in section 45 of the Insurance Act, in the first two years of the policy, if the insurance company comes to know that some material fact has not been disclosed by the proposer, it can declare the policy to be null and void. The insurance company can also keep all the premiums paid. This right can be enforced by the insurance company only during the first two years of the policy. After two years, fraud must be established by the insurance company if it wishes to make the policy void. This clause is referred to as the 'indisputability' clause and applies to life insurance.

D4 Life insurance: duty of disclosure

In the case of life insurance, the duty of disclosure arises at the time of proposal up until the time the risk is accepted by the insurance company and the policy cover has commenced.

Be aware

In the event that a lapsed policy is revived, the insurance company may ask the insured to disclose all material facts along with proof of continued good health. More details about policy lapse and revival are discussed in Part 2 of this chapter.

Example

Scenario 1: Arjun took out a whole of life policy from an insurance company at the age of 30. At the time of completing the proposal form Arjun declared all the material facts. Five years later Arjun is diagnosed with diabetes. Even if Arjun does not disclose this fact to the insurance company it will not affect his policy cover in any way as it happened five years after the policy cover had started. If Arjun's policy lapses and he revives the policy then, at the time of reviving it, the insurance company may ask him to disclose all material facts again.

Scenario 2: At the age of 35 Arjun wants to take out another policy (term insurance) but he is now a diabetic. This time while making the proposal, in accordance with the principle of utmost good faith, Arjun will have to disclose that he is suffering from diabetes.

Based on the disclosures made by Arjun, the insurance company will assess his proposal and may decide to accept or reject the risk. If the company decides to accept the risk it will advise Arjun of the premium it requires.

If Arjun does not disclose that he is suffering from diabetes and the insurance company finds out about this fact 6 months later, it may declare the policy to be null and void and keep all the premiums paid by Arjun to date.

E Indemnity

Indemnity can be defined as:

> financial compensation sufficient to place the insured in the same financial position after a loss as they enjoyed immediately before the loss occurred.

In short, this means that in the event of a loss the insurance company indemnifies (compensates) the insured for the loss they incur, under the terms and conditions of the policy.

Example

Suresh has taken out an individual health insurance policy with a sum insured of Rs. 2,00,000. Suresh falls ill and has to be hospitalised, resulting in a hospital bill of Rs. 40,000. So in this case the insurance company will compensate (indemnify) Suresh with Rs. 40,000.

Insurance cannot be used to make a profit

The principle of indemnity makes sure that the insured is compensated only to the extent to which they have suffered a loss. Thus the insured cannot profit from insurance.

Example

Rajesh has taken out an individual health insurance policy with a sum insured of Rs. 1,00,000. Rajesh also has health cover of Rs.1,00,000 from his employer. Rajesh falls ill and has to be hospitalised, resulting in a hospital bill of Rs. 25,000. So in this case Rajesh cannot make a claim of Rs. 25,000 from both insurers. Rajesh will get a total claim of only Rs. 25,000. So the principle of indemnity ensures that insurance cannot be used to make a profit.

To summarise: indemnity makes sure that the insured is neither better nor worse off after the claim is settled by the insurance company. It also makes sure that neither the insured benefits at the cost of the insurer, nor that the insurer benefits at the cost of the insured.

E1 Indemnity and life insurance

General insurance policies and health insurance policies are contracts of indemnity whereby the insured is compensated for the loss incurred in line with the principles explained above.

But the same **does not apply** to life insurance.

Example

If Ajit has taken out an endowment policy of Rs.1,00,000 for 10 years with an annual premium payment of Rs. 10,000 and he dies in the fourth year of the policy, the beneficiary will get the full amount of Rs. 1,00,000 (plus the bonuses accumulated up to that point), even though Ajit has paid premiums for only four years.

Therefore life insurance contracts are also known as **value contracts** and the principle of indemnity does not apply to them. In the case of life insurance, even if a person takes out multiple policies, the insured's death will result in all the insurance companies paying the full sums insured.

So remember that where life insurance is concerned, the concept of sharing claims, as per the principle of indemnity, does not apply; we can see this in the following example:

Example

Manish has taken out a whole of life policy from insurance company ABC for Rs. 15,00,000 and an endowment policy for Rs. 10,00,000 from insurance company XYZ. In the event of his death, within the policy term, both insurance companies will pay Manish's nominee. So Manish's nominee will get a total insurance amount of Rs. 25,00,000 (Rs. 15,00,000 + Rs. 10,00,000) from the two insurance companies.

Key points

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

Essential features of a valid contract of insurance

- A contract comes into existence when one party makes an offer which the other party accepts unconditionally.
- In an insurance contract, consideration is the premium paid by the proposer to the insurance company.
- Minors, people deemed to be of unsound mind and persons disqualified by law cannot enter into insurance contracts.

Insurable interest

- Insurable interest is the legal right of a person to insure a subject matter which can be their own life, the lives of family members or their assets.
- When an individual has insurable interest they benefit from the well-being of, and are adversely affected by damage to, the other person or asset.
- Other instances where insurable interest is deemed to exist include creditor-debtor, employer-employee and vice versa, partners in each other's lives, and companies in the lives of key persons.

Utmost good faith

- In an insurance contract both parties to the contract must act in good faith.
- We can define utmost good faith as 'a positive duty voluntarily to disclose, accurately and fully, all facts material to the risk being proposed, whether requested or not'.
- There is a duty to disclose material facts implicit in all insurance negotiations; this is particularly important at the proposal stage, before the contract comes into existence.
- The insurer also has a duty of disclosure to the insured. In order to fulfil this duty, the insurer must also behave with utmost good faith.

Material facts

- Material facts can be defined as those 'which would influence the judgment of a prudent insurer in fixing the premium or determining whether it will take the risk'.
- There are some facts, for example facts of law and of knowledge, that need not be disclosed.
- If the insured is in material breach of the duty of disclosure, the insurer may declare the contract null and void.

Indemnity

- Indemnity means placing the insured in the same financial position after the loss, as they were before the occurrence of the loss.
- Indemnity makes sure that insurance cannot be used by the insured to make a profit through inflated claims.
- Indemnity does not apply to life insurance because life insurance contracts are value contracts.

Question answers

3.1 The essential features of a valid contract are:

- Offer and acceptance.
- Consideration.
- Capacity to contract.
- *Consensus ad idem*.
- Legality of object or purpose.
- Capability of performance.

3.2 Circumstances in which insurable interest is deemed to exist are those where an individual has:

- unlimited interest in their own life;
- interest in their spouse's life and vice versa;
- interest in their children's life and vice versa; and
- interest in their assets.

Self-test questions

1.	Define utmost good faith and explain the meaning of it.
2.	What is indemnity?

You will find the answers on the next page

Self-test question answers

1.	Utmost good faith can be defined as: 'a positive duty to voluntarily disclose, accurately and fully, all facts material to the risk being proposed, whether requested or not'. This means that the parties to a contract must volunteer material information before the contract is concluded. The principle applies equally to both the proposer and the insurer throughout the contract negotiations, but the law sees the proposer as the main supplier of material facts to the contract.
2.	Indemnity can be defined as: 'financial compensation sufficient to place the insured in the same financial position after a loss as they enjoyed immediately before the loss occurred'. This means that in the event of a loss the insurance company indemnifies (compensates) the insured for the loss they incur, under the terms and conditions of the policy.

3
Part 2: Insurance practices

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Learning objectives

After studying this chapter, you should be able to:

- describe the main features of how insurance is bought and written;
- analyse the key documents used in insurance and their importance;
- define the key terms used in insurance;
- discuss the relevance of premium payment to valid cover.

Introduction

In the first part of this chapter we looked at the principles behind all insurance. In this second part we are going to build on this by looking at how insurance, and life insurance in particular, is bought. We will do this in two ways.

We will firstly look at the key documents that anyone who has insurance will become familiar with, and discuss their importance. These documents will be exchanged between the insurance company and the policyholder during the policy term. Secondly, we will look at some of the important terms used in life insurance that you will need to be able to explain to your clients.

To put these topics into their proper context we will begin by giving a brief overview of how insurance is bought and written.

Key terms

This chapter features explanations of the following terms and concepts:

Assignment	Cancellation	Lapse	Premium receipts
Assignor	Cooling-off period	Nomination	Policy document
Assignee	Conditional assignment	Notices	Prospectus
Absolute assignment	Exclusions	Paid up value	Revival
Appointee	Endorsements	Proposal form	Surrender value

F How insurance policies are bought and written

We have already established in earlier chapters why an individual should have insurance, what insurance is and the principles behind it. So, how does an individual go about buying an insurance policy? Well, first of all they will need to have heard that insurance is available.

F1 Source of preliminary information

Insurance companies spread awareness of, and generate interest in, their products through mass media advertisements. As we will see later (section G5C), the IRDA has issued specific guidelines on what prospectuses and advertisements issued by insurance companies should say. An individual may conclude from this information that they need insurance and approach the company or one of its agents. We will look at prospectuses in more detail in section G5C.

Alternatively, an individual may be approached by a life insurance agent who will introduce them to the products of the life company they represent.

F2 Purpose of buying insurance

Insurance should be bought by a person based on their needs. There are many insurance products available in the market, and which to buy should be decided after careful consideration. Based on their requirements, an individual may choose to purchase a whole life insurance policy, an endowment policy, a money-back policy, a child plan or a retirement plan etc. We shall look at these products in detail in later chapters.

F3 How life insurance is written

Most policies are written on what is known as a **single life** basis, with only one life insured. Usually, but not always, the person taking out the policy and the life insured are one and the same person. This is known as an **own life policy**. Policies can also be taken out jointly by two insureds – for example a husband and wife can take out one policy, with both being the policyholder and the life insured. This is known as a **joint life policy**.

F4 Proposal form

Advertisements and the prospectus are the means by which insurance companies invite proposals. The person seeking insurance is called the **proposer** – they are proposing themselves for life (or indeed any kind of) insurance. The proposer will complete the proposal form and submit it to the insurance company. The information in the proposal form is evaluated by underwriters who will then choose to accept or reject the proposal, or to accept it on modified terms. We will look at what the proposal form looks like and its importance in section G1.

F5 Quotations

A quotation is simply that – a quotation as to how much the policy will cost and on what terms. It will often be held open for a set period, during which the proposer can choose to take the policy or decide that it is not for them. If the proposer accepts the quotation, then the insurance company is bound to the terms and price that were offered in it. However, if a material fact relating to the proposer changes during the period of the quotation, then the insurance company is not bound to it.

F6 Insurance contract

An insurance contract commences from the date on which the insurance company issues the first premium receipt (see section G3A). The policy document can be sent later (see section G4). If a person dies before the issue of the policy document, but after the issue of first premium receipt, the insurance company is liable to pay the death claim.

F7 Renewals

Life insurance policies are long-term policies, running for a set period of often many years. Health insurance policies on the other hand, issued by non-life companies, are short-term policies that run for only one year. At the end of the year the policyholder is advised to renew the policy so that they do not lose the benefit of the protection that the insurance provides, and also because the insurance company will not want to lose the customer. The insurance company will therefore invite the policyholder to **renew** their policy. We will look at renewal in a little more detail later in the chapter.

F8 Summary

Now that we have set the scene by giving an overview of how insurance is bought, we can build on this knowledge by looking at the documents that are necessary in insurance and at some of the technical terms used in them. To put all this into a practical context we will follow the case study of Nitish Sharma and his life insurance agent, Mr Kumar.

Case study

Nitish Sharma has just been appointed to the position of lecturer in a degree college. He is 28 years old and is married to Sumedha who is a housewife. One day he is approached by an insurance agent, Mr Kumar. During their conversation, Mr Kumar demonstrates to Nitish his need for life insurance. Nitish says that he has already been thinking about this as he recently saw a prospectus issued by a life insurance company and so he agrees to purchase an insurance plan.

G Key documents

There are many important documents associated with insurance – we have already been introduced to some of them in the previous section. These documents provide information on the insured and on the insurance itself and sometimes provide proof that the insurance exists and, when it comes to making a claim, that a loss has occurred. We will look at what these documents are in this section.

G1 Proposal form

The first thing that Mr Kumar does on hearing that Nitish has seen the advantages of having life insurance and is willing to buy a policy, is to give Nitish a **proposal form** to complete.

Case study

When Nitish looks at the proposal form, he is perplexed at the amount of information that it asks for. He wonders why he needs to fill in a proposal form when he is already prepared to pay the price to purchase the insurance plan. He also makes the comment that this is all very well for him, as an educated man, but what if he had been illiterate – could he still buy an insurance plan?

Let us look at how Mr Kumar would answer Nitish's questions.

The proposal form or application form is the first document that the proposer needs to fill in and submit to the insurance company. In our case study Nitish is the proposer. The proposer should fill in the proposal form themselves in their own handwriting. However, there can be a few exceptions to this, for example where the proposer is illiterate or does not understand the language used in the form. Care therefore needs to be taken to ensure that the proposer is fully aware of and is in agreement with the purchase of the insurance plan.

The proposal form is the main source of the information the underwriter will use to assess the risk the person presents to the pool. Therefore it is important that the information provided by the proposer is correct. You should think back to the importance of utmost good faith and the relevance of material facts in the first part of chapter 3.

The insurance company collects the following information through the proposal form:

- information on the life insured, including details regarding their name, age, address, marital status, weight, height, medical history etc.;
- information on the proposer. If the proposer and the life insured are different people then information about the proposer such as name, age, occupation and relationship to the life insured (i.e. the reason they need to take out a policy on the life insured) are also to be given in the form;
- details of the type of insurance plan being requested;
- nomination details (see section H4A);
- details of the riders (if any) being requested (we will look what riders are when we come to look at the individual products available in the market); and
- details about any earlier insurance plans the proposer has taken out.

G1A Declaration in the proposal form

At the end of the proposal form there is a declaration for the proposer to sign. By signing this declaration the proposer states that the information they have provided in the form is correct and that they have fully understood the questions before answering them.

The signing of this declaration is important. By agreeing to this declaration the proposer is recognising that:

- the insurance company can cancel the contract and keep the premiums if it finds out that any of the information provided is not true; and
- by stating that they have understood the questions, they cannot claim that they were given wrong information or misled in any way, if a dispute happens in the future.

What about Nitish's question about illiterate proposers – how can they complete a proposal form and sign the declaration? If the proposer is illiterate, then an impression of the left thumb is taken and a third party has to attest the thumb impression. The person (third party) attesting the thumb impression has to declare that they have fully explained the questions to the proposer, in their language, and that they have correctly entered the answers after consulting the proposer. In this case the address of the declaring person may also be taken.

Sometimes the proposer's language will be different to that of the proposal form. In these cases, where the proposer completes the proposal form and also signs the declaration in their own language, then the proposer has to declare, in their own handwriting above their signature, that all the questions were explained to them and that they answered them only after fully understanding them.

This proposal form and the proposer's signature of the declaration will form the basis of the insurance contract and so are very important documents legally. This is why it is so important that the proposer understands the questions and answers them truthfully.

Example

Rakesh Chawla is an illiterate person. He is 48 years old and only speaks and understands the Hindi language. He has decided to purchase a life insurance policy, for which he contacts a life insurance agent. The agent provides Rakesh Chawla with the form which he needs to fill in. The form is in English and Rakesh is not well versed in this language. So the insurance agent advises him to ask his friend Nilesh Tandon, who is a school teacher and well versed in both Hindi and English, for help with filling in the form.

Nilesh Tandon agrees to fill in the form on behalf of Rakesh. He explains each question one by one to Rakesh in Hindi and duly records the answers provided by Rakesh on the form.

Once the form is complete, Rakesh Chawla needs to put his thumb impression on the form, declaring that he has understood all the questions and given the answers accordingly.

Nilesh Tandon also signs a declaration provided in the form to confirm that the questions in the proposal form have been explained to the proposer, in a language that he fully understands, and the answers have been recorded accordingly.

G2 Age proof

Case study

Nitish Sharma completes the proposal form and hands it to Mr Kumar who asks Nitish for his High School Mark Sheet as proof to certify his age. Nitish says that he will have to look for this – are there any other documents that he can submit as proof of age – and why does he need to prove his age anyway?

Age is one of the factors that insurance companies use to determine the risk profile of the proposer and thus the premium amount to be charged. This is why it is important that insurance companies verify the correct age of the proposer.

Documents that can be accepted as valid age proofs can be classified as **standard age proof documents** and **non-standard age proof documents**. Some of the documents that can be taken as standard age proofs are:

- a certificate from school or college records;
- a certified extract from registrar of births and deaths or from municipal records made at the time of birth;
- a passport;
- a Permanent Account Number (PAN) Card;
- the service register of the employer;
- a certificate of baptism;
- a certified extract from a family Bible, if it contains the date of birth;
- the identity card of defence personnel, issued by the defence department;
- a marriage certificate issued by a Roman Catholic Church.

Some of the non-standard age proof documents that can be accepted as a valid age proof are:

- a horoscope prepared at the time of birth;
- a ration card;
- an affidavit by way of self-declaration, elder's declaration; and
- a certificate from the village *panchayat.*

Along with proof of their date of birth an individual is required to submit proof of their address, a photograph and a deposit towards the premium. The insurance company may also ask the individual to submit bank statements for six months to a year. Apart from cash or cheque, the premium deposit payment can also be made by credit card, a direct debit from the proposer's bank account or through online payment gateways, electronic clearing system (ECS) etc.

In order to curb money laundering in the insurance sector the IRDA, in recent years, has tightened Anti-Money Laundering (AML)/Combating Financing of Terrorism (CFT) guidelines for insurance companies so that extreme care must be exercised during the Know Your Customer (KYC) process. To prove their identity in accordance with the KYC process, the customer needs to submit:

- an age proof;
- an identity proof;
- an address proof; and
- income proof documents (if required by the insurance company, depending on the insurance amount asked for).

The above documents are to be obtained to establish clearly the identity of the customer and their source of income for the premium being paid. More details about anti-money laundering will be discussed in chapter 12.

G3 Premium receipts

Case study

Nitish Sharma submits his valid age proof, address proof and photograph to Mr Kumar. He also gives him a cheque, in favour of the insurance company, for the premium. He asks Mr Kumar how and when he will hear whether or not his proposal has been accepted.

Mr Kumar tells Nitish that IRDA regulations state that the insurance company has to tell him of its decision within 15 days. He also tells Nitish that the insurance company will show its acceptance by issuing him with a first premium receipt and, maybe at the same time or later, the policy document.

In this section we will discuss the two premiums receipts – the first premium receipt and the renewal premium receipt. We will look at the policy document in the next section G4.

G3A First premium receipt (FPR)

As we have just seen in Mr Kumar's response to Nitish, the insurance company will inform the proposer that their proposal has been accepted and that it has received the premium through issuing the **first premium receipt** (**FPR**). The FPR is important as it is the evidence that the insurance contract has begun. The policy document, which is the evidence of the contract, may be issued some time later.

The first premium receipt contains the following information:

- name and address of the life insured;
- policy number;
- premium amount paid;
- method and frequency of premium payment;
- next date that premium payment is due;
- date of commencement of the risk (i.e. when the cover begins);
- date the policy matures;
- date the last premium will be paid; and
- sum insured.

G3B Renewal premium receipt (RPR)

After the issue of the FPR the insurance company will issue subsequent premium receipts when it receives further premiums from the proposer. These receipts are known as **renewal premium receipts** (**RPRs**). The RPRs act as proof of payment in the event of any disputes related to premium payment, and so are important. The RPRs should be kept in a safe place along with the FPR and the policy document so that they can be produced easily when required.

Be aware

The decision to accept or reject a proposal is taken by the underwriter. If the underwriter accepts the proposal with modified terms and conditions, then the FPR is issued only after the proposer has agreed to the modified terms and conditions and paid the additional premium (if any). IRDA regulations require that the decision on the proposal has to be passed to the proposer within 15 days. We will be looking at the role of the underwriter in more detail in the next chapter.

Question 3.3

Which documents can be accepted as valid proof of age?

G3C What is the 'free look-in period' or the 'cooling-off period'?

Case study

Before Mr Kumar sends Nitish Sharma's proposal, premium and proofs to the insurance company, Nitish has one last question: 'What happens if I change my mind after taking out the insurance policy?'

The issuing of the FPR signifies the conclusion of the contract and is binding on both the parties. However, IRDA regulations provide the proposer with the option to withdraw from the contract within a period of 15 days from the date of receipt of the policy document if they disagree with the terms and conditions of the policy. This period is known as the 'free look-in period' or 'cooling-off period'. If the proposer withdraws from the contract, then the insurance company will have to return the premium paid minus some deductions, such as the cost of covering the risk for the short period during which cover was provided, medical examination expenses and stamp duty.

We will return to the relevance of premium payment and valid cover in section I at the end of this chapter.

G4 Policy document

Shortly after Nitish Sharma receives the first premium receipt, he receives a copy of the policy document. What can Nitish expect from this document? What will it look like?

The policy document is the most important document associated with insurance. It is the **evidence** of the contract between the insured and the insurance company. It is not the contract itself: if the policy document is lost by the policyholder, it does not affect the insurance contract. The insurance company will simply issue a duplicate policy without making any changes to the contract. The policy document has to be signed by a competent authority and should be stamped according to the **Indian Stamp Act.**

A standard policy has the following sections:

Heading	**Preamble**
Operative clause	**Proviso**
Schedule	**Attestation**
Terms and conditions/Privileges and conditions	**Endorsements**

The **heading** of the policy document contains the name and address of the company and its logo.

The **preamble** of the policy states that the proposal and declaration signed by the proposer form the basis of the contract.

The **operative clause** lays down the mutual obligations of the parties regarding:

- the payment of premiums by the insured; and
- the payment of the sum insured by the insurance company on the happening of the insured event, subject to the production of age proof and title by the claimant.

The **proviso** of the policy states the general provisions relating to guaranteed surrender value, nomination, assignment and loans on security of the policy etc.

The **schedule** gives all the essential particulars of the policy, such as:

- the date of commencement of policy;
- the date the policy matures;
- the sum insured (when and how much the policy will pay);
- the premiums to be paid and their due dates;
- the nominee (if stated in the proposal form);
- any special clauses;
- details of riders;
- exclusions; and
- liens.

Insurers also include a printed copy of the proposal form completed by the policyholder in the policy document to remove any ambiguity.

The **attestation** confirms that the insurers have authenticated the policy document by signature. The attestation can be done by authorised officials of the insurance company.

The **terms and conditions** will refer to the:

- days of grace for payment of premium;
- consequences of failing to pay the premium; and
- availability of loans.

It is also in this section that information will be given on how to assign the policy, how to surrender the policy or make it paid up (we will look at what these mean in section H) and how to make a claim. This section will also detail any exclusion(s) under the policy.

An **exclusion** is a statement that a certain risk is not covered by the policy. If the loss is caused by the risk that is excluded from cover, the sum insured will not be paid by the insurance company. An exclusion may be one that is common to all life policies (even those issued by another insurance company). An example of this would be that the policy will not pay out if the life insured commits suicide within one year of purchasing the insurance policy. Other exclusions may be included in the policy by the underwriter because of the risk presented by that particular individual. For example, the underwriter may decide to exclude death resulting from adventure activities like trekking, water rafting or various other water sports etc. which are considered risky or dangerous by the insurer. We will look at why an underwriter might do this in chapter 4, when we consider how an underwriter will sometimes accept a poor risk on modified terms.

In order to make certain changes in the terms and conditions of the original life insurance policy, **endorsements** can be made on a blank sheet of paper and attached to the original policy document. A life insurance policy can be easily amended by using an endorsement. The endorsement is then part of the policy.

Policy information statement
The IRDA requires that the policy information statement should be issued with every policy. This policy information statement should include the following:

- the facility available for method and frequency of premium payment;
- the person or office to be contacted for any enquiry or service relating to the policy;
- the importance of telling the insurance company of any change of address of the policyholder and nominee;
- what to do in the case of a grievance or complaint; and
- information on the location of the Insurance Ombudsman.

Once the proposal has been accepted by the insurance company and the first premium receipt and policy has been issued to the proposer, the proposer is covered by the insurance. From this point we no longer refer to them as proposers – they are now **policyholders**, i.e. people who hold insurance policies.

Question 3.4

What information is provided in the first premium receipt (FPR)?

G5 Endorsements, notices and prospectus

Case study

As part of his discussions with Mr Kumar, Nitish Sharma asks if he would be allowed to make any changes to the method and frequency of premium payment etc. in the contract, and if yes, how.

Mr Kumar explains endorsements to Nitish. He also provides an explanation of some other documents, such as notices and the prospectus that first set Nitish thinking about life insurance.

G5A Endorsements

During the term of the policy the insurance company allows alterations to the original policy, through the attaching of endorsements. Using endorsements enables the modification of the sum insured, the policy term, premium payment method and frequency, the nomination and assignment etc.

The endorsement can be made on plain paper and attached to the policy document to indicate modifications in the policy.

In cases where the policyholder wants to change the nominee, the endorsement can be done on the back of the policy. Similarly, assignments can also be made on the back of the policy. (More details on nomination and assignment are discussed later in the chapter in sections H4A and H4B.)

G5B Notices

During the policy term the insurance company issues notices to the policyholder. These are:

- notices to remind the policyholder about the due date of premium payment;
- bonus notices;
- notices about premium defaults and policy lapsation;
- notices to revive the policy;
- notices about a benefit falling due – survival benefit/maturity benefit etc.; and
- an annual statement with respect to unit-linked policies.

It is important to note that these notices are used only for information and to remind the policyholder about the premium due date, payment of benefits, status of the policy etc.

G5C Prospectus

We saw in section F1 that the prospectus is used by insurance companies to give information about the product and generate interest among the public about their products. The **IRDA (Protection of Policyholders' Interests) Regulations**, as amended in October 2002, stipulate that the prospectus issued by the insurance company should explicitly state under each insurance plan:

- the scope of benefits offered;
- the conditions;
- any warranties;
- the terms and conditions;
- the entitlements;
- the exceptions; and
- any right to participate in bonuses.

If the right to participate in bonuses is deferred for some time after the commencement of the policy, then this should be explicitly stated. There should be a clear statement as to what benefits are guaranteed and which ones are not. The prospectus should also mention that non-guaranteed benefits in the future may not be the same as in the past and that they may vary.

G6 Documents required at the time of a claim

When an insured loss happens and it is necessary to make a claim the insurance company will require a number of documents from the claimant. For example, for life insurance the insurance company will require proof that the death has actually happened and so will need to see the death certificate. We will look at the documents required at the time of a claim in chapter 11, when we look at the topic of claims.

Suggested activity

Collect a proposal form of any one insurance company. Analyse the form and prepare a list of the information that is being asked for.

The key documents associated with insurance will contain many terms that have a particular meaning in insurance. To understand how an insurance policy works it is necessary to understand what these terms mean and so we will look at some of the key terms in the next section.

H Key insurance terms

We have already used some of the specialist insurance terms in the previous section and in this section we will explain these and others. We will divide the key terms into categories to help you understand them. These categories are:

- terms associated with the continued existence of the policy: terms such as **lapse, paid up value** and **surrender value**. We will also look at **revival** and **renewal** in this context;
- terms associated with who receives the policy monies: **nomination** and **assignment**; and
- terms associated with borrowing against a policy: **loan** and **foreclosure**.

H1 Lapse, paid up value and surrender value

These three terms describe what can happen should the insured find that they are unable to continue to make the premium payments. How they will operate for any particular policy will be described in the terms and conditions of that policy.

Case study

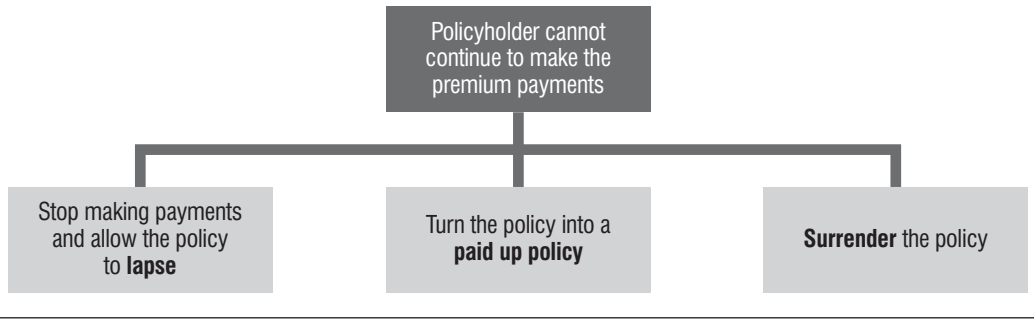
When Nitish Sharma receives the first premium receipt from the insurance company, he is assured that his proposal has been accepted. He then tells his wife about his investment. Sumedha is apprehensive about Nitish's decision and asks him what would happen if he is unable to pay the premium in future. Would he be able to get his invested money back?

Nitish has no idea how to answer her. He visits the agent, Mr Kumar, once again and raises the query with him. Mr Kumar then explains that if Nitish does not pay the premium his policy will lapse. If this happens Nitish can ask the insurer to make the policy paid up. He also informs Nitish that he can voluntarily cancel the policy by surrendering it. In this case the insurance company will pay the surrender value, subject to certain terms and conditions.

Nitish Sharma is confused by the terms (lapse, paid up, surrender value) that Mr Kumar is using and requests Mr Kumar to explain them in detail. So Mr Kumar starts explaining the policy-related terms to Nitish.

A policyholder has three choices if they cannot afford to continue making the premium payments. These are:

Figure 3.3



H1A Lapse

The policyholder is required to pay the regular premiums on the **due dates** agreed with the insurance company. Insurance companies do allow some **days of grace** beyond the due date during which the policyholder can pay the premium and still be considered timely. However, if they do not pay the premium within the 'days of grace' it is considered to be a default.

In the event of a default in the payment of the premium, the insurance company is entitled to terminate the contract. This termination is known as a **'lapse'**. No claims can be made on the policy after a lapse, and all premiums are forfeited.

Be aware

The grace period would normally be one month, but not less than 30 days for yearly, half-yearly or quarterly premium payments, and 15 days for monthly premium payments. However, some insurers allow 30 days even for monthly premium payments.

In practice, the Insurance Act does not allow the insurance company to keep all the premiums paid when a policy lapses. The reason is that every policy acquires a reserve for the following two reasons:

- premiums in the early years of the policy are more than are justified (level premiums); and
- the savings element in the premium.

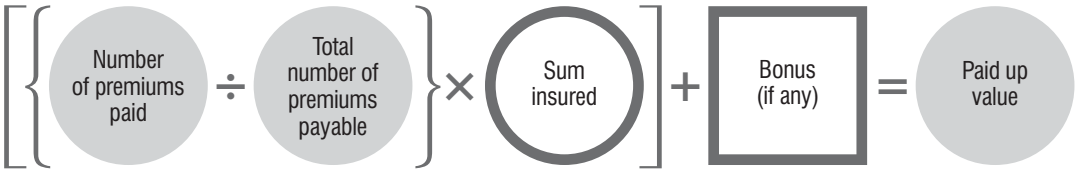
It would not be fair to the policyholder if they were to forfeit this reserve. The policy conditions provide various safeguards to policyholders when there is premium default. These provisions are called non-forfeiture provisions. A policy can be made paid up if sufficient premiums have been paid and there is a savings element to the policy. Whilst the policyholder usually requests this, by the nature of the contract it will be made paid up automatically, based on the number of premiums already paid.

H1B Paid up value

If a policyholder fails to pay a premium on a policy that is capable of having a value (e.g. an endowment or savings plan) and the policy lapses, then the insurance company is not liable to pay the full sum insured. Such a lapsed policy can be made a paid up policy. In a paid up policy the sum insured is reduced to an amount based on the amount of premiums already paid.

The formula for calculating paid up value is:

Figure 3.4



Insurance companies insist on a minimum amount that must be acquired as a paid up value. If the paid up value works out to be lower than this minimum amount, this non-forfeiture benefit would not apply and the policy would lapse. The policyholder may be able to collect the surrender value (which we will discuss in section H1C).

Normally insurance companies will offer the policyholder the right to convert a normal policy into a paid up policy if they have already paid premiums for a minimum of three years. After this period, if the policyholder is unable to pay the remaining premiums then under the paid up option the policy is not cancelled. Instead, the sum insured is reduced in proportion to the number of premiums paid. If other benefits related to the sum insured are payable, the benefits will now be related to the reduced sum insured, which is the paid up value.

What happens to bonuses if a with-profit policy is made paid up?
When calculating the paid up value of a with-profit policy, there is no change in the bonus already vested or granted. Only the sum insured is reduced in proportion to the premiums paid. The accrued bonus is added to the reduced sum insured to arrive at the paid up value. However, a paid up policy is not entitled to receive further bonuses.

Example

Rakesh Singh has a savings policy. The following are the details of the policy:

Policy term	20 years
Date of commencement of policy	4 June 2001
Sum insured	Rs. 5,00,000
Premium payment mode	Annually
Last premium paid	4 June 2008
Number of premiums paid	8
Total number of premiums due	20
Vested bonus	Rs. 50,000

As seen from the data above, Rakesh Singh stopped premium payment after the eighth year. The policy will not be fully cancelled. Instead the sum insured will be reduced in proportion to the premiums paid.

Paid up value = [(number of premiums paid ÷ total premiums payable) × sum insured] + bonus

= [(8/20) × Rs. 5,00,000] + Rs. 50,000
= Rs. 2,00,000 + Rs. 50,000
= Rs. 2,50,000

The paid up value of the policy will be Rs. 2,50,000

H1C Surrender value

As we have already mentioned, if the policyholder finds that they can no longer meet the premium payments they can cancel the policy by surrendering the policy before it becomes a claim or before it reaches maturity, and have the surrender value paid to them immediately. The policy must be capable of having a value attached to it, e.g. an endowment or savings plan. Policy surrender is the voluntary termination of the contract. Insurance companies stipulate a minimum term of three to seven years before a policy can be surrendered. The 'surrender value' or 'cash value' is the amount that the insurance company is liable to pay once a policy is surrendered. The surrender value is usually a percentage of the premiums paid or a percentage of the paid up value.

The surrender value is calculated based on the amount of premium paid. Hence:

- The surrender value will be low if the duration of the policy has been low.
- If a policy with tenure of 25 years is surrendered after a period of five years, then the amount of premium paid will be less than if the policy was surrendered after, say, ten years. As the surrender value is dependent upon the premiums already paid, it will be high for a policy surrendered after ten years as compared to the same policy if surrendered after five years.
- The surrender value will be lower for a longer-term policy compared to a shorter-term policy if both are surrendered after the same number of years.
- Consider two policies A and B. The term of policy A is 15 years and that of policy B is 20 years. Both the policies are surrendered after ten years and the premiums paid each year are the same. The surrender value for policy A will be higher than for policy B because the premiums in A have been paid for two-thirds of the term, whereas the premiums for B have only been paid for half the term.

The duration of the policy is the difference between the date of surrender of the policy and date of commencement of the policy.

Figure 3.5

The law requires insurance companies to mention in the prospectus or policy document, the minimum guaranteed surrender value, which may be described as a percentage of the premiums paid. However, the actual surrender value paid by insurance companies is more than the guaranteed surrender value.

H2 Revival

Case study

Mr Kumar advises Nitish Sharma against cancelling the insurance policy. There are two reasons for this. The foremost is that as the risk cover is cancelled, Nitish will become highly vulnerable to unfavourable circumstances. Also, if Nitish purchases a new insurance policy later at a higher age, he will have to pay a higher premium.

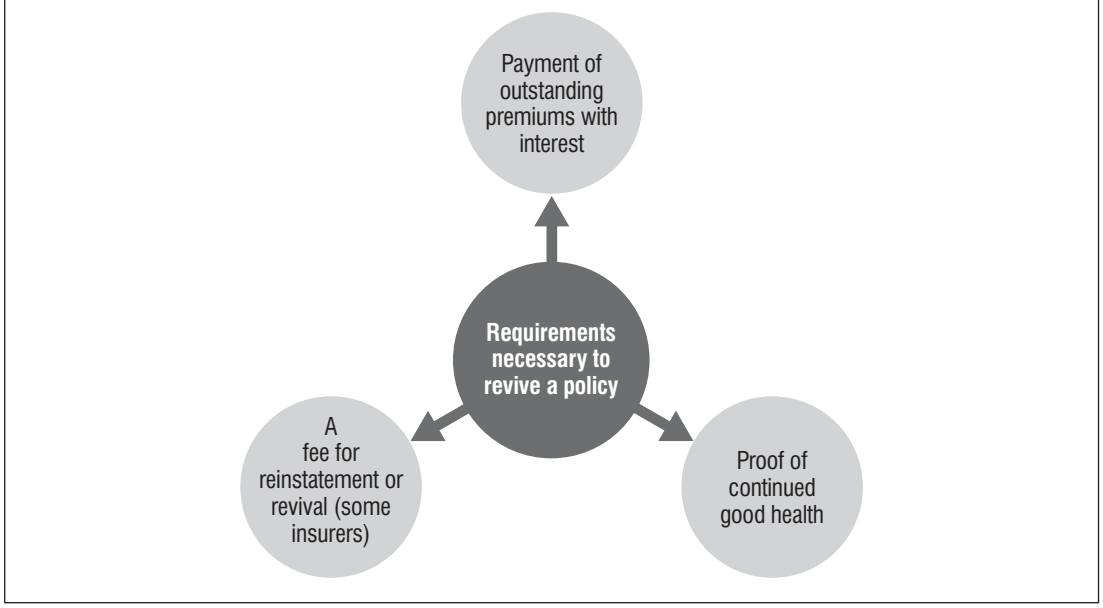
Mr Kumar then informs Nitish Sharma that if he is not able to pay the premiums for any reason and the policy lapses, the insurance company still offers the policyholder a chance to revive the policy on the same terms as the original or modified terms within a certain period.

When a policy lapses it benefits neither the insurer nor the insured. The insured loses the insurance risk cover for the full amount and is exposed to possible adverse circumstances should a claim arise. The insurer also loses. The level premium is based on the assumption that, barring death claims, the policies will run for the full term. The initial expenses incurred on setting up the policy in the first place are high and the insurer can recover them only if the policies remain in force. Generally it is people with bad health who are more likely to keep their policies in force, while some others with good health may lapse or surrender their policies. This will result in adverse selection. This means the insurer's liability is likely to be greater than it assumed that it would be when fixing the cost of insurance.

Because lapsation affects both parties adversely, insurance companies make it possible for lapsed policies to be brought back into full force. This process is called '**revival**'. Insurance companies provide the policyholder with the option of reviving a lapsed policy. Different insurers have different schemes for revival; all with a view to help policyholders revive lapsed policies on easy terms, including instalment revival and loan-cum-revival schemes etc.

To revive a policy, the following will normally be necessary:

Figure 3.6



Some insurers do not allow a policy revival if it has remained in a lapsed condition for more than five years. For a policy to be revived the requirement of proof of good health varies according to the duration of the lapse and also according to the sum insured.

H3 Renewal

We looked briefly at what renewal is in section F7. At the time of maturity of the policy, the insurance company will send a notice to their policyholder inviting them to **renew** their policy.

When issuing the notice to renew, the insurance company may take a fresh look at the risk brought to the pool by that policyholder. Consequently, it may choose to offer renewal on different terms or for a higher premium. It will also remind the policyholder that they will need to tell the insurance company of any material fact that has changed since they first took out the policy. The notice will then explain to the policyholder what they need to do to renew the policy.

It is up to the policyholder to then accept or reject this offer. If they accept the offer, they will follow the instructions and a new policy will start. If they reject the offer then the cover will cease.

H4 Nomination and assignment

Case study

Nitish Sharma has been researching the features and benefits offered under his insurance policy and has come across other terms that he does not understand. He contacts the agent Mr Kumar and asks for help.

He asks why Mr Kumar had insisted on nomination when filling in the proposal form. Nitish also asks: 'what is assignment and how is it done?'

H4A Nomination

Nomination is where the life insured proposes the name of the person(s) to which the sum insured should be paid by the insurance company after their death. The life insured can nominate one or more than one person as nominees. Nominees are entitled for valid discharge and have to hold the money as a trustee on behalf of those entitled to it. Nomination can be done either at the time the policy is bought or later. A person having a policy on the life of another cannot make a nomination. Under section 39 of the Insurance Act 1938, the holder of a policy on their own life may nominate the person or persons to whom the money secured by the policy shall be paid in the event of their death.

Be aware

When an assignment is done (see section H4B below) the nomination is no longer valid. The exception is when the assignment is done in the favour of the insurance company, in consideration for a loan granted against the insurance policy. The nomination remains valid in this case.

Important features of nomination

Nomination can be changed by making another endorsement in the policy. If there is insufficient space, the nomination can be done on a plain piece of paper and attached to the policy document with the signature of the life insured at the edges, where the paper is attached to the policy. Any changes to or cancellation of the nomination can be done by the life insured during the term of the policy.

With a joint life policy, nomination may not be required, as on the death of one of the lives insured the policy monies are payable to the surviving life insured. However, nomination can be made jointly by both the lives insured nominating a person to receive the sum insured, in case both the lives insured die simultaneously.

Nomination only gives the nominee the right to receive the policy monies in the event of the death of the life insured. A nominee does not have any right to the whole (or part) of the claim.

In cases where the nominee is a minor, the policyholder needs to appoint an appointee. The appointee needs to sign the policy document to show their consent to acting as an appointee. The appointee loses their status when the nominee reaches their majority. The life insured can change the appointee at any time. If no appointee is given and the nominee is a minor, then on the death of the life insured, the death claim is paid to the legal heirs of the policyholder.

Where more than one nominee is appointed the death claim will be payable to them jointly, or to the survivor or survivors. No specific share for each nominee can be made. The nomination can also be done in favour of successive nominees such as: 'Payable to Rashmi Gupta, failing him to Pallav Gupta, failing him Madhav Gupta'.

Nominations made after the commencement of the policy have to be intimated to the insurers to be effective.

Should the nominee die after the death of the life insured, but before the payment of the death claim, then the sum insured would form a part of the estate of the life insured and would be paid to their legal heirs.

Example

Vishal Mehta is a senior HR executive. At the age of 28 he purchased an endowment policy. He had nominated his two-year-old son Mohit in the policy. There were no details of the appointee mentioned, and Vishal promised the agent that he would get the signature of an appointee later on. At the age of 35 Vishal dies in a car accident. In the will that was produced, Vishal had appointed his father as the legal heir.

After Vishal's death his wife becomes the natural guardian of the child. Can she claim the policy money being the natural guardian of Mohit?

The answer is **No**. Natural or appointed guardians of minors are not entitled to the policy monies. If Vishal had appointed his wife as the appointee, then only she would have been able to receive the policy money, as Mohit the nominee is a minor.

In this case, the policy money will be given to Vishal's father, the legal heir as stated in the will.

H4B Assignment

Assignment refers to the transfer of title, rights and interest in an insurance policy to another.

Assignor	Assignee
• The person who transfers their title in the insurance policy is known as the **assignor**. • The assignor should be a major (18 or over) and should have a complete title in the policy.	• The person or institution to which the policy is transferred is known as the **assignee**.

Once the policy has been assigned, the assignee has ownership of the policy and does not need the consent of the assignor in matters relating to the policy. An assignment once made cannot be cancelled or altered in any form by the assignor. However, the policy can be 'reassigned' by the assignee in favour of the assignor.

Be aware

Although the assignee becomes the titleholder of the policy following assignment, they cannot make a nomination in the policy as the assignee is not the life insured.

Section 38 of the Insurance Act specifies the legal provisions relating to the assignment of insurance policies. It states that:

- the assignment can be done by an endorsement on the policy or by a separate deed. When assignment is made by an endorsement on the policy itself, no stamp duty is necessary. Separate deeds have to be stamped;
- it must be signed by the assignor or their duly authorized agent;
- the signature must be attested by a witness;
- the assignment becomes effective on execution;
- the insurance company needs to be informed about the assignment along with a notice;
- the insurance company considers the assignment to be effective only when it receives the notice regarding the assignment; and
- when there is more than one instrument of assignment, the priority of the claims shall be determined by the order in which the notices are delivered to the insurer.

Types of assignment
There are two kinds of assignment:

Conditional assignment	Absolute assignment
• The interest in the policy automatically reverts to the assignor on the occurrence of the specified condition.	• The assignee becomes the titleholder in the policy and can deal with the policy in any manner they choose.

Example

A conditional assignment can provide for reversion when:

- the assignee predeceases the assignor; or
- the assignor survives until the date of maturity.

H5 Loans and foreclosure

Case study

In the same conversation with Mr Kumar, Nitish Sharma says to Mr Kumar that he has heard that it is possible to raise a loan against a life insurance policy. Is this true?

Let us look at how Mr Kumar would answer such a question.

H5A Loans against a policy

The policyholder has the option to raise a loan against their insurance policy if the terms and conditions provide for such a facility. Loans are not granted for all policies.

The main features of loans against an insurance policy are as follows:

- In loans against insurance policies, the loan amount is a certain percentage of the surrender value of the policy.
- A loan can be taken by a policyholder against endowment policies, whole life policies and other policies, as allowed by the insurer. These types of policies will have a savings element to them. A loan cannot be taken against policies in which a part of the sum insured needs to be repaid (money-back) during the policy term. Term insurance policies do not acquire any surrender value and hence cannot be used to raise loans.
- The insurance policy needs to be assigned absolutely in favour of the insurance company at the time of raising the loan. The assignment in favour of the insurer for getting the loan under the policy does not invalidate an existing nomination.
- The repayment of the loan can be done by the borrower wholly or in parts during the term of the policy. The borrower also has the option to postpone the repayment until a claim arises.
- If the policyholder continues to pay the premium regularly, then the surrender value goes on increasing and would be more than the outstanding loan and interest at any point of time.

Be aware

Banks also provide loans of up to 75% to 90% of the total surrender value of the policy.

H5B Foreclosure

There are two ways in which an insurance policy can be surrendered:

- surrender by the policyholder; or
- surrender by the insurer (foreclosure).

If the borrower is not paying the interest or interest and principal, the outstanding loan with the interest thereon will be appropriated (deducted) from the claim payable (on maturity or death).

When a policy is surrendered (cancelled) by an insurer, it is known as foreclosure. The policy will be foreclosed by the insurer only in the case of lapsed policies. The policy may have been in force at the time the loan was granted, but subsequently the policy becomes lapsed, and the policyholder is neither paying the premiums, nor loan interest, nor principal.

There can be two major reasons for foreclosure:

- the borrower has chosen to repay the loan during the policy term and is unable to do so; or
- the debt (loan) has accumulated over the policy term until the claim arises, and the accumulated debt (loan) has exceeded the surrender value of the policy.

In the case of paid up policies, the surrender value will not grow as fast as the accumulated interest. The principal and interest could become more than the surrender value at some time. In that case foreclosure becomes necessary.

The borrower is issued a notice of foreclosure, requesting them to repay the interest arrears on the loan. If the borrower fails to repay the interest, then the policy is foreclosed, i.e. surrendered to loan. The balance surrender value (if any) is paid to the policyholder after settling the loan and the outstanding interest. The policyholder has to submit a discharge voucher for the same amount.

Can a foreclosed policy be reinstated?
The foreclosed policy can be reinstated before the discharge voucher is submitted by the policyholder for collecting the balance surrender value. To reinstate the policy, the policyholder will have to pay the arrears of interest and submit a 'Declaration of good health'.

What happens to the nomination in case of foreclosure?
On foreclosure, the nomination ceases to be operative. If a death claim arises before the payment of the surrender value, the payment is made to the legal heirs of the deceased insured.

This concludes our consideration of the key terms used in insurance. However, before we finish this chapter, let us return once more to the topic of the premium. You should have already understood as a result of studying this chapter that the payment of the premium is of great importance in ensuring that insurance cover remains in place. This is so important that it is worth looking at in more detail.

I Relevance of premium payment and valid cover

When an insurance policy is purchased, the risk gets transferred from the insured to the insurance company. In consideration for this transfer of risk, the policyholder has to pay a premium to the insurance company. If a proposer never pays any premium, the policy will never come into force. This is because, as we saw in the first part of chapter 3, consideration is needed if a contract is to be valid. If the proposer does not pay the premium, there is no consideration and so no contract. This is why, as we saw in section G3A, the first premium receipt is the evidence that the insurance contract has begun.

As soon as the proposal is accepted and the first premium is paid, the insurance company becomes liable to pay a death claim, subject to the terms and conditions of the policy. However, if the policyholder fails to make subsequent premium payments, the policy will become lapsed and they will no longer be entitled to the benefits of the policy should the worst happen. The best they can hope for is the return of some of their premium. We looked at this situation in section H1A.

You will see from this how important the premium is if a valid insurance contract is to be in place and the proposer is to receive the protection they sought in buying insurance.

Case study

Nitish Sharma has been worrying about his policy and contacts Mr Kumar one last time with some more questions. What if, he asks, he is late with a payment because he is ill and then dies before he can make it? What happens if he is killed while walking back from the post office after posting his premium cheque? Will he still be covered or will Sumedha lose all the protection he has worked so hard to give her should he die?

Mr Kumar patiently answers Nitish's questions once more.

What happens if the insured dies and the premium has not been paid?
As long as the delay in payment falls within the days of grace given by the insurance company, then, the insurance company is liable to pay the full claim to the nominee or legal beneficiary. The insurance company will deduct the unpaid premium from the claim amount.

When is the premium deemed to be paid?
The premium is deemed to be paid only when the insurance company receives the funds. If the payment has been made by cheque, demand draft or money order, then the payment is deemed to be paid when the amount has been deposited in the insurance company account. However, in practice, the premium is deemed to be paid when any form of payment is received.

What if the insured dies while the cheque/demand draft/money order is in transit?
If the life insured dies while the cheque/demand draft/money order is in transit, i.e. the cheque/demand draft/money order has already been issued by the policyholder but the insurance company has not received it, then the insurance company will seek 'proof of sending these instruments'. The proof can be provided for instruments such as 'demand drafts' and 'money orders'. The insurance company in these cases deems that the premium has been paid on submission of the proof. However, if a cheque was sent in the post, the insurance company will require evidence of posting.

Key points

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

How insurance policies are bought and written

- Insurance companies generate interest in their products through prospectuses and advertisements.
- A policy should only be purchased by an individual after they have carefully considered how well it meets their needs.
- Life insurance can be written on a single life or a joint life basis and may be on the proposer's own life or on the life of another.

Key documents

- The proposal form is the main source of information through which an underwriter assesses the risk of a proposal.
- Some of the documents that can be taken as valid age proof are a high school mark sheet, passport, birth certificate, driving licence, voter ID card etc.
- The insurance company informs the proposer that their proposal has been accepted and the premium has been received by the company by issuing the first premium receipt (FPR).
- The insurance company issues renewal premium receipts (RPR) when it receives subsequent premiums from the policyholder.
- The policy document is an important document. It is evidence of the contract between the insured and the insurance company.
- The insurance company allows modification/alteration of the original policy documents through endorsements.

Key insurance terms

- Due dates are the dates on which the policyholder needs to pay the premium to the insurance company.
- In the event of default in payment of premium after the days of grace, the policy is said to lapse.
- Paid up value = [(number of premiums paid ÷ number premiums payable) x sum insured] + bonus.
- 'Surrender value' or 'cash value' is the amount that insurance companies are liable to pay once the policy is surrendered.
- When a lapsed policy is reinstated it is known as policy revival.
- Nomination is where the life insured proposes the name of a person(s) to whom the sum insured should be paid by the insurance company after their death.
- Assignment refers to the transfer of the title, rights and interests of the insurance policy, by the assignor, to the assignee.
- If the borrower defaults in loan repayment, the insurance company has the option to cancel the policy. This is known as foreclosure.

Relevance of premium payment and valid cover

- The payment of the premium is the consideration of the insurance contract, and so without its payment the contract cannot exist and there will be no cover.

Question answers

3.3 Documents that can be accepted as valid age proofs can be classified as standard age proof documents and non-standard age proof documents. Some of the documents that can be taken as standard age proofs are:

- a certificate from school or college records;
- a certified extract from registrar of births and deaths or from municipal records made at the time of birth;
- a passport;
- a Permanent Account Number (PAN) Card;
- the service register of the employer;
- a certificate of baptism;
- a certified extract from a family Bible, if it contains the date of birth;
- an identity card of defence personnel, issued by defence department; and
- a marriage certificate issued by a Roman Catholic Church.

Apart from the above mentioned standard documents, some of the non-standard age proof documents that can be accepted as a valid age proof are:

- an affidavit by way of self-declaration, elder's declaration;
- a certificate by village *panchayat*;
- horoscope prepared at the time of birth; and
- a ration card.

3.4 The FPR contains the following information:

- name and address of the life insured;
- policy number;
- premium amount paid;
- method and frequency of premium payment;
- next due date for premium payment;
- date of commencement of the risk;
- date of maturity;
- date the last premium payment will be made; and
- the sum insured.

Self-test questions

3.	What happens if the nominee is a minor and no appointee has been made?
4.	What is the 'free look-in period' or 'cooling-off period'?
5.	What happens if a policy lapses?

You will find the answers on the next page

Self-test question answers

3.	If the nominee is a minor, an appointee needs to be appointed by the life insured. If no appointee is appointed, then, if the life insured dies, the death claim is paid to their legal heir(s) and not to the natural or appointed guardian of the minor.
4.	The insurance contract starts with the issue of the FPR. However, IRDA regulations require that the proposer be given an option to withdraw from the contract within a period 15 days of the issue of the policy. This period is known as 'free look-in period' or 'cooling-off period'. If the proposer withdraws from the contract, then the insurance company will have to return the premium paid minus some deductions for the cost of risk for the short period, medical examination expenses and stamp duty.
5.	Once the policy is 'lapsed', the policyholder forfeits all the premiums and no claims arise on the policy. However, insurers do not terminate the contract. They allow the policyholder to revive the policy by offering them various easy options, such as on payment of the premium arrears and on the provision of a signed declaration of continued good health.

4
Insurance underwriting

Contents	Syllabus learning outcomes
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Learning objectives

After studying this chapter, you should be able to:

- explain the process of underwriting;
- explain the various sources from where information is collected for underwriting;
- analyse moral and physical hazards;
- explain the difference between financial, medical and non-medical underwriting;
- explain the concept of Human Life Value (HLV) and its role in underwriting;
- describe the process of pricing a policy;
- determine the process of calculating premiums;
- describe the process of calculating bonuses;
- explain the concept of liens;
- describe the role of the agent in underwriting.

Introduction

Underwriting is the name given to the procedure of:

- assessing the risk which people bring to the pool;
- deciding whether or not to accept the risk, or how much to accept;
- determining the terms, conditions and scope of the cover to be offered; and
- calculating a suitable premium.

For life insurance, underwriters are responsible for selecting the individuals the insurance company can insure from among those submitting proposals, and also the price it can insure them for, based on their risk profile.

As we have seen, the business of insurance is based on the principle of risk sharing. The insurance company carries the risks of the person insured in accordance with the policy terms and conditions. Hence the underwriters have to be extra careful in choosing the individuals to be insured from the group of proposers and in setting a fair price in line with the risk that each individual presents to the pool. An underwriter who fails to do this can affect the stability of an insurance company's business.

In this chapter we will look at the information the underwriter must have to be able to assess accurately the risk presented by a proposer. Their assessment of the risk will influence the premium to be charged, and later we will look at how pricing is carried out and how the premium is calculated. First, however, we will start by taking a brief overall look at the process of insurance underwriting.

Key terms

This chapter features explanations of the following terms and concepts:

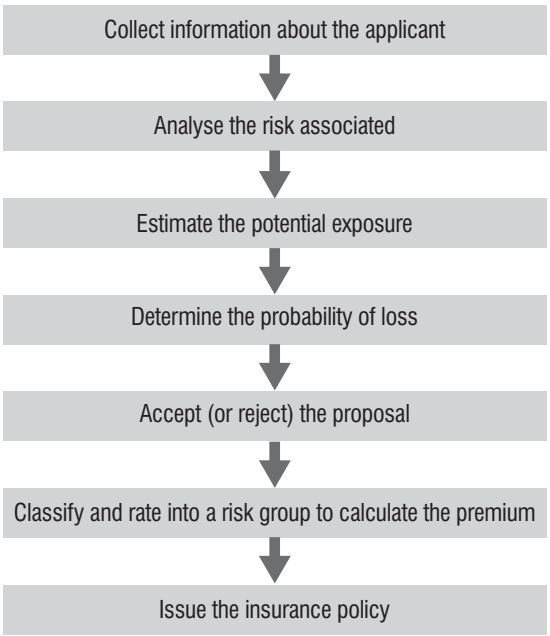
Underwriter	Gross premium	Moral hazards	Non-medical underwriting
Human life value (HLV)	Loading	Physical hazards	Risk premium
Bonuses	Financial underwriting	Medical underwriting	Liens
Adverse selection	Risk groups	Level premium	Time value of money

A The process of insurance underwriting

An underwriter is responsible for the classification, analysis and selection of the risks presented to them. Different companies have different guidelines as to how risks are classified and priced. Each company develops its own criteria and guidelines for the selection of risk, and the underwriter works within these with the aim of ensuring that the company continues to operate efficiently.

The process of insurance underwriting is as follows:

Figure 4.1



Be aware

The word 'risk' in life insurance is mainly used with reference to the life insured or the insured person.

The first step in insurance underwriting involves reviewing the information about the proposer from all the possible sources. For life insurance, significant information includes a person's age, occupation, income, personal habits, own health and family health history, in addition to the report of the agent on all these aspects.

The underwriter analyses this information and makes a decision on whether to accept or reject the proposal. This is a specialised process: the insurance underwriter has to examine all the facts available to them and analyse a proposer's real intentions for taking insurance. We will look at how this information is collected and used later in this chapter.

Fraudulent intentions: insurance underwriters have to be careful to determine the intentions of the proposers: not all will be honest or genuine. The intention of the proposer has to be analysed carefully before deciding on whether to accept the proposal or not.

The insurance underwriter then examines the information to determine the probability that the company might have to pay a claim based on the circumstances. In this step, the underwriter determines **maximum possible loss (MPL)**. MPL refers to the maximum amount of loss that can occur, if a certain event occurs.

The underwriter will then decide whether to accept the risk at ordinary rates, accept the risk with modified or special terms (e.g charge a higher premium), accept with a lien, postpone or reject the risk as falling outside those that the company considers acceptable.

The underwriter must also protect the company from **adverse selection**. This is a term used to describe the situation where an insurance company accepts too many proposers who bring a higher than average risk to the pool. The concept of adverse selection is based on the view that people who fear that they are prone to risk are more likely to want to take out life insurance as opposed to people who feel that they are prone to low risk. If a company does find itself exposed to adverse selection it may find that it pays out more claims than anticipated. This obviously has a bad effect on the success of the company.

Example

Rakesh Sharma has recently being diagnosed with diabetes. He is only 38 years old. Rakesh is very keen to get insurance cover and is willing pay a high premium. Rakesh Sharma's main intention in taking out an insurance plan is to transfer the cost of the medical expenses that are likely to occur in the near future to the insurance company. Also, in case he dies, the claim from the life insurance company should be sufficient for his family to maintain a decent lifestyle.

If people like Rakesh Sharma are selected by the insurance company in large numbers, this could lead to adverse selection. The potentially huge medical expenses that may arise will have to be borne by the insurance company.

The underwriter may choose to reject Rakesh Sharma's proposal on the basis that he brings too high a risk to the pool. However, rejection is not the only solution available to the underwriter. The underwriter can chose to:

- accept the proposal at ordinary rates;
- accept the proposal with extra premium;
- accept the proposal with a lien;
- accept the proposal with modified terms;
- accept the proposal with a specific/modified clause;
- postpone the decision for a certain period; or
- reject the proposal.

Example

Hiten Patel applies for an insurance policy from an insurance company. In his proposal form, he declares that he is undergoing treatment for a heart-related problem. He also states that he has been operated on for the same problem before.

The insurance underwriter in this case will have to collect the information about the nature of the illness, treatment available, operation and recovery procedure. Based on the information, the underwriter will decide about the risk associated with Hiten. The underwriter may charge him a higher premium or exclude health issues related to his heart from the cover provided.

Be aware

Different insurance companies use different criteria for deciding whether a proposal is acceptable. If an existing disease is not considered suitable for cover by a certain company, another company might cover it to some extent with the payment of extra premium.

Once the decision has been taken to accept a risk, the underwriter will classify it into a **risk group**. Each risk group has a rating based on company guidelines, with those risks presenting a higher risk being classified in a high risk group and being charged a higher rate. The risk group is very important as this is used to decide what premium the proposer will have to pay. The underwriter can change/modify the rating before arriving at the final premium.

If the premium and terms offered by the underwriter are accepted by the proposer, the policy can now be issued to the proposer, customised if necessary to take account of the risk presented by that proposer.

Be aware

The regulations issued by the IRDA, require that the decision on the proposal must be conveyed to the proposer within 15 days of receiving the proposal.

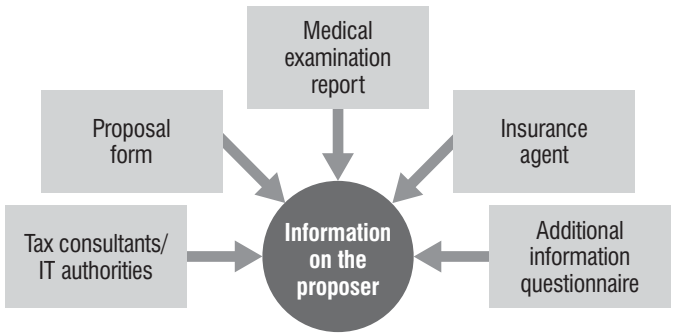
Question 4.1

When the underwriter receives a proposal for insurance, what are the various decisions that they can take in respect to that proposal?

B Obtaining the required information

The underwriter can collect the information about the proposer from several sources. Much of this is obtainable from the specific documentation that the underwriter requires, for example, the proposal form.

Figure 4.2: Sources of information about the proposer



B1 Proposal

The proposal form, filled in and signed by the proposer, is the most important source of preliminary information to the insurance underwriter. The proposal contains the following information:

Personal information:	• This part of the form contains information such as the name of the proposer, their address, age, annual income, an estimate of monthly expenditure, occupation, marital status, any other insurance policies taken out by them etc. • In cases where the proposer and the life insured are different individuals, then the proposer's name and address also needs to be entered on the form.
Medical information:	• This part of the form contains information on the proposer's past medical history and present medical condition. Also, information on the proposer's weight, height and other specifications, their medical history and that of their family etc. is collected. A doctor's report on the medical condition of the proposer can also be taken at this stage, if the underwriter or the type of policy makes one necessary. • If the policy is being taken out on a non-medical basis (see section D), then the proposer may be asked to provide information on their past illnesses, injuries and surgical operations, along with information about their doctor.
Agent's remarks:	• The form also contains remarks made by the agent about the proposer. The agent will give their analysis on the proposer with regard to their lifestyle, habits and hobbies. They should also mention the proposer's financial status and any other information that they think could be useful to the underwriter when ascertaining the risk.

B2 Medical examination report

A complete medical check-up on the proposer can be carried out by the insurance company or by a certified doctor. This is done to reduce the chances of adverse selection by the company, i.e. the selection of a large number of unhealthy individuals as against healthy individuals. The examination may be carried out because the sum insured, or the proposer's answers to the health questions, mean that the underwriter wants more information on the risk before agreeing to accept it.

It may be the policy of the insurer to ask for a medical examination report on all proposed risks of a certain type.

Some insurers classify proposers according to their age. The number of medical examinations requested for those in the lowest age bracket will be low, steadily increasing until those in the highest age bracket are required to have a comprehensive medical check-up. We will look at medical and non-medical underwriting further in section D.

B3 Insurance agent

The insurance agent interacts directly with the proposer and so is in a good position to judge their risk profile. The agent has the opportunity to assess the answers of the proposer and determine their truthfulness, and the underwriter can seek the help of the insurance agent regarding the proposer at any time.

B3A Agent's Confidential Report

An 'Agent's Confidential Report' needs to be prepared by the insurance agent. If the amount of insurance cover required is standard, then the agent prepares a report based on the proposer's financial position, number of dependants, lifestyle, habits and hobbies. If the amount of insurance cover required is larger than usual, then the agent needs to prepare a more detailed report. The information for this report is collected through the family, friends and neighbours of the proposer.

Sometimes, these reports are required to be prepared by senior employees of the insurance company (such as the Unit Manager or the Sales Manager) and can be referred to as a 'Moral Hazard Report'.

These days there are some specialised inspection agencies that can carry out the inspection for the insurer. These companies prepare and present a report on the proposer's employment history, financial position and creditworthiness.

B4 Additional information

The underwriter seeks additional information when the amount of the insurance cover required is larger than average or the risk profile of the proposer is high.

Where the amount of insurance cover sought by the proposer is relatively high, then additional information on the proposer's medical report can be requested. Special reports from senior officials and the insurance agent on the proposer's income, occupation, lifestyle, habits etc. will also be required to evaluate the risk involved in the proposal.

B5 Report from tax authorities

The underwriter can refer to information from the income tax authorities and tax consultants regarding a proposer's income tax records, tax deduction report etc. This will enable the underwriter to determine whether the proposer has any outstanding tax commitments or has defaulted on them in the past.

Suggested activity

Collect a proposal form from any life insurance company. Prepare a list of the details/information that the form asks for. What kind of information is the proposal form asking for?

C Moral and physical hazard

We looked at hazard in chapter 2, where we saw that it is divided into two types:

- physical hazard; and
- moral hazard.

In this section we will return to this topic to consider in more detail how moral and physical hazard apply to life and health insurance.

C1 Physical hazard

Physical hazards refer to the physical characteristics of the risk associated with the life insured. We looked briefly at some of these in chapter 2.

Some of the physical hazards that relate to life insurance are as follows:

Age
The age of an individual is an important hazard when determining the risk associated with the life insured. The higher the age of the proposer, the higher will be the probability of their natural death.

Occupation
The proposer's occupation can increase the chance of their death. Certain jobs carry more risk to health, of death or of injury, than others and would be considered less attractive by the insurance company than less risky occupations. The hazards of different occupations can be considered on the following criteria:

Environmental:	• Exposure to danger or violence etc. can result in dangerous living conditions of the person, which increases the chances of early death.
Physical conditions:	• The proposer works in poor physical conditions, such as a dusty and poorly ventilated factory. The chances of illness increases for the proposer.
Risk from accident:	• The proposer works as a driver or with machinery, which increases the risk of accidents.

Example

The proposer's occupation may be classified as hazardous if they work in any of these: coal mines, ferrous metallurgical industries, chemical industries, explosives factories, or if their work involves: climbing poles, working at heights, working with high voltage electricity etc.

Gender
Some companies charge a differential rate for females based on their profile, background etc.

Residence
The security of a proposer's home is an important physical hazard. If the neighbourhood where the individual lives is considered to be an unsafe, violent and dangerous area, then the risk to individual life increases.

Habits
Habits such as drinking, smoking and the use of tobacco are considered to be hazardous to health. They can increase the risk that a proposer will die early or suffer a serious illness.

Hobbies
If the individual indulges in dangerous hobbies, such as bungee jumping, car racing, mountain climbing, sky diving, scuba diving etc. then the risk to the individual's life increases. These kinds of adventurous sports are less attractive to the insurance company.

Physical characteristics
The physical characteristics of a person are used to determine the health of the proposer. Data regarding their height, weight, size etc. can determine how healthy the individual is.

Example

Ravi's height is 153 cm and his weight is nearly 80 kg. This shows that he could be overweight. This increases the chance of him developing heart disease and other ailments, such as diabetes and high blood pressure.

Medical condition
When carried out, a complete heath check-up of the proposer will check their blood pressure and pulse to determine their medical fitness. A blood and urine sample is also taken to check if the proposer has developed certain diseases.

Physical handicap
Physically handicapped persons are also considered to present an increased physical hazard as their disability may increase their risk of an early death.

Medical history of the family
Certain illnesses, such as diabetes, a tendency to suffer from heart disease and some cancers are hereditary in nature. If a family member suffers from such an illness, then the chances that the proposer may also suffer from it increases.

Personal history
The personal history of the individual with respect to their health records, habits, lifestyle, credit history etc. are also important criteria.

C2 Moral hazard

Moral hazard is more difficult to define than physical hazard because it relates to the **conduct, attitude and/or intentions** of the proposer. It is also hard to minimise or correct poor moral hazard.

The following examples illustrate the nature of moral hazard in relation to life insurance:

- reckless or careless attitude to health and personal safety;
- previous history of dishonesty (perhaps criminal activity that is revealed by checking court records); and
- previous claims history if it reveals a history of fraudulent/frequent claims, bankruptcy or other financial difficulty.

Fraud and moral hazard
Intention to commit fraud is an aspect of moral hazard that life insurance underwriters need to pay particular attention to.

Underwriters will be alert to proposals for life insurance which display certain characteristics which, based on their knowledge and experience, are possible indicators of fraudulent intentions. The following are some examples:

- The proposer is requesting insurance for a fairly large amount at a later stage of their lifecycle.
- The insurance is being taken out by an individual with no dependants.
- The insurance policy is insuring a non-earning family member (because the death of a non-earning member does not affect the livelihood of the dependants).
- When the nominee of the policy is not among the dependants of the insured.
- When the proposer is seeking insurance for an amount which is much higher than their income.
- If the past premium payments of the individual are much higher than they are capable of paying based on their income.
- When the medical check-up is carried out at a different place from the place of residence.
- If any aspect of the relationship between the agent and proposer causes the underwriter concern.

Underwriters use the information described in section B to help them assess the circumstances presented by the proposer.

Question 4.2

Can the area where the proposer lives be considered a physical hazard? Give reasons to support your answer.

D Financial, medical and non-medical underwriting

D1 Financial underwriting

Underwriters will pay careful attention to the financial aspects of a proposed risk for reasons other than to identify any fraudulent intentions. As we shall see, financial underwriting works to cap the amount of life insurance an individual can get. The amount of life insurance that an individual is eligible for can be arrived at through the 'Human Life Value' (HLV) concept. The HLV concept tries to measure the economic value of a person in monetary terms. More details on HLV are covered in section E of this chapter.

Financial underwriting is used to make sure that the person who is being insured qualifies for an amount of insurance that does not exceed their insurable interest. An individual's personal and family income is considered for financial underwriting.

If an individual is seeking a sum insured which is way beyond their income, then an underwriter needs to evaluate whether the amount of insurance cover being asked for exceeds the insurable interest. As we know from chapter 3 part 1, section B, insurable interest must exist for a life insurance contract to be valid. Insurable interest means that there is a firm reason behind the amount of life insurance that is being applied for. The higher the sum insured, the more justification will be required by an underwriter. Typically this means that the amount of insurance that is available to any proposer is capped at a certain point, over which they have no real justification for coverage.

Factors analysed under financial underwriting include the individual's income, age and net worth etc.

Insurance companies offer two kinds of insurance policies: one which requires medical underwriting and one where no medical underwriting is required.

D2 Medical underwriting

Medical underwriting is where the underwriter actually researches the health and medical history of the individual in a detailed and accurate way by checking the medical records of the proposer for the past few years and insisting on a medical check-up. This medical check-up can be either general or more comprehensive depending upon the age of the proposer, their medical history and the amount of insurance cover they are asking for.

If the proposer is found to be in perfect health, then they would be considered as low risk by the underwriter.

Be aware

Insurance companies maintain a schedule that determines the degree of medical tests required depending upon the proposer's age, medical history and the amount of insurance cover they are requesting.

D3 Non-medical underwriting

As the name suggests, under this category no medical examination is required for insurance to be agreed. The medical assessment of the proposer can be both a time consuming and expensive exercise. Also, in many cases (mostly with proposers living in rural areas), specialised medical services would not be available so it can be difficult for a proposer to obtain a medical report from a qualified doctor.

In non-medical underwriting, instead of a medical report the insurance is based on the physical characteristics of the individual, such as age, height, weight etc. as revealed by the proposal form. The proposal form is usually more detailed for this kind of insurance.

All proposals are checked by agents, field officers and branch officials. In addition, a high ranking official may be called upon to submit a special report.

If the proposer is in regular employment, then the leave records of the employee can be assessed for insurance. If a personal statement or the family history reveals the existence of a medical condition(s), then a medical examination may be requested.

Non-medical insurance underwriting carries more risk to the insurer as proposers may have a medical condition that would have been revealed by a medical examination, but which does not come to light in the proposer's answers on the proposal form. The chances of adverse selection may be greater with this method of underwriting and, as a consequence, these policies may be priced at a higher rate.

Safeguards adopted in non-medical business
Because the chances of adverse selection are greater with medical underwriting, insurance companies practice the following safeguards:

- a restriction on selection (female lives);
- putting limits on the sum insured;
- a restriction on maximum entry age;
- a restriction on the maximum term for which the policy can be issued;
- a restriction on the maximum age at maturity;
- a restriction on the types of insurance plans allowed;
- restrictions on high risk plans;
- limiting cover to certain categories of lives (based on education, social and economic background);
- restricting the class of lives eligible (to individuals employed in reputable organisations, who have undergone a medical exam at the time of recruitment, for whom leave records are maintained, and they have completed at least one year of service etc.); and
- requiring a moral hazard report from an officer of the insurer.

Suggested activity

Visit an insurance company and collect a proposal form for medical insurance and non–medical insurance. What sort of additional information is asked for by the non-medical form compared to the medical form? Prepare a summary report to help you to understand the difference in the two approaches.

E Human life value (HLV)

The key role of life insurance is to provide protection for the family of the insured, should the insured die unexpectedly. It does this by paying out the sum insured under the policy, should the worst happen. But how much should this sum insured be? How much is the insured's life worth?

E1 What is human life value?

Ask a person how much their life is worth and without a second thought they will say that human life is priceless and no amount of money can compensate for the value of a human being. But insurance companies and their agents will differ. To arrive at the amount of insurance cover that a person should take out they need to assign a monetary value to human life. This is called human life value (HLV). Like real estate, equities/shares or commodities, a human being is also an asset and has the potential to generate income. Through **human life value (HLV)** the insurance company tries to measure the economic value of a person or how much the person is worth in monetary terms.

In life insurance, HLV is used as a yardstick to determine how much life insurance cover a person should have. The correct cover will ensure that if the person dies today, there will be no economic loss to their family. Of course, emotional loss cannot be compensated for. The lump sum amount that the person's family will get from the insurance company will compensate for the future income of the life insured; the income they would have earned had they survived.

E2 How much life insurance should one have?

What many people often do not realise is that, in spite of having a number of insurance policies, if the amount of cover provided by the individual policies is small they can be grossly underinsured. So what then is the correct amount of life insurance cover that a person should have? We can answer this by looking at the different ways of arriving at human life value (HLV). The amount of life insurance cover that a person should have should be equal to their HLV.

E2A Income replacement method

This method takes into consideration the future income earning potential of a person during the remaining years of their working life, so that in the event of their untimely death their family will not suffer financial loss.

This is a two-step process:

Step 1:	• Calculate the total future income the person will be able to earn during their remaining working years.
Step 2:	• Calculate the present value of this amount (arrived at in step 1) as at today. This is the person's **human life value**. The life insurance cover that the person should take out should be equal to this HLV figure. In the event of their untimely death, this method captures the future income potential of the person, which they would have earned had they survived until retirement. • **In summary, this method equates human life value to the present value of future earnings**.

Example

Rajesh is a 35-year-old man earning Rs. 4,00,000 per annum. Rajesh's family consists of his wife (housewife), 4-year-old daughter and his retired parents who are now dependent on him. The net contribution made by Rajesh to the family is Rs. 25,000 per month (Rs. 3,00,000 per annum) after deducting taxes and personal expenses.

Let's assume that Rajesh's salary will increase by 5% every year and his family contribution (Rs. 3,00,000) will also increase by 5% every year.

Annual income	Rs. 4,00,000 per annum
Expected rise in salary	5% p.a.
Net income after taxes and personal expenses	Rs. 3,00,000 per annum
Current age	35 years
Remaining working years	25 years
Future value of earning potential	Rs. 1,43,18,129
Discount rate (PPF Rate)	8%
Present value of future earnings	Rs. 20,90,703

Rajesh's worth to his family is Rs. 1.43 crore over his remaining working life if he survives until he is 60 years old. But if something happens to Rajesh today, his family stands to lose this money.

We need to find the value of this Rs. 1.43 crore as at today. So if we take the discount rate as 8% (risk-free PPF rate) then the value of Rs. 1.43 crore as at today equals Rs. 20,90,703 (Rs. 20.90 lakhs).

This effectively means that a one-time amount of Rs. 20.90 lakhs invested at 8% interest rate for 25 years will yield Rs. 1.43 crore on maturity.

Therefore the figure of Rs. 20.90 lakhs is Rajesh's human life value (HLV) and he should take out life insurance cover of Rs 20.90 lakhs to protect his future income.

E2B Simple method

Alternatively, there is a simpler method to calculate HLV than using the income replacement method.

Example

Let's take the same example of Rajesh again. Let's assume that the current Bank Fixed Deposit (FD) rates in the market are 8%. So if someone invests Rs. 37,50,000 (Rs. 37.5 lakhs) in a Bank FD at 8% per annum interest rate, the yearly interest earned will be Rs. 3,00,000 (3 lakhs).

So Rajesh's HLV is Rs. 37.5 lakhs and he should take out life insurance of Rs. 37.5 lakhs so that in the event of his untimely death, his family will receive a payment of Rs. 37.5 lakhs. If they invest this in a Bank FD at 8% interest rate, it will give them Rs. 3,00,000 yearly income. This Rs. 3 lakhs per annum will substitute Rajesh's yearly contribution of Rs. 3 lakhs and take care of the family's expenses in his absence.

The table below explains the calculation of human life value for Rajesh:

Annual income	Rs. 4,00,000 per annum.
Taxes & personal expenses	Rs. 8,000 per month
Net monthly contribution to family	Rs. 25,000 per month
Net annual contribution to family	Rs. 3,00,000 per annum
Bank FD rate	8%
Human life value calculation	3,00,000 / 8% = 3,00,000 / 0.08 = 37,50,000
Insurance amount required (HLV)	Rs. 37,50,000

Rs 37,50,000 invested in Bank FD at 8% interest rate will give annual return of 37,50,000 × 0.08 = Rs. 3 lakhs per annum.

This method will ensure that the family will continue to receive Rs. 3 lakhs per annum as long as Bank FD rates stay at 8%. This method assumes that the annual salary will remain constant at Rs. 4,00,000 throughout, and does not take into consideration any expected increases in salary. It also assumes that Bank FD rates will remain constant at 8% throughout, and does not take into consideration the increase or decrease in interest rates.

Be aware

Human life value is not a one-time calculation. It is an ongoing process which needs to be revisited from time to time. As age increases human life value diminishes.

F Liens

There are certain cases where the underwriter will feel that the risk associated with a person might decrease over time. In such cases, the underwriter can accept the proposal with a lien. As the risk is assumed to diminish over a period of time, the lien is operable for that period on a diminishing basis. A lien is generally used as a substitute to charging a high premium for a high risk.

In simple words, if the insurance company categorises the proposer as high risk because their physical characteristics do not satisfy the standard ones as determined by the insurance company, then it will charge the proposer a high premium. However, the proposer has an option to request a lien. If the lien is granted, then for a certain period, if something were to happen to the proposer, the insurance company would be liable to pay only a restricted amount of the sum insured.

Example

In the case of a diminishing lien of 20% for the next five years, the lien will cease to exist after the completion of the five years. In other words, from the sixth year onwards the insurance company will pay out the full sum insured in the event of a claim.

If the insured dies within the lien period, then the insurance company will not have to pay the full sum insured.

The guidelines for liens which are normally followed by insurance companies are:

- the lien should diminish by an equal amount over a specific period of time; and
- if the term of the policy is a multiple of three, then the lien operable is one third of the term of the policy.

The conditions under which a lien can be applied differ amongst insurance companies. Generally a company imposes a lien if it considers the applicant to present an extra risk because their physical characteristics do not match the standard ones as determined by the company.

The following case study will help to explain the concept of liens:

Case study

Mukesh Gupta is 31 years old and wants to take out a life insurance plan from IGP insurance company. The company in their initial enquiry finds out that Mukesh is underweight. IGP insurance company categorises Mukesh as falling into the high risk category. The company agrees to provide insurance to Mukesh, in spite of his risk profile, if he agrees to pay a higher premium.

Mukesh instead asks for a lien to be imposed, and so IGP life insurance company imposes a decreasing lien of 15% for three years.

Analysis

1st year: If Mukesh dies within the first year of taking out insurance, then only 85% of the sum insured will be payable by the insurance company.

2nd year: If Mukesh dies in the second year of taking out insurance, then only 90% of the sum insured will be payable by the insurance company.

3rd year: If Mukesh dies in the third year of taking out insurance, then only 95% of the sum insured will be payable by the insurance company.

4th year: No lien is operative. If Mukesh now dies, the insurance company will pay the full sum insured.

G Pricing and calculating the premium

Pricing refers to the calculation of the premium that will be charged on the insurance policy.

The pricing of the insurance policy is an important decision for the insurance company and it will have a number of prime objectives in mind in this respect.

In addition to being concerned about charging premiums that are sufficient to meet claims, expenses and produce profits at the desired level, the company will also be keen to ensure that premiums are **competitive** so that it does not lose business to other insurance companies.

It will also consider the **process** of calculating the premium to be charged with the aim of keeping it simple, easily understood and not needing to be changed too frequently.

For life insurance the premium charged is based on the mortality rate as revealed in the mortality tables (you will remember that we introduced these in chapter 2, section B2), and we will look at how insurers use these tables and rates and how the premium to be charged is actually calculated later in this section. First, however, we will discuss how insurance companies decide what the price of their policies will be.

G1 Pricing elements

Bearing in mind the main objectives of the company, various other factors will affect the price the insurance company will charge for its cover. These are the pricing elements and we will look at these briefly now. Later we will see how these relate to how the premium is calculated.

Mortality rates

We have already mentioned that insurers use mortality tables to help calculate the premium. These tables also contain mortality rates, which in simple words can be defined as the probability that a certain individual will die before their next birthday. We will look at how mortality tables and rates are used to calculate the premium in section G2A.

Loading

All companies incur expenses in going about their business and insurance companies are no different. The premium is the key source of income for an insurance company and so the premium needs to cover the cost of meeting these expenses. The addition of these expenses to the premium is called loading.

Income from investment of premium

The premiums that are collected by insurance companies for traditional plans are invested as mandated in the **Insurance Act 1938**. The profits they earn from their investment can help to cover the insurance company's expenses and so can be taken into account when considering the price.

Benefits promised
The pricing will depend upon the benefits promised by the company. The larger the benefits offered by the insurance company, the higher the premium will need to be to cover the cost of providing that benefit.

With-profit policyholders pay a slightly higher premium for the benefit of sharing in the bonuses and are generally rewarded well by bonus declarations.

Premium plan being taken
The policyholder can pay the premium in a number of ways:

Single premium plan:	• In this plan, the policyholder pays a single lump sum payment at the inception of the policy. The premium amount should be sufficient to meet the administrative and other expenses during the entire term of the policy.
Level premium plan:	• In this type of plan, the policyholder pays the same amount of premium for the entire duration of the policy. When pricing this sort of policy the insurance company will need to allow for the time value of money, in other words it must be sufficient to meet future claims, future administration and the effects of inflation. Many life insurance policies are on a level premium basis and we will look at how the level premium is calculated in more detail in section G2B.
Flexible premium plan:	• Insurance companies also allow the policyholder to choose a flexible premium payment plan, where the policyholder can pay the premium amount at their convenience. They can choose whether they wish the premium to remain the same over the term or to change the amount of premium paid based on affordability. The premium amount can generally increase by 5% annually, but the exact terms and conditions for flexibility depend upon the insurance company.

All of these will influence the premium that is finally charged to the policyholder.

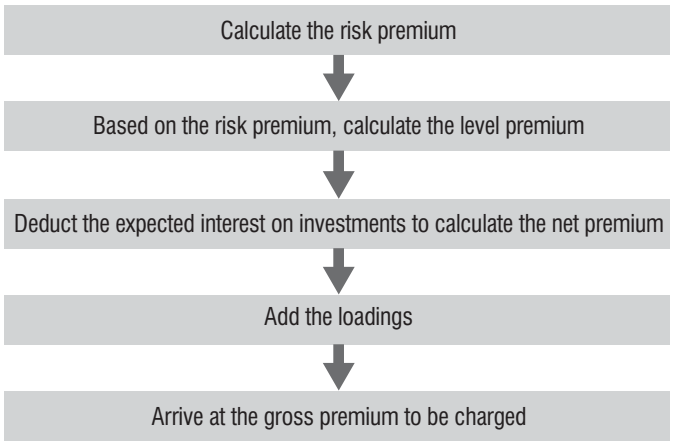
Question 4.3

What is a lien in insurance?

G2 Calculating premiums

The process of calculating the premium is as follows:

Figure 4.3



G2A Calculate the risk premium

The life insurance premiums collected by the insurance company are kept in a single pool, known as the common fund or life fund. All the future claims on the company are settled using this common fund. Therefore, the insurance company has to make sure that there is enough in the common fund to meet those claims.

Determining the correct amount for the common fund is a difficult task, as no one can accurately predict the future. However, as we have seen, using the statistics on death rates from previous years, insurance companies can now estimate fairly accurately the probability of an individual dying before their next birthday. This probability – known as the mortality rate – is used to calculate the risk premium.

Be aware

A mortality table shows for each age the number of persons living at that age and the number of people dying at that age. It is based on death statistics collected over the past 100 years or more.

Mortality tables differ among insurance companies.

The mortality rate is the probability that a certain person will die before their next birthday.

Mortality tables are prepared by mathematicians, known as actuaries, who determine the premium to be charged, based on mortality rates.

The risk premium is calculated using the mortality rates in the mortality table of the respective insurance company. The formula is:

Figure 4.4

The risk premium is the premium that has to be charged just to meet the claims of those who die during the year.

To see how this works, let's look at a case study.

Case study

Ajay Gupta, an insurance agent, has sold three life insurance policies.

The **first** insurance policy has been sold to a 25-year-old single man who has recently started to work for a reputable IT firm after completing his engineering degree. He has taken a sum insured of Rs. 5,00,000.

The **second** policy has been sold to a 36-year-old man. He is married and has two children. The individual has been insured for Rs. 8,00,000.

The **third** policy has been sold to a 48-year-old businessman who has insured his life for a substantial sum of Rs. 40,00,000.

The agent, Ajay Gupta, is calculating the premium for the three clients. Let's see how he goes about doing so:

Client 1: Age = 25 years. Sum insured = Rs. 5,00,000. Mortality rate = 0.0001

Risk premium = Rs. 50.

Client 2: Age = 36 years. Sum insured = Rs. 8,00,000. Mortality rate = 0.00081

Risk premium = Rs. 648.

Client 3: Age = 48 years. Sum insured = Rs. 40,00,000. Mortality rate = 0.00091

Risk premium = Rs. 3,640.

We can see that the premium charged differs with the mortality rate and the sum insured. The larger the sum insured, the higher the premium. We can also see that the mortality rate increases with the age of the insured person.

G2B Based on the risk premium calculate the level premium

As we saw earlier, with many life insurance policies the insurance company charges the same amount of premium for the entire policy term: it cannot be changed. Therefore, the premium set will need to take into consideration the future expenses and claims that the insurance company will have to pay. It will also need to take into account the effects of inflation, which means that the value of money decreases over time, so the premium the policyholder pays now will not hold the same value in later years. This means that the cost of inflation will be borne by the insurance company in the later years of the policy. Consequently, the premium will need to be set at a higher level than would appear to be appropriate initially. The higher premium collected in the early years is put into a reserve by the insurance company to meet the cost of future claims and expenses.

Let's look at the basic concept of level premiums with the help of an example.

(**Please note**: this is just a sample scenario)

Table 4.1

	Claim payment	Expenses	Segregation of premium
Year 1	Only a minimal claim amount will be paid.	Administrative expenses will be high.	Some of the premium amount received will be reserved for future. The rest will be used for claim payment and the expenses.
Year 2	The amount paid will be higher than the 1st year.	Administrative expenses will high but lower than Year 1.	Reserve fund will increase, but the amount deposited will be less compared to Year 1.
–			Reserve fund increases.
–			Reserve fund increases.
–			Reserve fund increases.
Year 10	The amount paid will be high.	Administrative expenses will be low.	The entire premium collected for that year is used for the payment of the claims and expenses. No amount is transferred to the reserve fund from the premium collected in that year.
Year 15	The amount paid will be high.	Administrative expenses will be even lower.	The premium collected for that year is not sufficient to meet the expenses and claims. Hence an amount is taken from the reserve fund to meet the deficit.
–			Reserve fund decreases.
–			Reserve fund decreases.
Year 20	The insured dies.	Expenses for processing the claim along with other administrative expenses.	The funds from the premium and reserve funds should be sufficient to pay the claim.

Remember, this table is only provided to give a simple understanding of the concept of level premium. In actual practice, the calculation of the premium is a much more complex process. The above table contains the calculation for a single life insurance policy, but insurance companies calculate the premium payment for a **group** of policies. The claims are paid from the common fund and the reserve fund is maintained for a **group** of polices.

Hence the reserve will be calculated by grouping homogeneous policies, based on the same age group, risk associated, type of policy taken, policy term etc. The consolidated amount for the reserve fund is determined and this amount is then divided by the number of policies.

In an ideal scenario the reserve fund will increase in the initial years, break even in later years, and then begin to diminish in later years until it finally becomes nil. But new proposers go on enrolling and the premiums and claims keep flowing in and out of the fund.

G2C Calculate the net premium

The premium that is collected by the insurance companies for traditional plans is invested in securities as mandated in the **Insurance Act 1938**. The insurance companies earn interest as income from their investments.

This interest earned is also considered for the premium calculation. The actuaries make an estimate of the amount of interest that the investments are expected to earn. Based on the estimate of these interest earnings the premium charge can be reduced.

Figure 4.5

There are some important points to remember when thinking about how the premium is adjusted for the interest earned on its investment:

- the premium is invested, until it is required to pay claims;
- for level premiums, the reserve funds are also invested; and
- the interest expected to be earned also depends upon the term of the policy.

Be aware

The actuaries follow a conservative approach for calculating the expected rate of interest on investments. The expected interest is adjusted with premiums.

G2D Add loadings

A further adjustment is made to the net premium in order to calculate the gross premium (the actual premium that is paid by the policyholder). This adjustment is to take account of the expenses and profit of the insurance company. This process is known as loading.

The following items are added in loading:

- administrative expenses, such as the cost of running the building, employees' salaries, etc.;
- medical expenses incurred for medical underwriting;
- processing fee;
- expenses involved in the renewal of the policy;
- claim settlement expenses;
- profit margin; and
- bonus loading for with-profit policies.

Be aware

Maximum expenses are incurred at the time of inception of the policy. These expenses have to be spread over the entire term of the policy when determining the premium.

G2E Arrive at gross premium to be charged

The type of policy – whether it is a single premium plan, a level premium plan, flexible premium plan or an annually renewable plan – will affect the gross premium to be charged. For instance, when calculating the premium for a single premium plan the insurance company will need to determine how many policyholders are likely to take up the plan and how many death claims it will expect to have to pay during the policy term.

Similarly, whether the premium is to be paid annually, semi-annually, quarterly or monthly will also need to be taken into account. Most insurance companies first calculate the premium for annual payment, and then make a further adjustment for monthly payment. Insurance companies generally collect a 'frequency loading' if the premium is not being paid annually.

Example

Let's assume that an insurance company charges a 5% frequency loading for a monthly premium plan. The annual gross premium has been calculated as Rs. 25,000. So the monthly gross premium that the policyholder will have to pay will be:

$25{,}000/12 \times 1.05 = \text{Rs. } 2{,}187.50$

Be aware

Some insurance companies calculate the gross premium inversely. That is, they first calculate the monthly premium and then calculate the annual premium. Certain discounts are allowed for annual premiums. The reason for the discounts is that the higher the frequency of premium payment, the higher the administrative cost for the insurance company. So discounts are offered by insurance companies to encourage policyholders to choose an annual premium payment plan.

Question 4.4

Briefly define the following terms:

- loading;
- frequency loading.

H Calculating bonuses

The policyholders who purchase participating insurance policies (with-profit policies) are entitled to participate in the profits of the insurance company. These profits are distributed to the policyholders in the form of bonuses. There are four types of bonus given by insurance companies.

- simple revisionary bonus;
- compound revisionary bonus;
- terminal bonus; and
- interim bonus.

H1 Simple revisionary bonus

The insurance company declares this bonus and adds the declared bonus to the sum insured. This is paid out at the time of the claim or the maturity of the policy, or at any other time as specified by the insurance company.

Example

If ABC insurance company declares a bonus of 5% for every Rs. 1,000 sum insured then the bonus will be Rs. 50. If Smita Patel has bought a policy for a sum insured of Rs. 1,00,000 then her share of the bonus will be Rs. 5,000. This amount declared will remain the same until the time it is paid out, unlike a compounded bonus where the amount is added to the sum insured and the next year's bonus is calculated on this enhanced amount.

H2 Compound revisionary bonus

Under this method the insurance company computes the annual bonus on a compound interest basis, i.e. the bonus is added to the sum insured and the next year's bonus is calculated on the enhanced amount.

Case study

Rahul Khanna owns two participating policies of Rs. 5,00,000 each. Let's assume that on the first policy he gets a bonus using the simple revisionary method and on the second policy he gets a bonus using the compound revisionary method.

The insurance company has declared a bonus of 5% of the sum insured. Rahul has a sum insured of Rs. 5,00,000 so the bonus will be Rs. 25,000. Hence Rahul's payable maturity amount will increase to:

- sum insured for simple revisionary basis = Rs. 5,00,000 + Rs. 25,000 = Rs. 5,25,000.
- sum insured for compound revisionary basis = Rs. 5,00,000 + Rs. 25,000 = Rs. 5,25,000.

In the next year, the insurance company declares a bonus of 3% of the sum insured. This year Rahul's payable maturity amount will increase to:

- sum insured for simple revisionary bonus = Rs. 5,25,000 + Rs. 15,000 = Rs. 5,40,000.
  (Rs. 15,000 is 3% of Rs. 5,00,000)
- sum insured for compound revisionary bonus = Rs. 5,25,000 + Rs. 15,750 = Rs. 5,40,750. (Rs. 15,750 is 3% of Rs. 5,25,000)

Note: in the above case the bonus in the case of the simple revisionary method will always be calculated on the sum of Rs. 5,00,000.

In the case of the compound revisionary bonus, in the first year the bonus will be calculated on the sum of Rs. 5,00,000 and this will be added to the Rs. 5,00,000. In subsequent years the bonus will be calculated on the increased sum and added to the amount it was calculated on.

H3 Terminal bonus

This bonus is given by the insurance company as an incentive to the insured to continue with the company long-term until the end of the policy. For long-term policies, of say 20, 25 or 30 years, the insurance company may give a terminal bonus on maturity along with the sum insured and the regular bonuses that are declared by the company every year. Some companies may declare the terminal bonus every year, but it accrues and is payable only on the maturity of the policy. This bonus is also known as a 'persistency bonus'.

H4 Interim bonus

A valuation has to be made every year by insurance companies, by law. Policies on which death claims are made or which mature between the two valuation dates also contribute to the surpluses, although this is disclosed only in the valuation made after their closure. As these policies have left the insurance company's books before the valuation date, they will not participate in the process of valuation. However, insurance companies pay an 'interim bonus' to such policies at the rates as at the last valuation. In India the payment of interim bonus is made mandatory under section 112 of the **Insurance Act 1938**.

Suggested activity

Visit the website of any life insurance company. Study the bonuses declared by the company for the past five years. How is the bonus distributed to the participating policyholders by the company?

I The agent's role in underwriting

Agents are in direct contact with the proposer and so have an important part to play in the underwriting process and are considered as 'primary underwriters'.

- The agent has to ensure that the proposal form submitted is completely filled out by the proposer. They also have to make sure that the questions have been answered honestly by the proposer as the proposal form is the basis on which the proposal will be accepted or rejected.
- If the agent is helping to complete the form, they should fill it out honestly and accurately. The answers provided should not be prejudiced in any case. The answers of the respondents should be recorded as objectively as possible and any elements of misinformation or incomplete information need to be avoided.
- Being in direct contact with the proposer, the agent is in a good position to assess why the proposer wants to take out insurance. If they feel that the proposer's intentions are not genuine, they should mention that in their report. As the agent conducts a personal discussion with the proposer and their family, the agent needs to assess the responses they give. If the proposer supplies information that seems to be contradictory, they need to question them further about it.
- The agent can help the proposer to calculate their human life value (HLV), to determine the amount of life insurance they should take. Taking life insurance as per the HLV calculation amount provides income protection to the family and helps it meet its financial liabilities, even after the income provider's premature death.
- The agent can speed up the underwriting process by submitting the required documents and the proposal form in a timely manner. Should an additional medical check-up be required, the agent should help the proposer make the necessary appointment with the doctor and ensure the doctor's report is submitted as quickly as possible.
- If the insurance proposal is accepted, the policy may be sent directly to the insured or given to the agent for delivery. The agent may still have a role to play even if the proposal is rejected. Although the insurance company will send a letter to the proposer explaining why their proposal has been rejected, the agent can get in touch with the proposer personally and explain the reason(s) for the rejection.

Question 4.5

What is the role of the agent when the underwriter rejects the proposal?

Key points

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

The process of insurance underwriting

- Underwriting is the name given to the procedure of assessing proposals and deciding whether to accept the risk and, if so, on what terms.
- Each company develops its own criteria and guidelines for the selection of risk.
- The insurance underwriting process includes the following steps: collection of information; analysis of the risk; estimating potential exposure; determining the probability of occurrence of loss; accepting or rejecting the proposal; classifying and rating the accepted policy in a risk group; and issuing the policy.

Obtaining the required information

- The underwriter can collect the information about the proposer from several sources such as the proposal form, medical examination report, agent's confidential report, additional information and a report from the tax authorities.

Moral and physical hazards

- Physical hazards refer to the physical characteristics of the risk associated with the life insured, e.g. age, occupation, gender, residence, habits, hobbies, physical characteristics, medical condition, physical handicap, medical history of family, personal history etc.
- Moral hazards refer to the attitude, state of mind or intentions of the proposer.

Financial, medical and non-medical underwriting

- Financial underwriting usually caps the amount of life insurance an individual can get. Financial underwriting is used to make sure that the person insured qualifies for an amount of insurance that does not exceed their insurable interest.
- For medical underwriting the underwriter needs to check the medical records of the proposer for the past few years and requires a medical check-up.
- For non-medical insurance, the proposal form is more detailed. In non-medical insurance underwriting, the insurance agent or a high ranking official may be called upon to submit special reports.

Human life value (HLV)

- In life insurance HLV is used as a yardstick to determine how much life insurance cover a person should have.
- The income replacement method of calculating HLV equates human life value to the present value of future earnings.

Liens

- Where the underwriter feels that the risk associated with a person might decrease over time they may accept such proposals with a lien.
- If the insured dies within the lien period, then the insurance company will not have to pay the full sum insured.

Pricing and calculating the premiums

- Pricing refers to the process of calculating the rate of the premium that will be charged on insurance policy.
- The process of calculating the premium is as follows:
  - calculate risk premium;
  - based on risk premium calculate the level premium;
  - deduct the expected interest on investments;
  - add loading; and
  - arrive at the gross premium to be charged.

Calculating bonuses

- Policyholders who purchase participating insurance policies (with-profit policies) are entitled to participate in the profits of the insurance company. These profits are distributed to the policyholders in the form of bonuses.
- There are four types of bonus given by insurance companies: simple revisionary bonus; compound revisionary bonus; terminal bonus; and interim bonus.

The agent's role in underwriting

- Agents play an important role in the underwriting process as they are in direct contact with the proposer. The agent's role in the risk selection process is particularly important.

Question answers

4.1 The underwriter can take any of the following decisions regarding the proposal:

- accept the proposal at ordinary rates;
- accept the proposal with extra premium;
- accept the proposal with a lien;
- accept the proposal with modified terms;
- accept the proposal with a specific/modified clause;
- postpone the decision for a certain period; or
- reject the proposal.

4.2 Place of residence of a proposer is an important physical hazard.

If the neighbourhood where the individual lives is categorised as unsafe, violent and dangerous, then the risk to individual life increases.

4.3 Where an underwriter feels that the risk associated with a person might decrease over time, they may accept the proposal with lien. As the risk is assumed to diminish over a period of time, the lien is operable for that period on a diminishing basis. If the insured life dies during the period of the lien, the insurance company will only pay a proportion of the sum insured as described in the lien.

4.4 Loading is where the net premium is adjusted to take account of the expenses and profit of the insurance company when calculating the gross premium to be paid by the insured.

Frequency loading is an adjustment to the premium to take account of the increased administration costs associated with paying the premium more frequently than annually.

4.5 If the proposal is rejected the company sends a letter to the proposer giving the reason. The agent can get in touch with the proposer personally and explain the reason(s) for the rejection.

Self-test questions

1.	What is an 'interim bonus'?
2.	How does an insurance company take account of the effects of inflation when calculating a 'level premium'?

You will find the answers on the next page

Answers to self-test questions

1.	If a policy pays out a death claim or matures between two valuation dates then, although it does not participate in the next process of valuation, the insurance company will pay out an 'interim bonus' based on the rates set at the previous valuation. Such interim bonuses were made mandatory under section 112 of the Insurance Act 1938.
2.	An insurance company will take account of the effects of inflation when calculating the level premium. It will then put some of the premium collected in the early years of the plan into a reserve to meet the cost of future claims and expenses. The policyholder pays the **same amount** for the entire duration of a level premium plan.

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.

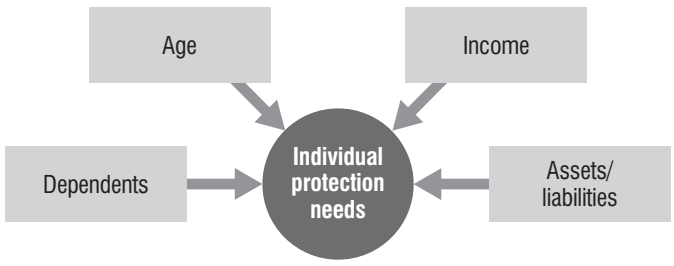
Consider this…

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

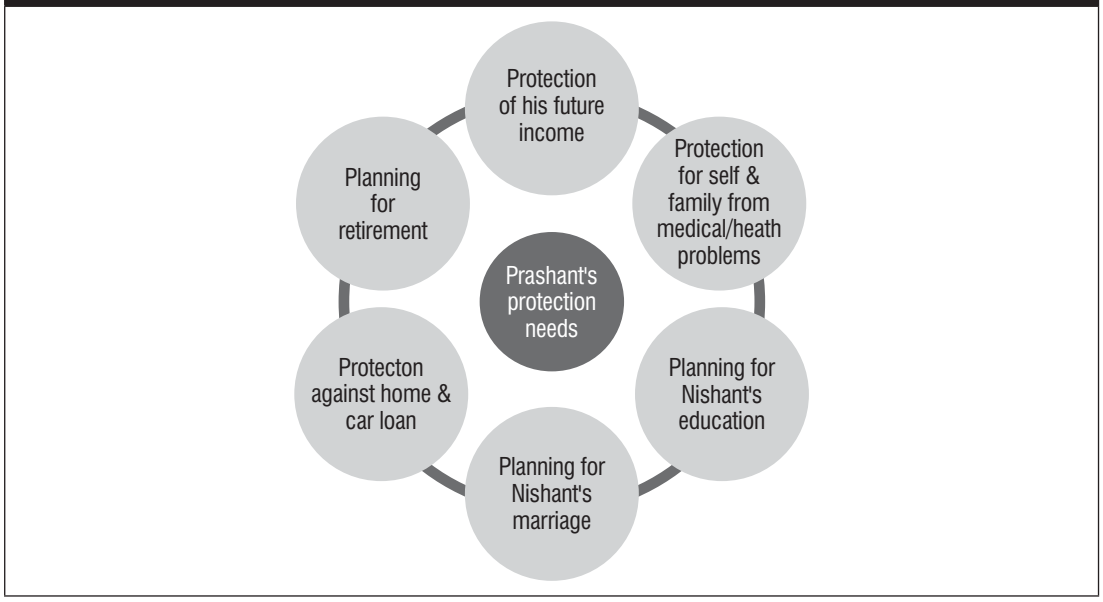
Some companies allow an increase/decrease in the sum insured by 5–10% every year. In this way with a higher insurance cover every year, the life insured can protect themselves from inflation.

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.

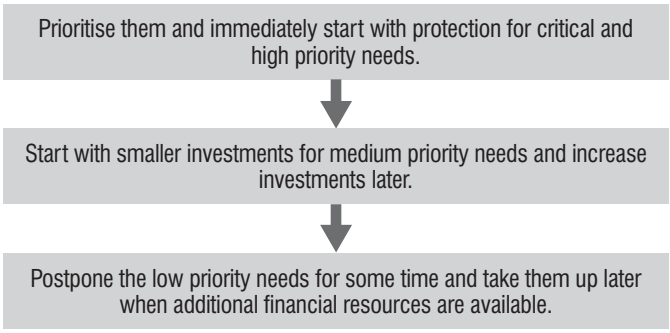
D2 How to prioritise needs

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



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.

Prioritising protection needs

- Prioritising needs is important for a person who has limited financial resources and cannot finance all their protection needs at the same time.
- An individual can prioritise their needs as critical; high priority; medium priority; and low priority, and allocate resources towards them accordingly.

Question answers

5.1 The two basic elements of most life insurance plans are:

- **Death cover** – this amount is paid to the nominee/beneficiary in the event of the 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, such as money-back policies, also make periodic payments to the life insured during the term of the policy before maturity, known as survival benefits.

5.2 The features of a group insurance plan are as follows:

- 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 such as 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.
- With 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 is 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 Regulator (IRDA) issued guidelines on group insurance policies.

Self-test questions

1.	List the various protection needs of an individual.
2.	What are convertible plans? What is their significance?

You will find the answers on the next page

Self-test answers

1.	The various protection needs of an individual include: • income protection; • medical expenses needs; • children's education; • children's marriage; • loans on various assets; and • family's maintenance.
2.	Convertible insurance plans can be converted from one type to another. For example, a term insurance plan can be converted into an endowment plan, a whole life plan or any other plan as allowed by the insurance company. A convertible plan is useful when the life insured cannot afford to pay a higher premium initially. So they can 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.

6
Savings products

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Learning objectives

After studying this chapter, you should be able to:

- identify the need for professional advice on savings products;
- explain the factors that determine the savings needs of individuals;
- describe the main features and benefits of savings products;
- discuss the key savings products available in the market;
- describe the tax and inflation implications on savings products;
- describe the implication of interest rates on savings products;
- prioritise the savings needs of individuals and apply savings and investment products to meet those needs.

Introduction

In the previous chapter we learned about the types of **life insurance** plans that can meet a client's protection needs arising out of death or disability. As we saw in chapter 1, a life insurance agent's role is not restricted to advising on and selling just life insurance – you will also be expected to advise your clients on other financial products, including savings products.

In this chapter we will focus our attention on the range of **savings products** that are available in the market, from which we shall move on to look at some other financial products, such as health insurance and accidental death products in the next chapter.

Historically the word 'savings' was used to describe the process of setting aside small amounts of funds on a regular basis to accumulate capital. The word 'investment' has been used mainly to describe the use of lump sums of capital or surplus income in certain products with an expectation of good returns. These days the words 'savings' and 'investment' are being used almost interchangeably.

Be aware

Most people need the help of a savings/investment plan to achieve their financial objectives in life.

There are various savings/investment products that are available in the market for an individual to choose from: they can choose whether to invest in products by means of a lump sum or by making small periodic payments. We will look at some of these products and also highlight the important role that professional advisers have in selecting suitable savings-related products for their clients.

Key terms

This chapter features explanations of the following terms and concepts:

Asset management company (AMC)	Compounding	Gratuity	Traditional deposits
Bank deposits	Disposable income	Lock-in period	Savings needs
Bonds	Financial planning analysis process	Investor's convenience	Shares
Child plans	Post office savings	Mutual funds	Speed of transactions
Cumulative deposits	Fund managers	Interest rates	Taxation and tax planning

A The need for savings/investment advice

The savings needs of each and every individual are unique. Most individuals do not make wise decisions in terms of investments as they will often invest in certain products without fully evaluating the product features and their own financial needs. These decisions are often taken at random, based on peer influence or even as a last-minute resort to save on taxes.

In this section we will discuss the two major reasons for which professional advice should be taken by individuals with regards to their savings and investment needs.

A1 Ignorance about the financial planning process

Individuals are often unable to identify their own savings and investment needs. They concentrate more on meeting their short-term needs rather than on their long-term requirement for funds. Also, the tendency to spend rather than save is greater as the immediate appeal of consumer goods is more apparent and persuasive than the intangible, future benefits of saving.

Professional insurance agents help individuals by taking them through the financial planning process in which they can identify their present and future financial needs. Some of the long-term goals an individual may have include saving money for their children's education and marriage, saving money to purchase a house, or repaying the existing home loan at an earlier date and planning for their retirement.

A2 Ignorance about the full range of financial products available

The majority of people are not aware of the various savings and investment products that are available in the market. As a result they are unable to select suitable products which meet their financial needs.

It is here that the insurance agent can offer assistance by:

- having a good knowledge of the various products that are available;
- matching the products with the individual's financial needs; and
- evaluating the tax efficient returns of the products, taking into account the tax treatment of the products and the tax eligibility criteria of the individuals.

In summary, agents should guide the prospective investor using their financial planning skills to offer quality advice thereby encouraging saving in a purposeful and needs-based manner, and not necessarily just for maximising returns.

Suggested activity

Visit an IRDA certified life insurance agent of any company of your choice. Conduct a personal interview with them to understand how they identify the financial needs of their clients, and discuss how the financial planning process works.

B Factors that determine the savings needs of an individual

In this section we will look at the various general saving needs an individual might have, and some of the factors that determine their specific savings needs.

B1 General savings needs

Individuals can save for their future by investing in various savings products. Individuals with no existing capital need to accumulate it by saving from income, and individuals with sufficient capital need to invest it wisely to preserve its value.

B1A Individuals without capital

The precise savings needs of an individual are unique to them. Many people undertake financial planning in a rather disorganised way by saving for a particular need or goal and not going through a comprehensive financial planning process where they identify **all** their financial needs. As part of the comprehensive financial planning process some of the **common** savings needs/financial goals of an individual may include the following:

- Building a contingency/emergency fund to meet unexpected financial difficulties owing to a medical contingency, temporary job loss etc.
- Planning and investing for children's higher education.
- Planning and investing for children's marriages.
- Buying a home or a second home (depending on whether the individual already owns one). And repaying the home loan as early as possible.
- Planning and investing for other goals like buying a car, annual vacations with the family, planning and investing for children's primary education, accumulating initial capital for their own business and donating money to charity etc.
- Planning and setting up a retirement fund to maintain the same standard of living when regular monthly income stops, without compromising on anything.

Be aware

It is important to remember that financial planning is not a one-off activity. The investments needed to achieve these goals need to be reviewed regularly until the goals are achieved.

B1B Individuals with capital

Individuals who have capital will generally have the following savings needs:

- The need to increase their existing wealth as much as possible for future needs. These may include initial capital for starting a new business, taking a world tour, making donations to charitable causes and so on.
- The need to ensure that a sufficient amount of capital is left behind as an inheritance for their children.
- The need to ensure that there is sufficient income for maintaining a certain lifestyle once they retire.

B2 Factors that determine the savings needs of a particular individual

The main factors that determine the precise savings needs of an individual are as follows:

B2A Duration of investment

The duration for which an individual needs to keep the money invested is an important factor that determines savings needs. The life insurance agent should help individuals to determine the amount they need to save for their future. Where individuals need to achieve a **savings target** at the end of specific number of years, the length of the savings period determines how much must be invested as a lump sum or as a series of regular contributions.

Be aware

The savings target depends upon the individual's income, number of dependants, their assets and liabilities, disposable income, the expected return on investment and the length of time they wish to keep the money invested.

Case study

Gopal, Deepak and Pavandeep are salaried individuals working for a reputable Multinational Company (MNC) and they all plan to retire at the age of 60.

Gopal is 30 years old and is married with one child. He has set himself a retirement fund target of Rs. 1 crore.

Deepak is 40 years old and is married with two children. He has also set himself a retirement fund target of Rs. 1 crore.

Pavandeep is 50 years old and has also set himself a retirement target of Rs. 1 crore.

Gopal has 30 years to achieve his target, Deepak has 20 years and Pavandeep 10. Assuming the return given by their investments is 12%, the following table shows the monthly investments that all three men will have to make if they are to achieve their retirement targets.

Individual name	Current age	Years left to retire	Retirement fund target	Annual return expected	Monthly investment required
Gopal	30	30	Rs. 1,00,00,000	12%	Rs. 3,277
Deepak	40	20	Rs. 1,00,00,000	12%	Rs. 10,975
Pavandeep	50	10	Rs. 1,00,00,000	12%	Rs. 45,060

As we can see from the above table the more time the individual has to invest, the lower the monthly investment amount required to reach the target will be. So it is always a good idea to start saving for retirement as early as possible.

Be aware

In the long run the practice of compounding works wonders. In compounding, the returns earned (quarterly, semi-annually, annually etc.) are reinvested along with the existing investments to earn higher returns.

B2B Amount of disposable income

The amount of the regular investment also depends upon the surplus amount or the disposable income that the individual has. This in turn will depend on the individual's income, the number of dependants they have and their current liabilities. The surplus amount is the spare amount of money left over after an individual has paid all their monthly liabilities.

Generally, there will be different times in an individual's life when the amount of disposable income they have will vary. For example, an individual who is married with young children would have higher liabilities and their income would be low compared to an individual who is married with older children. As a result of this the surplus amount available for investment will be low. As the individual moves into the next life cycle stage, their income will increase which will result in higher savings and also higher investments.

Therefore you can see that a suitable product which provides considerable flexibility to the individual with respect to their savings needs should be chosen.

Be aware

Remember that nobody should be encouraged to commit more to savings and investment than they can genuinely afford.

B2C Existing assets and liabilities

Professional advisers must also consider the individual's current assets and liabilities as these affect both the client's needs and their ability to finance them. Individuals can use their assets as security for borrowing to meet their financial needs.

Example

A person can use their assets, like property or gold, as security and take a loan against them in order to finance paying off the outstanding balance on a credit card, paying off personal loans or borrowing money to pay for children's higher education.

An individual may accumulate liabilities at various life stages, such as taking out a home loan, car loan, education loan for children, personal loans and credit card debts, and the professional adviser must take account of a client's liabilities as part of their savings and investment advice.

Consider this…

What are the savings needs of your family? Prepare a list of the various needs.

C Features and benefits of savings products

We will now look at the main features and benefits offered by the various savings products and how these features influence their suitability to meet a particular individual's needs.

C1 Capital or income growth

Some savings products provide regular **income** (interest paid by a bank fixed deposit), some provide **capital growth** (gold) and others provide a mixture of the two (equity shares). All of these products will be discussed later in the chapter. Remember that the objective of the individual investor should be matched with the investment profile of the product.

C2 Guarantees

Some products are available with guaranteed returns, some provide variable returns and others provide a mixture of guaranteed and variable returns. So products should be chosen based on the risk profile of the individual client.

Example

Insurance Company ABC has launched a guaranteed return insurance product. For this product the company is **guaranteeing** the following additions:

- Rs. 60 per thousand maturity sum insured, per year, for a five year policy term.
- Rs. 65 per thousand maturity sum insured, per year, for a ten year policy term.

This effectively means that Insurance Company ABC is guaranteeing returns of 6% and 6.5% for a policy of five and ten years respectively.

C3 'Lock-in' period

Most savings products have a stipulated 'lock-in' period during which the funds cannot be withdrawn by the individual. Therefore the client should carefully determine their needs and the length of time for which their money will be inaccessible before deciding which product to invest in.

Example

Investments made in a tax savings bank fixed deposit have a lock-in period of five years. So during this period the investor cannot withdraw their funds from the fixed deposit. Also they cannot take out a loan against this fixed deposit, which they can normally do in case of other bank deposits.

Investments made in equity-linked savings schemes (tax saving mutual funds) have a lock-in period of three years. During this period the individual cannot withdraw money from these mutual funds (but they can do in the case of other mutual funds that do not have a lock-in period).

C4 Penalties

Penalties are associated with the premature withdrawal of funds from fixed term contracts. This is an important consideration which needs to be evaluated before investing in such products.

Example

Ajay has opened a two-year recurring deposit account in a bank in which he makes a monthly deposit of Rs. 1,000. After seven months Ajay is unable to make any further monthly deposits. In fact he also wants to withdraw the deposits that he made in the previous seven months and close the account. So in this case the bank will charge a penalty to Ajay for premature withdrawal of his money and closing the account before the scheduled tenure of two years.

Some mutual funds have a lock-in period of, say, six months or one year. If the customer withdraws their money before the expiry of the lock-in period, the mutual fund deducts an **exit load** (a charge for early withdrawal within the lock-in period) and pays the balance amount.

C5 Risk

All savings products carry a level of risk and these can be rated as low risk, medium risk and high risk. Low risk products offer lower returns compared to high risk products. Hence the products should be carefully chosen based on the individual's circumstances and their **risk appetite**.

Example

The risk appetite of individuals will vary depending on their circumstances:

- A young individual in their early twenties who is just out of college and has started earning may have a high risk appetite, as their responsibilities would be low.
- For an individual in their mid-thirties who is married with children it is not advisable to invest in high risk investments as they have more responsibilities to take care of. Hence the level of risk appetite can be moderate for them.
- For an individual in their mid-fifties who is nearing the end of their working life, the appetite for risk is very low.

C6 Buying and selling mechanisms

Buying and selling mechanisms are important in two ways: convenience to the individual investor and the speed of the transaction.

Example

Savings products can be purchased through various channels such as individual agents, the internet, call centres, ATMs, and corporate agents like banks and brokers etc. Procedures for purchasing savings products are normally straightforward provided the individual submits all the documents promptly. The purchase of savings products via the internet not only provides convenience to the individual investor but also speeds up the transaction.

An individual can buy and sell shares online through a broker's website. This is convenient for them and also ensures immediate execution of the transaction. They do not need to visit the broker's office and they are not required to call up the broker's office or the call centre.

Similarly, an individual can take out a bank fixed deposit via the bank's website or through the bank's call centre even while they are on holiday as they will not be required to visit the bank branch. This again ensures convenience to the customer.

C7 Flexibility

Flexibility refers to the ability to switch between different forms of investment, the payment of variable contributions, and even to temporarily stop making contributions altogether. These features can easily increase the attractiveness of the product. Flexible products also allow for the partial withdrawal of funds without affecting the product in force. Generally, the greater the product flexibility, the more suitable it is. However, features like allowing a temporary break in contributions and partial withdrawals can result in lower long-term investment returns.

Example

Unit-linked insurance plans (ULIPs) allow policyholders to switch their investments from one fund (equity) to another fund (debt). They also allow policyholders to take premium holidays (temporarily stop making contributions) and to make partial withdrawals.

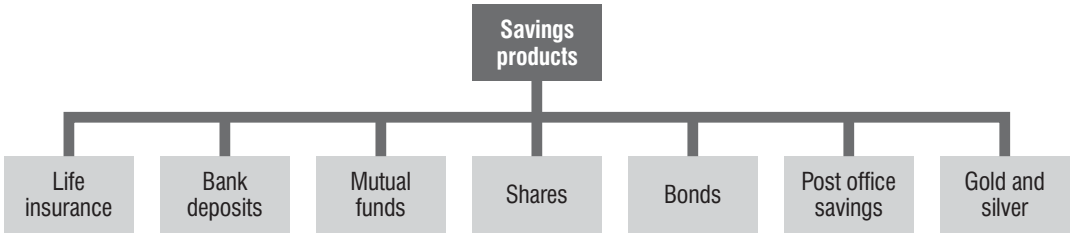
Consider this…

Companies rate their investment products according to the risk associated with them. These products are rated as high risk, medium risk and low risk. Which types of clients should invest in each of the investment product categories as described above?

D Types of savings products

In this section we will outline the following types of savings products:

Figure 6.1



D1 Life insurance

Many life insurance products, along with the primary life cover, come with a savings element. The savings component of the premium is invested by the insurance company on behalf of the policyholders and the returns earned are shared among policyholders in the form of bonuses.

In participating plans like endowment plans and whole life plans the insurance company takes the investment risk. In ULIPs the investment risk is borne by the policyholder.

Besides meeting protection needs, life insurance products are an excellent choice for investors to invest funds for long-term goals like children's education and marriage, retirement and others.

D2 Bank deposits

Bank deposits are one of the oldest and most preferred savings products. They are an instrument where an individual has to invest a lump sum amount with a bank for a fixed tenure at a fixed interest rate. Bank deposits are commonly known as fixed deposits or term deposits. Bank deposits are considered safer than many other investment products and they offer decent returns. In a bank deposit the amount, tenure, interest rate and method of payment of interest are decided at the inception of the deposit.

The investor can choose from three types of deposits:

Traditional deposits	With this type of deposit the bank pays the interest on the depositor's fund on a monthly/ quarterly/half yearly/yearly basis as chosen by the depositor at the time of making the deposit.
Cumulative deposits	With this type of deposit the bank pays the principal and the total interest at the end of the term. In a cumulative deposit the interest is normally compounded on a quarterly basis.
Recurring deposits	With this type of deposit the investor deposits a specified amount every month over a chosen time horizon. These deposits are ideal for people looking to accumulate money for financial goals like children's education, marriage, buying a vehicle etc.

The interest rate on these deposits varies with the maturity period. Bank deposits provide returns in the form of an interest payment. The principal amount deposited with the bank at the time of opening the deposit is returned back to the depositor on the maturity of the deposit.

D3 Mutual funds

A mutual fund is a fund that brings people with a common objective together. Money collected from these people is invested on their behalf and the returns are shared back amongst them. Mutual funds are managed by Asset Management Companies (AMCs). The AMCs invest the money according to the objective of the scheme in equities, debt instruments, money market etc. The AMCs employ qualified and experienced fund managers (also referred to as portfolio managers) who are responsible for investing the funds based on the type of fund (or scheme) that is chosen by the investor.

The main advantage of investing in mutual funds is risk diversification. The individual's funds are spread over different securities to get optimum returns with minimal risk.

Mutual funds provide two types of income:

- **regular income** in the form of dividends declared by the mutual fund scheme from time to time; and
- **capital appreciation** where the mutual fund units are sold at a price higher than the price at which they were bought.

However, there can also be capital loss in mutual fund investments. If the financial performance of the companies in which the mutual fund scheme has invested is poor, it will lead to a fall in the share prices of those companies. This in turn will reduce the value of the investments of the mutual fund investors who have invested in the units of that scheme. You can see therefore that the performance of a mutual fund scheme is based on the performance of the securities in which the scheme has invested.

D4 Shares

Equity shares represent ownership of a company. Whenever a company wants to raise money for its growth, set up a new production unit, acquire another company, acquire technology, working capital etc. the company may offer shares (ownership in the company) to the public.

Example

Let's assume a company's total capital of Rs. 10,00,000 consists of 1,00,000 equity shares of Rs. 10. If the owners (promoters) of the company want to raise money for the company's expansion by offering 10,000 shares to the public; then it is said that the owners are diluting 10% of their ownership in favour of the public. If an individual acquires 100 shares from the total 10,000 shares on offer, they are said to have acquired 0.1% (100 shares out of a total 1,00,000 shares) shareholding (ownership) in the company.

Once the shares are offered to the public, the buying and selling of shares takes places through stock exchanges. Stock exchanges act as intermediaries and offer a trading platform for the buying and selling of shares between individuals. However, individuals cannot directly buy or sell shares through the stock exchanges, they have to place their buy and sell orders through stock brokers (members) of the stock exchanges. The two main stock exchanges in India are the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE).

Individuals who purchase shares have the right to receive a share in the company's profits in the form of dividends. The profits are distributed in proportion to the number of shares held by the shareholders.

Equity shares provide three types of income to the investor:

Dividend income	The company may share a portion of the profits that have been earned with the shareholders in the form of a dividend declared from time to time.
Bonus shares	When a company accumulates large cash reserves, it capitalises them by issuing bonus shares (free shares) instead of distributing them as dividends. Bonus shares are issued in proportion to the existing equity share capital of the company. The issue of bonus shares is a vote of confidence from the management to its shareholders about the good financial performance and future prospects of the company.
Capital appreciation	When shares are bought at a lower price and sold at a higher price, the difference between the two prices is known as the profit or capital appreciation.

Be aware

An investor can also incur a capital loss on equity investments. The returns on equity investments depend on the financial performance of the company. If shares are bought at a higher price and later sold at a lower price due to the deteriorating financial performance of the company, it will result in a capital loss.

D5 Bonds

Bonds are similar to bank fixed deposits in that they provide regular income to the investor in the form of interest payments. However, bonds can also be traded between buyers and sellers. Apart from banks, bonds are also issued by the Government, companies and other institutions to raise money from the public. In simple terms, a bond is a loan provided to the issuer by the investors. Hence in the case of bonds, the investors are the lenders who receive interest on their loan. At the end of the tenure the original amount (principal) is returned back to the lender.

There are different kinds of bonds in which the investor can invest, these include:

- corporate bonds;
- Government securities (G-secs);
- commercial paper; and
- treasury bills.

D6 Post office savings

Post offices in India offer several savings products such as:

- National savings certificate (NSC).
- Kisan vikas patra (KVP).
- Public provident fund (PPF).
- Post office savings account.
- Recurring deposit account.
- Time deposit account.
- Post office monthly income scheme (POMIS).
- Senior citizens saving scheme (SCSS).

These are all products in which an individual has to invest a lump sum amount for a fixed period of time (except for recurring deposits where regular investments are made and savings accounts). The investor earns a fixed interest rate which is specified at the time of investment.

D7 Investment in gold and silver

India is one of the world's largest importers of gold, and gold and silver are one of the most popular and oldest savings instruments in India. There are various ways of investing in gold and silver, the most popular in India being jewellery. Other ways of investing in gold and silver include bars and coins sold by banks and jewellers. Apart from physical gold, investing in gold in electronic format is also increasing. Gold ETFs (exchange traded funds) are like mutual funds in which gold units can be traded in electronic format on a stock exchange, just like shares. In gold ETFs one unit represents one gram or half a gram of gold.

Reasons for investing in gold and silver include:

- good returns;
- portfolio diversification;
- hedge (protection) against inflation; and
- insurance against uncertainties.

Question 6.1

What is a mutual fund?

?

E Tax and inflation implications for savings products

An individual's personal tax position will have considerable influence on the choice of suitable savings products.

E1 Tax implications

The last quarter of the financial year is the busiest time for insurance agents and other financial advisers. It is during this time of the year that salaried individuals and others are busy tax planning and making investments in tax saving products to minimise tax deductions from their salaries. In fact it could be said that many people make investments purely to minimise their tax liabilities.

This is the wrong approach towards savings and investment, as there needs to be a proper financial plan in place before a particular investment product is chosen. In this section we will look at the tax implications for savings products.

E2 Income Tax Act 1961

This Act came into effect on 1 April 1962 and has undergone several amendments since then. Every major amendment is effected through a Finance Act (at the time of the union budget presentation) and other amending acts. Additionally, the Central Board of Direct Taxes (CBDT) issues circulars clarifying the various provisions related to income tax.

When working on effective tax planning, it is important to understand the exemptions and deductions provided by the Government. The investor can take advantage of the following tax deductions under various sections of the Income Tax Act as per prevailing income tax rules.

E2A Section 80C

Under section 80C a deduction from taxable income is allowed for investments made in the following products:

- Life insurance premium paid for traditional products.
- Unit-linked insurance plans (ULIPs).
- Pension plans.
- Repayment of the principal component of home loan.
- Employee provident funds (EPFs).
- Equity linked saving schemes (ELSs).
- Tuition fees paid for children.
- Five-year tax saving bank deposits.
- Public provident funds (PPFs).
- National savings certificates (NSCs).
- Senior citizen savings schemes (SCSs).
- Stamp duty and registration charges.
- Infrastructure bonds.
- Pension funds.
- Post office time deposit – five years.

Be aware

The above list of the financial products is for the Financial Year 2010/11. The list is revised from time to time. The amount allowed as deduction from taxable income is also subject to review each year.

In the 2010 union budget, section 80CCF has been introduced which allows deductions from taxable income for investments up to a specified limit in infrastructure bonds. This deduction is over and above the deduction allowed under section 80C.

E2B Section 80D

Section 80D allows deductions from taxable income for the premium paid towards health insurance for the individual, their spouse and children. For premiums paid for health insurance for parents, an additional deduction is allowed. For premiums paid for senior citizens, a higher deduction from taxable income is allowed compared to the deduction made for other individuals.

The amount allowed as deduction from taxable income is subject to review from time to time.

E2C Section 80DD

Under this section a deduction from taxable income is allowed for expenditure (up to specified limits) incurred on medical treatment/training/rehabilitation for a disabled/handicapped dependant. The expenses can be for the treatment for disability, disease/ailment (as specified under this section) of the individual or a dependent relative. To take advantage of this deduction a certificate in the prescribed format needs to be produced by a medical practitioner.

E2D Section 80E

Under section 80E a deduction from taxable income is allowed for the interest paid on an education loan.

E2E Section 24(b)

Under section 24(b) a deduction from taxable income is allowed on the interest paid (subject to specified provisions) on a home loan.

Question 6.2

List five financial products for which an individual can claim a tax deduction under section 80C of the Income Tax Act 1961.

E3 Inflation implications

We looked at the impact of inflation on insurance cover in chapter 5. When considering financial planning the investor must make sure that the amount required for meeting future expenses is calculated taking into consideration the impact of inflation on the prices of goods. If inflation is running at 5% and you earn 8% on your investments in a bank fixed deposit, you would have earned a return of 3% **net of inflation**.

Of course, in real life the situation is not quite as simple as this. The inflation rate would not be **exactly** as predicted. It could be higher or perhaps even lower. It is always a good practice to assume a higher rate of inflation rather than the actual inflation rate for the past five or ten years when producing future calculations. The returns on investments may also be subject to taxation. Inflation and taxation together suppress the real returns which may turn out to be lower than the anticipated returns.

As a result, an investor has to make sure that the returns on their investments should be sufficient to provide them with enough income after taking into account inflation and tax deductions.

F Implication of interest rates on savings products

Changes in interest rates will affect those offered by savings and investments products and can, therefore, have an adverse effect on the investment decisions of an investor.

In this section we will look at the effects of changes to interest rates.

F1 Increase in interest rates

In the case of an increase in interest rates, the interest rates on deposits and loans go up. The decision to increase interest rates is made by the Central Bank of the country (**Reserve Bank of India**) when it is in the interests of the country's economy to encourage savings and to discourage people from borrowing for unnecessary expenditure, and thereby reducing the demand for credit. The effects of an increase in interest rates are as follows:

- The demand for lending products from banks and financial institutions suffer as borrowing becomes expensive for the individuals and they postpone their purchases.
- On the other hand, bank deposits with higher interest rates become more attractive and people choose them resulting in an increase in savings. There is also an increase in the purchasing of bonds which have higher interest rates.
- However, a high interest rate scenario is not good for the stock markets. Borrowing becomes costly for companies which leads to higher interest payments. This can put pressure on the profitability of companies which can lead to the selling of shares and subsequently lower share prices.

F2 Decrease in interest rates

In the case of a reduction in interest rates, borrowing becomes cheaper and there is an increase in investments made by companies. This is done to stimulate the economy so that there are more investments and an increase in the demand for goods and services in the economy. The effects of a decrease in interest rates are as follows:

- Low interest rates increase the demand for lending products. Investors take out loans for the purchase of financial assets, which results in increased consumption.
- Investment in other financial products (like equities and real estate) is preferred compared to investment in bank deposits due to the low interest rates offered.
- Investors who have already locked-in their investments at a higher interest rate in bonds and bank deposits are at an advantage when interest rates fall.

Question 6.3

Briefly discuss the effects of a reduction to interest rates on savings products.

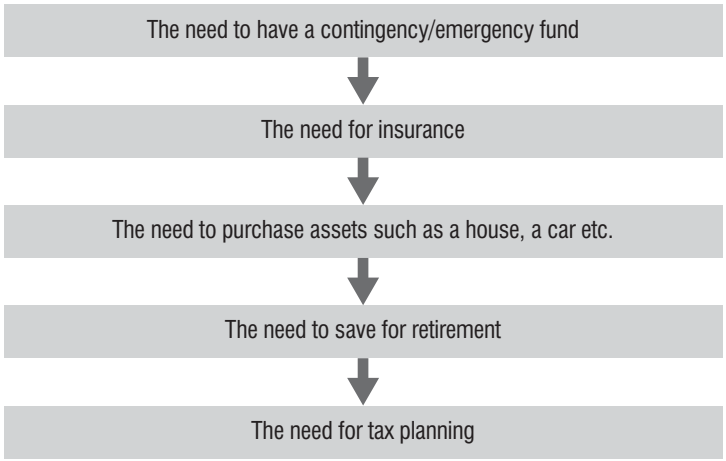
G Prioritising savings needs

The savings needs of each individual are unique, so it is very difficult to standardise the process of prioritising savings needs. The life insurance agent has an important role to play in helping the individual to analyse and prioritise their savings needs.

In this final section of this chapter we will discuss some guidelines that serve as a sound basis for prioritising savings needs.

We start by setting out a list of common savings needs and how, broadly, to prioritise them:

Figure 6.2



G1 Contingency/emergency fund

The foremost need for an individual is the easy availability of emergency funds. These funds can be required for a variety of different purposes, such as meeting unexpected medical expenses due to an illness in the family, temporary job loss, emergency travel, payment of children's tuition fees etc. The amount in this fund should be roughly enough to cover three to six months of expenses.

Individuals should invest the emergency fund money in savings products that offer easy liquidity (investments that can be easily converted into cash without much loss in value). Bank deposits and debt mutual funds are the preferred products in this case.

G2 Insurance

Insurance offers financial security to an individual and their family in case unexpected situations should arise. As insurance needs differ among individuals, there is a variety of insurance products which offer security for these different needs. Some of the needs for which an individual may seek insurance are:

- The need to have sufficient funds to cover the family in case of the unexpected death of the income provider. This need should be the top priority for any individual. Term insurance should be the preferred product to address this need. Once an individual has a suitable term insurance plan they can look at savings products like endowment plans, whole life plans, money-back plans or ULIPs to address their savings needs.
- The need to have adequate health insurance cover for the entire family to meet any medical emergencies. Major hospitalisation and treatment expenses paid from the individual's own pocket can push back the financial planning of an individual by a few years. Hence this need assumes significant priority and a family floater health insurance plan can address this need.
- The need to provide sufficient funds for children's higher education and marriage. A child insurance plan can address this need. An individual can prioritise this need once the income provider has taken out adequate term insurance for themselves and health insurance for the entire family. Child insurance plans come in two varieties. Risk averse investors can choose child endowment plans, whereas investors who are willing to take the risk can choose child ULIPs and allocate their money to an equity fund.

- The need to have a regular income or an annuity after retirement. Insurance companies provide retirement plans to address this need. An individual can invest a lump sum amount, or during their working life they can make regular contributions towards a retirement plan. This amount is invested by the insurance company on behalf of the policyholder. Initially an individual can start providing for their retirement needs with a small amount as they have other high priority needs to take care of. Later, as the individual's income increases they can step up investments for their retirement fund. These accumulated funds (retirement funds) are then used to buy an annuity plan. As we saw in chapter 5, in an annuity plan the insurance company makes regular periodic payments to the annuitant after retirement as per the terms of the plan. We will discuss annuities in more detail in the next chapter.

G3 Assets

During their lifetime, individuals will need to purchase various assets; however, some individuals may not have the funds to make a lump sum down payment. To address this need there are several lending products that are available in the market which can help individuals with the purchasing of these assets. Examples of some of these assets are as follows:

- Purchase of a home or property.
- Purchase of a car or two-wheeler.
- Purchase of consumer goods such as a refrigerator, television, laptop etc.

The need to buy a house is a priority for many individuals, but considering the huge investment involved an individual needs to do lot of planning for this. The individual should first accumulate funds to pay margin money and the remaining amount can be financed through a home loan. An individual should make sure that the money paid for the home loan EMIs does not affect their investments for other needs such as having funds to pay for their children's education, marriage, and also funds for their own retirement. There has to be a balance between the money allocated for EMIs and money allocated for meeting other needs. Care should be taken to ensure that EMIs do not exceed 40% of the monthly take home salary.

Be aware

The bank does not offer the full amount of the property value as a loan. Only a certain percentage, say 75% or 80%, of the total value of the property may be offered as a loan by the bank. The rest of the amount has to be paid by the individual. This money is known as down payment, margin money or home owner's equity.

The need to purchase a car or a two-wheeler can be placed further down the priority list. An individual can consider this need once they have provided the finances for other, higher priority, needs. Consumer goods can then be bought from regular monthly cash flows or can be financed through personal loans or credit cards.

G4 Retirement

The next high priority need is securing funds for the future. Individuals should make sure that they have a sufficient and regular source of income once they retire. This need depends on the lifestyle that an individual needs to maintain along with the cost of living during their retirement. Both of these factors determine the amount that needs to be saved so that they can live comfortably once they have retired. We have already seen in section G2 that this need can be partly addressed by investing in a retirement or pension plan from an insurance company at an early age. For working professionals retirement needs are partly addressed through the retirement benefits that their employer provides on retirement, such as a gratuity, employee provident fund (EPF) and pension, if applicable. Self-employed people don't have the luxury of employee benefits as they are responsible for themselves.

In summary then, an individual can address their retirement needs by investing in mutual funds for the long term along with retirement plans and employee benefits appropriate to their circumstances.

Be aware

A gratuity is an employee benefit that is paid by the employer to the employee in gratitude for the services rendered by the employee to the company.

To be eligible for a gratuity the employee needs to have completed five years of continuous service. The amount of the gratuity is calculated based on the employee's number of years of service. The employer keeps making contributions to the gratuity on behalf of the employee during their employment by the company and it is paid out when they leave the company, retire or die.

Gratuity eligibility, calculation, payment and its tax treatment are defined by the **Payment of Gratuity Act 1972**.

G5 Tax planning

We have seen that the various needs of an individual include the need to make provisions for insurance, and to provide funds for children's education, children's marriage, home and retirement. An individual should make sure that while investing to fulfil these needs they select investment products which make optimum use of income tax deductions allowed under various sections of the Income Tax Act (as discussed in section E2 of this chapter).

Be aware

An individual's investment portfolio should be as tax efficient as possible, but the tax benefits of any savings or investment product should be considered as an **additional** benefit rather than the primary benefit.

Therefore, the buying decision should be based on the **need** and not the tax benefits offered by the product.

Case study

Rakesh Mohan is a software engineer and is married with a two-year-old child. He is the sole income provider in the family and his wife Radha is a housewife. He has invested in an ULIP product which he purchased in January from an insurance agent as he wanted to save income tax by gaining the deduction from his taxable income. He pays Rs. 25,000 annually for the ULIP.

Apart from this he has no other investments. He has earned a good bonus from his company this year and is looking for some savings products to invest in using this money. He meets his life insurance agent for advice on which savings products he should invest in. After discussing Rakesh's income and his current investments, the agent prepares the following list:

- Investment in a ULIP product is a good investment, despite the main reason for choosing this product being the tax benefits. However, the annual amount invested in the ULIP is quite low and this needs to be increased to meet Rakesh's future financial needs. Rakesh can keep investing in this ULIP for his retirement.
- Rakesh needs to create an emergency fund by putting aside some money in a bank deposit or in a debt fund. The agent suggests that Rakesh set aside Rs. 1,00,000 as an emergency fund.
- Rakesh should take out term insurance cover to protect his future income and liabilities. He should also take out a health insurance policy for his family.
- Rakesh should consider investing in a child insurance plan to provide for his child's education or other financial requirements that may arise in the future.
- Rakesh is currently staying in a rented apartment, so the agent suggests that Rakesh should consider purchasing his own house. In order to do this Rakesh should start accumulating money for the margin money payment for a house. The remaining amount can be financed through a home loan. Purchasing a house through a home loan will not just provide him with his own house, but it will also provide him with the tax benefits that are available on the home loan principal payment as well as the interest repayment.

G6 The difference between short, medium and long-term needs

We saw in section G1 that clients should have access to funds in an emergency, and a client's needs can be categorised into long-term, medium-term and short-term, based on the time duration within which funds will be required. Based on these needs, suitable investment products should be selected from the range of products already discussed.

Short-term needs	funds would be required within a period of, say 1-5 years. Short-term needs include saving for emergencies etc.
Medium-term needs	funds would be required within a period of 5-15 years. Medium-term needs include savings for children's education, marriage etc.
Long-term needs	funds would be required after more than 15 years. Long-term needs include retirement planning.

Suggested activity

Prepare a list of short-term, medium-term and long-term needs for your family. Once the list is prepared, prioritise them. The needs that are to be addressed foremost should be placed at the top of the list.

Summary

You will now have an understanding of both life insurance and savings products and how to go about identifying and prioritising the individual needs of your clients in relation to these types of product, and how to apply the right products to meet those needs.

Before we move on to looking at what a professional financial planning process involves in more detail in chapters 8 and 9, we shall discuss the other financial products that you need to understand in the next chapter.

Key points

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

The need for savings/investment advice

- Professional advisers can help individuals go through the financial planning process in which they identify their future financial needs.
- Financial planners can help individuals in constructing an investment portfolio where returns can be maximised with minimum risks. Financial planners can match the products based on the individual's financial needs.

Factors that determine the savings needs of a client

- Individuals with no existing capital need to consider comprehensive financial planning.
- The common savings needs include:
  - building an emergency fund;
  - planning and investing for children's education;
  - planning and investing for children's marriages;
  - buying a house;
  - planning and investing for other goals like buying a car, annual vacations etc.; and
  - planning and investing for retirement.
- Individuals with capital have different needs like increasing their existing capital, leaving behind capital as inheritance for children, being able to live comfortably once they have retired etc.

Features and benefits of savings products

- Some savings products provide income growth (regular income), some provide capital growth and others provide a mixture of the two.
- Some products are available with guaranteed returns, some provide variable returns and others provide a mixture of both.
- Low risk products offer lower returns compared to high risk products. Hence the products should be chosen carefully and based on the risk appetite of the individual.

Different types of saving products

- Many life insurance products come with a savings element. The savings component of the premium is invested by the insurance company on behalf of the policyholders and the returns earned are shared with the policyholders in the form of bonuses.
- Bank deposits are products where an individual has to invest a lump sum amount for a fixed tenure at a fixed rate of interest decided at the time of making the deposit.
- Mutual funds are schemes managed by Asset Management Companies (AMCs).
- A mutual fund is a scheme that brings people with a common objective together. Money collected from these people is invested on their behalf and the returns are shared back amongst them.
- Equity shares represent ownership of a company. Equity shares provide income in the form of dividend income, bonus shares and capital appreciation.
- The buying and selling of shares is done through brokerage houses on the two stock exchanges in India – the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE).
- Bonds are debt instruments that are issued by companies, governments and other institutions to raise money from the public. Bonds pay regular interest to the investor.
- Gold ETFs (exchange traded funds) are like mutual funds in which gold units can be traded in electronic format on the stock exchange, just like shares. In gold ETFs one unit represents one gram or half a gram of gold.

Tax and inflation implications for savings products

- By investing in various savings products the investor can take advantage of the various tax deductions allowed under various sections of the Income Tax Act as per the prevailing Income Tax rules.

Implication of interest rates on savings products

- Interest rates are increased to reduce the demand for credit and increase saving among individuals.
- Interest rates are reduced to increase the credit demand, encourage consumers to spend more and increase demand for goods and services.

Prioritising savings needs

- Savings needs can be broadly prioritised as the need:
  - to have a contingency/emergency fund;
  - for insurance;
  - to purchase assets like a house, car etc.;
  - to save for retirement; and
  - for tax planning.
- Needs can be categorised into short, medium and long-term.

Question answers

6.1 A mutual fund is a fund that brings people with a common objective together. Money collected from these people is invested on their behalf and the returns are shared back amongst them. There are qualified and experienced fund managers (also referred to as portfolio managers) at the AMCs who are responsible for investing the funds based on the type of fund (or scheme) that is chosen by an investor.

The biggest advantage with investment in mutual funds is risk diversification.

Mutual funds provide two types of income:

- regular income in the form of dividends declared by them from time to time; and
- capital appreciation, when the mutual fund units are sold at a price higher than the price at which they were bought.

6.2 Any five from the following:

- Premiums paid for traditional life insurance plans.
- Pension plans.
- Unit-linked insurance plans (ULIPs).
- Repayment of principal component of home loan.
- Employee provident funds (EPFs).
- Public provident funds (PPFs).
- National savings certificates (NSCs).
- Five-year tax saving bank fixed deposit.
- Senior citizen savings schemes (SCSs).
- Equity linked savings schemes (ELSs).

6.3 In the case of a reduction to interest rates, borrowing becomes cheaper and there is an increase in investments made by companies. This is done to stimulate the economy so that there is an increase in investments and an increase in the demand for goods and services in the economy. The following points should be noted with regards to lower interest rates:

- Low interest rates increase the demand for lending products. Investors take out loans for the purchase of financial assets which results in increased consumption.
- Investment in other financial products (such as equities and real estate) is preferred compared to investment in bank deposits, due to the low interest rate offered by deposits and bonds.
- The investors who have already locked-in their investments at a higher interest rate in bonds and bank deposits are at an advantage if interest rates fall.

Self-test questions

1.	What are the main reasons for investing in gold and silver?
2.	Under which section of the Income Tax Act can an individual get a deduction from taxable income for the premium paid towards a health insurance policy? a) Section 80C. b) Section 80D. c) Section 80E. d) Section 80F.
3.	In which of the following bank deposits does the bank pay the principal and interest to the individual at the end of the term? a) Savings deposits. b) Traditional deposits. c) Cumulative deposits. d) None of the above.

You will find the answers on the next page

Self-test answers

1.	The main reasons for investing in gold and silver include: • good returns; • portfolio diversification; • hedge (protection) against inflation; and • insurance against uncertainties.
2.	b) Section 80D. Under this section an individual paying a premium for medical insurance for themself, their spouse and their children is eligible for a deduction from taxable income.
3.	c) Cumulative deposits.

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.

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.

Question 7.1

List some of the features and benefits of health plans.

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:

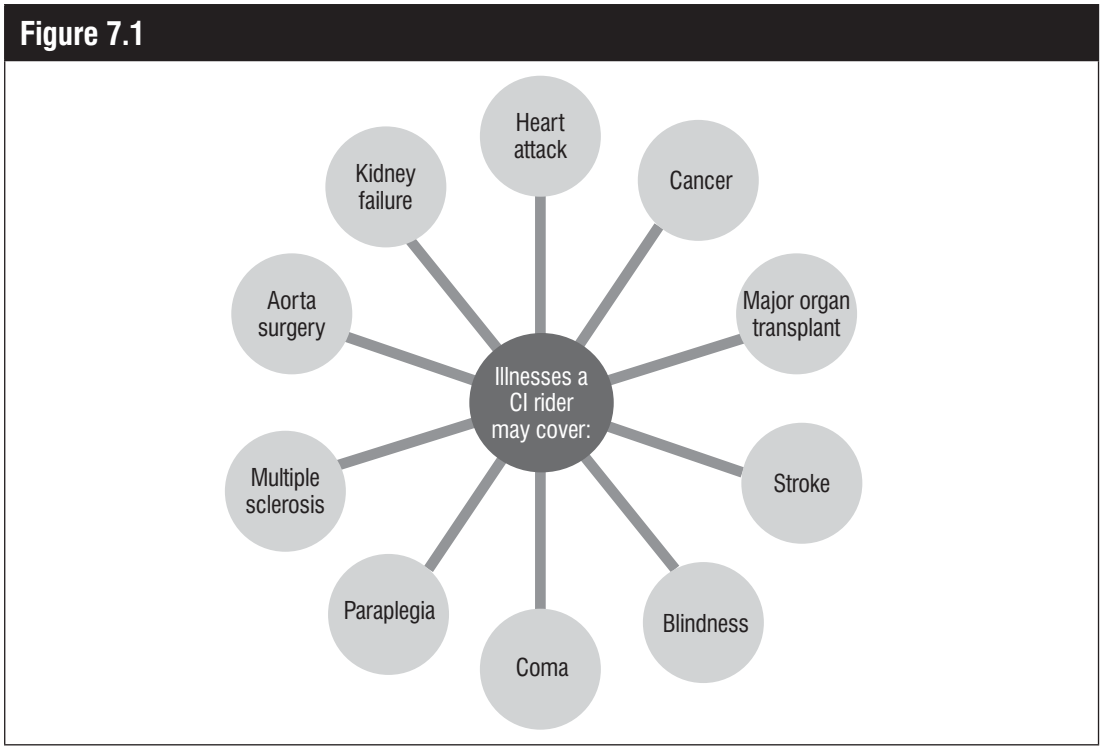
- Mahesh can take out this rider only at the age of 15 years and above, but not after 55 years of age.
- On Mahesh reaching 60 years of age the rider will automatically expire even though the base policy may continue.
- Mahesh cannot opt for this rider for a sum insured of less than Rs. 50,000.
- Mahesh 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.

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.

?

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.

Question answers

7.1 Some of the features and benefits of health plans are:

- pricing;
- cashless facility;
- medical examination;
- pre-existing illnesses cover;
- co-payment;
- no-claim bonus;
- immediate care; and
- no need for lump sums from savings or loans.

7.2 The list of critical illnesses covered may vary among insurers. Some of the critical illnesses covered under critical illness rider include:

- heart attack;
- cancer;
- kidney failure;
- major organ transplant;
- stroke;
- aorta surgery;
- blindness;
- paraplegia;
- coma; and
- multiple sclerosis.

7.3 Commutation: before receiving regular/periodic annuity payments the individual can make a lump sum withdrawal. This is known as commutation. Insurance companies normally allow 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.

Self-test questions

1.	List some of the annuity plans available in the market.
2.	Explain the accidental death benefit rider.
3.	Explain the two phases of an annuity plan.

You will find the answers on the next page

Self-test question answers

1.	Some of the annuity plans available in the market include: • life annuity; • guaranteed period annuity; • joint life, last survivor annuity; • life annuity with return of the balance of the purchase price; and • increasing annuity.
2.	In the event of 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 the terms and conditions specified in the policy. The ADB rider is important in India considering the increasing number of deaths due to accidents. The insurance company specifies the products with which this rider can be taken. The insurance company also specifies the list of exclusions under which the benefit of the rider will not be payable.
3.	The two phases of an annuity plan include the accumulation phase and the regular annuity phase. **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 their 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).

8
Identifying client needs

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Learning objectives

After studying this chapter, you should be able to:

- identify who your prospective clients are;
- describe the typical life stages of a client;
- describe the factors that affect the life stages of a client and the different client needs by life stages;
- explain the differences between real and perceived needs of a client;
- describe the communication, questioning and listening skills essential for an insurance agent;
- explain the process of prioritising needs;
- discuss the difference between short, medium and long-term needs;
- explain how to confirm assumptions and agree objectives.

Introduction

An individual changes roles several times throughout their lifetime and a man can be a responsible son, a loving husband and a caring father. The series of roles that an individual plays in their lifetime can be seen through a **lifecycle**.

Though each client will have their own unique set of needs, life insurance companies and industry analysts have identified some standard needs based on the different life stages, and in this chapter we will study how an insurance agent can help in fulfilling these needs.

Key terms

This chapter features explanations of the following ideas:

Assets	Lifecycle	Prioritisation of needs	Communication skills
Listening skills	Questioning skills	Quantifying needs	Long-term needs
Real needs	Income	Medium-term needs	Short-term needs
Liabilities	Perceived needs	Surplus funds	

A Who is your client?

A1 Prospective clients

As we have seen, an insurance agent's main task is to understand their client's needs and then recommend suitable products. Any individual that an insurance agent comes across and who has any financial need is a prospective client. Prospective clients may have various needs which they themselves may not be aware of. In such a case it is the duty of the insurance agent to make the prospective client realise their needs and recommend suitable insurance protection and/or investment products to meet them. As we have established in the previous three chapters, life insurance companies and other financial institutions offer a range of products which cater for the different needs of an individual. To remind you, some of the most important of those needs are as follows:

The need to:

- provide sufficient funds for dependants in case of the premature death of the family income provider;
- build a contingency fund to take care of any emergencies that may arise;
- save funds for the children's education, marriage etc;
- provide protection for family members against home loan and other debts in the absence of the family income provider;
- save funds for retirement; and
- address any other requirements that may arise from time to time.

Any individual who has at least one of the above needs is **a prospective client** for the insurance agent.

A2 Client needs

In this section we will draw together all that has already been said in previous chapters about identifying and satisfying client needs. We will discuss the overall process and so consolidate your understanding of how you should go about the process in order to provide a professional service to your clients.

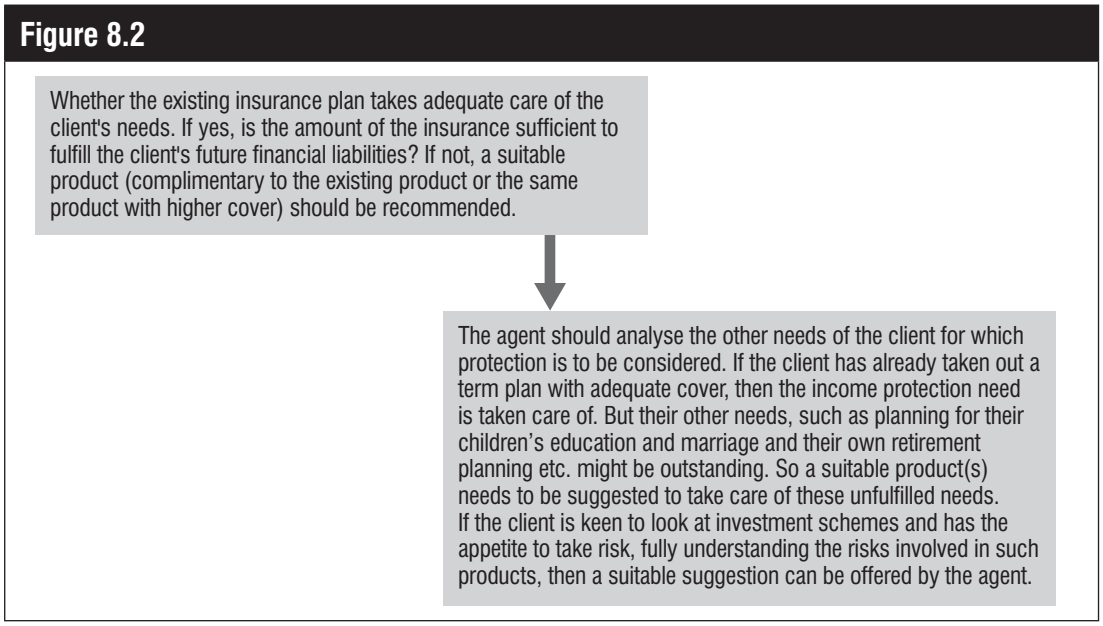
As we have established, it is the responsibility of the insurance agent to determine the legitimate needs of their clients, prioritise them and then to recommend suitable insurance or savings products. The process involves the following steps:

Figure 8.1

1. **Identifying needs**: an insurance agent needs to collect and analyse the following information:
   - details of the client in terms of their financial assets and liabilities;
   - marital status;
   - future financial goals of the client for themselves and their children;
   - number and age of dependants;
   - employment status, i.e. their existing grade and scope of promotion within their company;
   - income – which includes salary, business income and income from other sources and investments (if any);
   - details of health status and heredity medical conditions; and
   - existing protection, savings and retirement provision (if any).
2. **Quantifying needs**: in the financial planning process an insurance agent needs to quantify each of the needs in monetary-terms and then calculate suitable amounts that an individual needs to save and invest for the future.
3. **Prioritising needs**: the amount available for investment is the client's income less their living and other expenses, i.e. the monthly surplus available. The client's needs must be prioritised, as their investment capacity may be limited and the total amount to be spent may be more than the surplus funds available. The insurance agent should suggest the best product mix, where limited funds can be allocated to fulfill the maximum needs of the client. Prioritising these needs helps the client to determine which investment(s) can be deferred, and so the needs which are given highest priority in the ranking are the ones for which investment should be made first.

What if the client already has some existing insurance plans?
In this case, the insurance agent needs to find out two things:

Figure 8.2



Example

Narendra is a 32-year-old government employee. He is married to Mamta, who is a housewife. The couple have two children – a son and a daughter. What could Narendra's different financial and protection needs be?

1. To provide for his wife and children in case of his premature death.
2. To provide funds to his family to repay the home loan and the car loan taken out by him, in case of his premature death.
3. To provide medical protection for the entire family including himself.
4. To save for the children's education and marriage.
5. To save for his retirement.

Narendra has already taken out a term plan with a cover of Rs. 10,00,000. In this case, the insurance agent needs to analyse and advise on two things:

1. Whether the insurance cover of Rs. 10,00,000 is sufficient to take care of the liabilities and the family's needs in case of Narendra's premature death. If the answer is no, then another term plan to cover the liabilities and family's needs that have not been already provided for, should be recommended.
2. Products for Narendra's other needs such as house purchase, pension plan, child plan etc. But remember the decision has to be based on the priorities and investment capacity of the client.

Narendra wants to send his children abroad for higher studies. For this he is ready to make substantial financial sacrifices in his leisure activities for the future benefit of his children. For Narendra his children's education takes priority over his other needs. In this case the insurance agent should suggest a suitable child plan into which a major share of his investments can be directed with the remaining amount being directed towards other needs. Later, as Narendra's income increases and he has more money at his disposal, he can increase investments to meet his other needs.

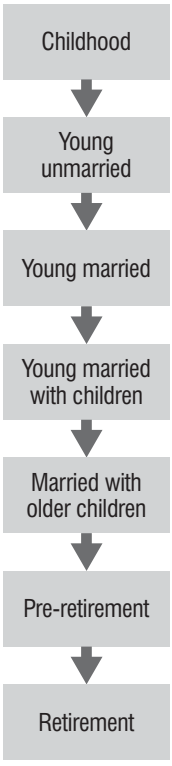
Suggested activity

Prepare a list of your own future financial goals. Estimate the amount that you will need to invest to achieve these goals. What investments will you make in order to achieve them?

B The typical life stages of a client

The life stages of a client can be divided as follows:

Figure 8.3



The life stages listed above are applicable to a person whether they are an employee, self-employed or business person etc.

B1 Childhood

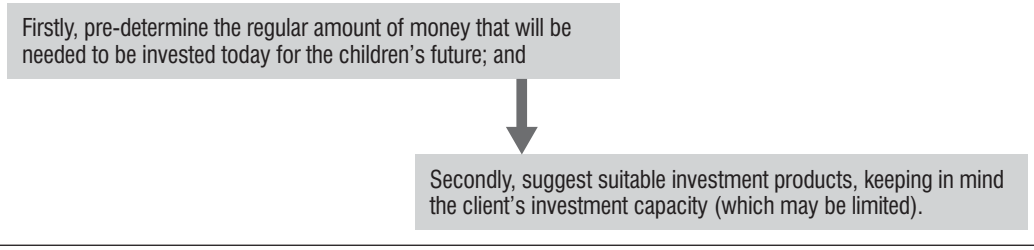
Children are very unlikely to have protection needs. Children normally do not have any income of their own and are almost entirely dependent upon their parents/guardians.

At this stage there are two basic needs for parents/guardians:

- to secure their children's financial position, if they themselves die prematurely; and
- to provide for their children's future expenses, such as primary and higher education, marriage and other living expenses.

Investment towards their children's future is an important need that every parent will want to give top priority to. There are two things that an insurance agent has to do:

Figure 8.4



B2 Young unmarried

This stage of the lifecycle can be divided into two categories:

- **Young unmarried with no dependants** – in this case, the individual's protection need is low as there are no dependants. Instead, the need to invest any surplus income and earn high returns gains priority. So suitable investment plans such as ULIPs – which allow participation in the growth of capital markets along with tax benefits – should be recommended. The ability to change these when other priorities arise (for example marriage and dependants) should be considered. The individual may also look forward to saving money for their marriage, payment toward purchasing a house, providing health insurance for parents (if not already taken out or the parents are unable to fund it themselves).

Case study

Young unmarried

Ankur Arora is a 24-year-old civil engineer, who works as an assistant manager with a construction company. He draws Rs. 18,000 as his net monthly salary. Ankur is a 'young unmarried' individual and lives with his parents. His father is an engineer in a thermal power plant. Being unmarried, Ankur does not have any responsibilities or liabilities. Ankur's father advises him to save money for the future and invest in some good investment plans.

Accordingly Ankur meets with an insurance agent who advises him to invest in a unit-linked insurance plan (ULIP) which will give him exposure to the equity market for long-term capital growth of his investments.

- **Young unmarried with dependants** – if an individual is one of the income providers for a family (along with the parents), then the family will be adversely affected if the young person dies prematurely. Hence the individual needs to protect their income. The individual should be recommended to take out a suitable life insurance plan and the sum insured should be sufficient to take care of the family's financial needs after their death. The remaining money can be invested for long-term wealth accumulation.

B3 Young married

At this life stage the individual gets married. Their financial needs change, as they now start thinking about purchasing a house, starting a family etc. These individuals can be further categorised into two types:

- **Double income family** – when both the partners work then financial dependency on one person is reduced. Such couples are also commonly known as **Double Income No Kids (DINK)** couples. In the event of one of the partner's premature death, the effect on the family's finances will be considerably lower than compared to a single income family. An individual **term** life insurance plan for both partners is suitable at this stage so that the loss of income due to the death of one partner can be compensated for to some extent. The couple may also look to invest in products that can offer them high returns and help them with wealth accumulation for the future. Investment in unit-linked insurance plans (ULIPs) is recommended for such couples as ULIPs have the potential to deliver high returns through participation in the capital markets along with insurance protection.

- **Single income family** – if only one partner is earning and the other partner manages the home then savings are likely to be lower than for the double income family. For such couples the need for income protection assumes priority over other needs. The income earner should buy a term insurance plan so that in the event of their premature death, the surviving spouse will receive a sufficient sum from the insurance company to replace the income provider's loss of income.

Case study

Young married

Continuing with Ankur's case study, three years after becoming established with his company, he gets married to Kavita. She is a teacher in a private school. Ankur and Kavita are now an example of a double income family where both partners are earning. In the event of the premature death of Ankur, Kavita will not be entirely affected financially as she will still be earning in her own right.

At this stage, Ankur and Kavita's main need is to protect their income against premature death, disability resulting from injury or long-term sickness. If one of them dies, the sum insured along with their own income will support the surviving partner. The couple should buy individual term life insurance plans and look at investing their remaining surplus cash in mutual funds or unit-linked insurance plans for long-term capital growth of their money.

B4 Young married with children

At this stage the responsibility of an individual increases when children are born. This stage can be further classified into two types:

- **Double income family** – here both the parents are earning, meaning that the effect of the loss of income due to the premature death of one of the partners will be less. Protection of income is important. A suitable individual term life insurance plan for both partners should be recommended so that in the event of the death of one partner an adequate sum is received by the family to replace the loss of income.

  As both the partners are earning, the investment capacity of such families will also be higher. Investments towards their children's future can be a high priority for these families. A suitable child investment plan should be recommended after the income protection need has been taken care of. A family floater health insurance plan covering the couple and their children is advisable at this stage. The couple should also start making small contributions towards a retirement plan, which can be stepped up later.
- **Single income family** – for these families, income protection is very important. A suitable-term life insurance plan should be recommended as the loss of income of the earning member of the family could lead to serious financial problems. In the event of the earning parent's death, an adequate sum insured will help the family to maintain a decent lifestyle, and the children's education also will not be affected. Once the income protection need is taken care of, a child investment plan should be given priority. A family floater health insurance plan covering the couple and children is advisable at this stage.

Case study

Young married with children

Ankur and Kavita are blessed with a daughter after two years of marriage. Kavita leaves her job to take care of the child. At this stage the family's income is reduced with Kavita no longer working, and at the same time expenses increase with the birth of the baby. Hence the income protection needs of the family have greatly increased. It is advisable that Ankur increases the term insurance cover that he already has. He should also start investing in a child investment plan to provide for his daughter's education and marriage expenses. Ankur should also buy a family floater health insurance plan which covers him, Kavita and their daughter. He should also start making small contributions towards a retirement plan which can be stepped up later.

Be aware

Child education planning

- The insurance agent should take into consideration the cost of the education course selected by Ankur.
- The agent should assume an education inflation rate and, based on the date when Ankur's daughter will enrol for higher education, work out the amount that will be required at that time.
- Then, assuming a reasonable rate of return, the agent should arrive at the monthly amount to be invested to accumulate the education fund.
- Accordingly Ankur should start making regular investments towards the daughter's education fund in a child insurance plan.

B5 Married with older children

This is the stage where the financial responsibility of the couple towards their children will be in respect of their higher education and marriage. The income of the couple is likely to be higher than previously as they will have gained considerable experience and made progress in their working lives. At this stage the need to protect children against the premature death of their parents is low compared to previous years as the parents will have already made significant investments towards the children's future needs. However, the couple should review their investments to ensure that there will be sufficient funds to cover the cost of higher education and the marriages of their children.

The need to focus investments towards their retirement fund also gains importance at this stage and as the couple has already made significant investments towards their children's education and marriage, they can now step up investments towards their retirement fund. As their age increases, the couple will be more vulnerable to sickness and disease and should therefore also look at enhancing their health cover.

Case study

Married with older children

Ankur is now aged 48 and his son and daughter have grown up. His daughter has enrolled in a medical college as she wants to become a dentist and his son has enrolled in an engineering course. Ankur's father has retired and receives a pension which is enough to support both him and Ankur's mother. At this stage, Ankur's risk appetite has reduced significantly. He has gradually started shifting his investments from high risk ones like equities to low risk ones like deposits, as there is a need for guaranteed funds for the education and marriages of his children over the next few years. He is also more focussed towards stepping up investments towards his retirement fund. Ankur has also enhanced the family floater health cover.

B6 Pre-retirement

This is the stage when the children will have completed their higher education, be married and will have become financially independant. The income of the individual/couple will still be high as they will be at the peak of their careers. At this stage the entire focus is shifted towards the retirement fund and health protection as other needs are mostly taken care of. After retirement, the major area of concern for a couple would be meeting day to day financial expenses, regular health checkup expenses, hospitalisation and other medical expenses. The individual will see how the investments already made towards the retirement fund are faring and will consult with his insurance agent on whether there is a need to make any changes. The couple should also review the health cover and see if it is adequate.

Case study

Pre-retirement

At this stage Ankur's children have become independant. Ankur's daughter has become a dentist and now runs her own clinic. She recently married an eye surgeon and has settled down. Ankur's son is working with a leading MNC as a software engineer. He is also married. Ankur's parents have died and have left their estate to him.

At this stage Ankur is concentrating on his retirement fund as most of his other needs have passed. Ankur meets his agent and discusses the performance of his retirement fund so far and whether any changes are required. The agent advises him to transfer the remaining small portion of his equity portfolio to low risk investments as he cannot afford to take any risks at this stage that the retirement fund will fall in value just when it is needed to provide an income for the rest of his life. Ankur also consults his insurance agent to review the family health cover at this stage to see if it is adequate.

B7 Retirement

This is the stage where the income of an individual/couple is limited to the returns on investments that they made in the earlier stages of their working life. In the case of salaried employees, their regular monthly income will have stopped. If the returns from their investments are not sufficient to meet their financial liabilities little can now be done. The individual can use their accumulated retirement fund and their employee benefits amount from provident fund, gratuity, leave encashment etc. to buy an annuity plan from an insurance company. This will provide a regular monthly income to take care of living expenses for the rest of their lives. This is also the age when individuals are most prone to illness and disease. The individual should review the health cover for themself and their spouse to see if it is adequate to meet the couple's healthcare requirements.

In the case of self-employed professionals and businessmen, there is no defined retirement age. If they and their insurance agent feel that they have accumulated enough money in their retirement fund to take care of their expenses for their remaining lifespan then they can retire. With the retirement fund they can buy an annuity plan from an insurance company which will give them enough regular income to meet their expenses.

But if the individual and their insurance agent feel that the retirement fund is insufficient to sustain the post-retirement years, then the businessman must continue to work and the self-employed professional continue with his profession until sufficient money is accumulated. The retirement fund proceeds can then be used to buy an annuity plan from an insurance company for regular annuity payments to meet retirement expenses. At this stage the individual should also review the health cover for self and spouse to see if it is adequate to meet their healthcare requirements.

Case study

Retirement

Ankur and Kavita, with the help of their insurance agent, planned and managed their retirement fund well during their working lives. As a result they are now receiving sufficient monthly income from the annuity plan they bought that more than takes care of their living expenses during their retirement years. Even after retirement Ankur and Kavita do not have to make any compromises in their standard of living. They have also consulted their insurance agent regarding their health cover to make sure it is enough to cover their healthcare requirements. Having led a successful and responsible working life, both are now enjoying spending time with their grandchildren.

B8 Summary

We have seen that in a typical lifecycle, all clients have two primary needs – protection and investment. However, remember that there can be changes in these needs over a person's lifetime. Below is a summary:

Lifecycle stage	Client needs
Children	Need for parents to: • financially secure the children in the event of the premature death of parents; • provide for their future financial responsibilities, such as education, marriage etc.
Young unmarried	• Protection need – life cover for self, provide for family in case of premature death, disability etc. • Health protection for dependent parents (if not already taken out). • Saving for short-term needs like marriage, house etc. and long-term needs like retirement.
Young married with children	• Protection need – life cover against death for both spouses. • To provide for the children's future – education, marriage etc. • A family floater health insurance plan covering the couple and children. • Small contributions towards a retirement plan, which can be stepped up later.
Married with older children	• Protection need – financial protection for the family in the event of the premature death of the income provider. • To continue providing for the children's future – education, marriage etc. • Step up investments towards retirement plan. • Enhance health cover with increase in age.
Pre-retirement	• Investment for retirement. • Income protection needs. • To leave inheritance to children. • Review the health cover and see if it is adequate.
Retirement	• Need to invest funds wisely to ensure an adequate regular income during retirement. • Review the health cover and see if it is adequate. • Estate/inheritance planning.

Suggested activity

Visit any two couples who are in the following stages of the lifecycle:

- Young married without children.
- Young married with children.

Gather information from them and prepare a list of different needs of each couple. Are the needs of the two couples similar? Consider your findings.

Question 8.1

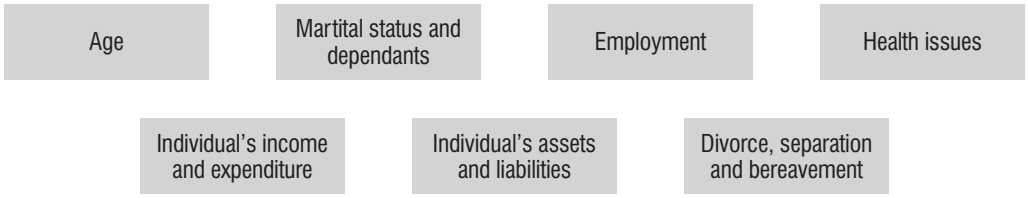
What could be the different needs in a typical lifecycle for the following life stages?

- Young married with children.
- Married with older children.

C Factors that affect the life stages

Not every client will go through all the life stages discussed in the last section. The presence of several factors influences these life stages significantly. The main ones are:

Figure 8.5



C1 Age

The younger the age of an individual, the lower their liabilities will be. As a person grows older they will complete their higher education and become employed. Their protection needs will increase due to the new responsibilities they take on such as marriage and a family.

C2 Marital status and dependants

When an individual gets married and starts a family, their responsibilities will increase and they will wish to provide for their family. They are also likely to be thinking of buying a home, a car and taking annual vacations etc. These can all result in increased financial liabilities. With all the above responsibilities and increase in liabilities you can see that protection needs become very important for an individual after marriage.

C3 Employment

An individual's employment status can influence their financial planning needs and investment capacity. An individual can be employed as a:

- public sector employee;
- private sector employee; or
- self-employed.

In addition, a person may have a short professional career (such as a professional sportsman) or they may be unemployed.

C3A Public sector employee

If an individual works in the public sector, then their need for life insurance, pension plans and other medical related plans will not be high. The reason for this is that the public sector makes contributions towards provident funds, pension funds and gratuities under retirement benefit schemes for its employees. Public sector employers also offer benefits such as life insurance for the individual and health insurance for their family.

C3B Private sector employee

The need for a pension plan, life insurance, health insurance etc. is greater in the case of private sector employees. While most private sector employers provide benefits such as a gratuity and provident fund, many of them do not provide any pension benefits. Some companies provide life insurance for the individual and health insurance for their family, and some give the option to the employee to contribute towards the premium. However, other companies do not provide any of these benefits and the employee needs to make their own arrangements.

C3C Self-employed

In case of self-employed individuals two important factors need to be considered:

- self-employed individuals may have fluctuating income; and
- they may be the sole income provider for their families.

The need for life insurance is high amongst the self-employed. Once this need is taken care of then the focus can be shifted towards other needs such as child investment plans and retirement plans.

C3D People with short careers

Some people have a short earning career span. Film or television actors and actresses, sport persons, professional artists etc. will typically have a short earning career spanning, say, 5, 10 or 15 years. During these years when they are at the peak of their performance they will make a substantial amount of money in the form of professional fees. But once this peak earning phase is behind them, their income falls drastically or even stops completely.

People in this category need to protect their income from premature death or disability during their peak earning years, and the income earned during these years needs to be invested in such a manner that it will provide a regular income for the remainder of their career and in their retirement.

C3E Unemployed

Unemployment can occur at any stage of a person's life. It can happen to a self-employed individual as well as to salaried individuals and can occur due to ill health or the economic situation.

If someone becomes unemployed their financial plans can be severely affected as their priority will shift towards ensuring they can provide basic amenities for their family such as housing and food. In the case of prolonged unemployment, the individual will not be in a position to meet the regular premium payments for any policies or investments they have. This may result in policies being lapsed. In such cases the individual should try to revive the policy at a later stage when they are employed again or they can convert the policy into a paid-up policy. Surrendering the policy is another option.

So you can see that this is the stage for which an individual needs to plan in advance. They should have disability insurance and also have built up an emergency fund that will cover their expenses in the short-term.

C4 Health issues

Health risks tend to increase as an individual gets older and their chances of obtaining life and health protection will be reduced. There can also be instances where a person may suffer from continued bad health, irrespective of their age.

If insurance companies accept these risks, they may modify the conditions of acceptance and/or charge a higher premium.

C5 Individual's income and expenditure

Every individual's income and expenditure pattern is different based on their lifestyles and habits. Expenditure includes all outgoings i.e. amount spent on food, clothing, housing and leisure activities. It also includes the liabilities of an individual such as repayments of a home loan, car loan etc. For financial planning purposes it is essential that an individual has surplus income after meeting all of their expenses.

However, if expenditure exceeds income then this will result in debt and the individual's capacity to make investments will be nil.

C6 Individual's assets and liabilities

Assets are what an individual owns and liabilities are what they owe. Assets can be acquired by an individual through saving, inheritance or business activity. If an individual's assets are more than their liabilities, they will have surplus money available for investment. If their liabilities exceed their assets, then they need to ensure that all due payments are met on time.

Example

Raghav Mishra is a doctor and runs his own private clinic. His father was also a doctor and used to run a clinic. After his death, Raghav's father left his house, clinic, plot of land and bank fixed deposits worth Rs. 10,00,000 to Raghav.

Raghav is fortunate enough to have a substantial income of his own as well as the assets that he has received from his inheritance. In the case of individuals like Raghav, who have substantial assets and good cash flows from their regular income, their investment capacity is high and their ability to take risks is also high.

Any assets which are no longer suitable or are earning fewer returns than expected should be reviewed and cashed-in for investment into other assets. Similarly an individual's liabilities, such as a home loan or a car loan, should be covered by adequate life insurance so that in the event of the income earner's premature death, the family can pay off the debts and avoid financial troubles with lenders.

C7 Divorce, separation and bereavement

Marital breakups can adversely affect the financial planning for individuals. In the case of divorce or separation, the financial objectives of individuals will change and also their investment capacity will decrease (especially if both spouses are working). As a result, existing investments should be reviewed.

In the case of divorce and separation, financial planning for women (housewives) becomes extremely important as a woman may not have any financial arrangements other than those of her husband. So protection and retirement needs assume even greater importance.

A widowed woman will become the custodian of her husband's financial assets and she will have the responsibility of providing for her dependent children. Her main concern will be to manage the assets and enhance or preserve their investment value to provide for her dependent children.

D Client needs: real and perceived

It is important to understand that there are differences between *real* and *perceived* needs. Real needs are the actual needs of a client which should take priority over others, whereas perceived needs are imagined or thought to be important by the client (for example wanting to buy an expensive car when there is adequate public transport and the client has insufficient savings or income to buy one).

Real needs are determined by the use of financial planning techniques and analysis. Perceived needs can be understood by analysing an individual's thoughts and desires. Let's have a look at some of the problems faced by agents in advising clients about real and perceived needs:

- As we discussed earlier in this chapter, different financial needs occur at different stages of the lifecycle of an individual. However, when the time comes for financial planning, an investor might shy away from actually making investments. A young man might aspire to have Rs. 10,00,000 ten years from now, but for this he needs to sacrifice some of his leisure activities and save and invest regularly.
- The second problem is that clients often fail to understand the importance of saving for the future and do not appreciate the benefits that this will bring. They will want to give priority to their present needs as opposed to their future intangible needs.
- Individuals may not understand their real needs and may fail to prioritise them sensibly. There can be cases where an individual might choose to invest in child plans first, whereas their priority need would be to provide financial protection for their family in the event of their premature death, illness or disability.

The job of an insurance agent is to help clients in identifying real needs. The process is as follows:

Identification of real needs	• Insurance agents should help their clients in understanding their real needs. This can be done by educating them about the concept and importance of insurance.
Identification of current and future needs	• Insurance agents should help their clients to understand their current and future needs.
Quantification and prioritisation of needs	• Once the needs are identified, they must be quantified in terms of monetary value and prioritised.
Financial planning review	• Clients should meet with their agent regularly to review whether their financial planning needs have changed over time. If so, then new investments should be made to suit the changed circumstances.

Example

Real need – I need to save for my retirement.

Quantification of real need – I need to make provision to have a continued monthly income of Rs. 20,000.

Question 8.2

Explain in brief how the following factors influence life stage needs:

i) Health issues.

ii) Income and expenditure.

iii) Assets and liabilities.

E Communication, questioning and listening skills

For an insurance company an insurance agent is very often the first contact point with their prospective clients. When advising clients the insurance agent must be able to evaluate effectively the information being provided by them. This can be done by asking focused questions and using good listening skills. Agents may have to 'read between the lines' as clients may be unfamiliar with insurance-terms and jargon and this may hinder their understanding of their needs.

In this section we will discuss three essential skills that every insurance agent must have – communication skills, questioning skills and listening skills.

E1 Communication skills

An insurance agent should have good communication skills so that they are able to establish and retain a client's interest and involvement in the financial planning process. Effective communication skills are important right from the start of any meeting with the client and even more so if the client starts to lose interest in the process at any point.

Good communication skills include:

- a good command of the client's local language and dialect;
- a friendly approach towards clients and a genuine interest in them. Agents should be able to encourage clients to speak about their concerns relating to their future and present needs; and
- whenever a client asks a question, or makes a point, the agent should answer the question honestly and continue to engage the client in a two-way dialogue. This will encourage the client to participate in the financial planning process.

E2 Questioning skills

An insurance agent needs to ask different questions in order to understand clients' financial planning needs. For this an insurance agent needs to have good questioning techniques. These techniques include:

- using different types of questions; and
- the phrasing of the questions.

E2A Different types of questions

An agent can ask different types of questions to help understand their clients' needs. Questions can be classified by structure or by purpose:

1. **Classification by structure**: in this classification, questions can be of two types: open-ended and closed-ended. Both types of questions have different objectives and effects and you should make sure that you can use them correctly.
   a) **Open-ended questions** – this type of question encourages the client to talk freely and highlight issues which are most important to them.

Example

Some examples of open-ended questions are:

- Why do you think that?
- Where do you see yourself 10 years from now?
- How do you feel about that?

   b) **Closed-ended questions** – these questions are structured so that the client has to provide short specific answers. The client's response is restricted to 'yes', 'no', 'a specific fact', or 'a specific amount'.

Example

Some examples of closed-ended questions are:

- Are you currently employed?
- How many children do you have?
- Do you have any current investments?
- Are you married?

2. **Classification by purpose** – in this classification, questions can be either open or closed and include questions that:
   - seek information;
   - explore and collect additional information;
   - check meaning or understanding;
   - confirm points already agreed; and/or
   - commit the client to action.

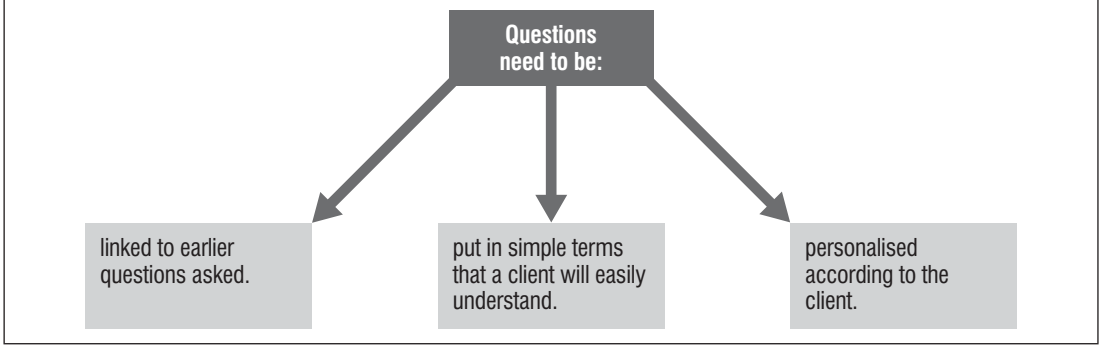
Example

Classification based on purpose	Open-ended questions	Closed-ended questions
Information-seeking questions	Tell me about your children.	How many children do you have?
Questions for collecting additional information	What plans do you have for your children's future?	Do you wish to provide professional education for your children?
Questions to check meaning or understanding	When you say that you want to provide professional education, would you like to send them abroad for further studies?	When you say you want to provide medical education, do you mean for them to be a doctor or pharmacist?
Questions to confirm on points already agreed	Just refresh my memory as to how concerned you are about your children's education.	You did say earlier that you would like to send your children abroad for higher studies?
Questions for committing the clients to action	You really want to do something about your children's education?	Can I assume that you wish to purchase a child plan?

E2B Phrasing of questions

The questions listed above are an illustration to help you to understand the different types of questions that can be asked. In reality, the above questions will not be asked in such an abrupt manner, and instead, they need to be phrased more pleasantly and personally. For this:

Figure 8.6



E3 Listening skills

Developing good listening skills is also important for an insurance agent so that they can interpret the client's answers correctly.

The agent should concentrate on the client's answers and the other information that is provided. The agent should record the client's answers and their body language should also be studied by the agent, as this will help in determining their level of interest in financial planning.

E4 Handling objections from clients

You should always bear in mind that some prospective clients may be reluctant to purchase a life insurance policy as they fail to see the importance of life insurance; they may also be uncomfortable in discussing the timing of their death and what will then happen to their family. An insurance agent must overcome this situation sensitively before being able to recommend suitable needs-based products to clients.

Once an agent has made their recommendations, some of the common objections that a prospective client may have are:

1. The product doesn't meet my need(s).
2. A competitor's products are offering additional benefits.
3. I don't have the funds for investment.

As an insurance agent you must be extremely careful in handling such objections. Whenever clients raise objections, you should make use of open-ended or closed-ended questions to understand the real reason behind the objections, and try to overcome them. Good communication and listening skills, as well as asking appropriate questions are tools that can be extremely useful in this case.

Some ways of handling the above objections include:

The product doesn't meet my need(s)	• Ask the client some open-ended questions to understand their concerns and provide more information on the product, or else suggest another product after reviewing the needs of the client again.
A competitor's products are offering additional benefits	• Present a comparative analysis on some of the related products and discuss their pros and cons. Then accordingly advise as to why the particular product is being suggested to them.
I don't have funds for investment	• Revisit the importance of proper financial planning and the importance of needs-based investment. Explain the importance of a having an insurance plan and the consequences of not having one.

Suggested activity

Suppose that you have an appointment with a client for whom you have to analyse their different needs and prepare a financial plan. Prepare a list of open-ended questions and closed-ended questions that you will ask to gather the necessary information.

Question 8.3

Explain the difference between real and perceived needs in brief.

F Gathering client information including family information

As part of the planning process, the insurance agent needs to gather personal (including family) data, professional data and information related to the client's finances using a form called a **fact-find**.

- The personal details section includes the client's name, age, address, contact details and marital status.
- The family details section will include the number of members in the family and their details such as their name, age and occupation.
- The agent may also record the address of the client's family physician and the addresses of some close friends of the client etc.
- The agent will then note the professional details of the client such as whether they are employed, self-employed or run a business. Based on the client's profession the agent will ask more details about it.
- The agent will then ask about the client's cash flows and their existing investments.

Note: more details on all the sections of the fact-find will be discussed in the next chapter when we look at the financial planning process.

G Understanding priorities – a summary

As we have already discussed, an insurance agent should help his clients to understand their real financial and protection needs. These needs can be prioritised based on several factors:

Lifecycle	• Different needs are prioritised depending upon the different stages of the lifecycle. For an unmarried young individual, life insurance cover will gain priority over a pension plan.
Existing insurance policies	• If the client already has adequate term insurance cover then the priority shifts to other needs.
Amount of surplus funds available	• The amount of surplus funds available will also affect the priority rating given to different needs. A client with substantial funds available for investment might purchase different products based on their diverse needs. However if the surplus funds are limited, then they should choose financial products which can provide cover for their basic needs.

Example

If a young married couple with a small child already has adequate life insurance cover, their priority will shift towards a child insurance plan and a savings or retirement plan.

H Confirming assumptions and agreeing objectives

A needs analysis should be done by an insurance agent after agreeing the client's objectives. During the needs analysis any assumptions made should be confirmed with the client. The agent's professional expertise will be important at this stage when evaluating the information gathered from the client.

For the needs analysis, an agent must evaluate all financial investments and commitments already made and the future commitments that will be required in order to fill the remaining gaps.

Similarly the client's objectives need to be analysed. This is done in order to estimate the amount that will be required to achieve these objectives. The insurance agent needs to determine if sufficient funds can be put aside to meet these objectives.

If there is a gap between the amount needed for the future and the amount now available, additional cover should be suggested to the clients to protect against it.

Be aware – the importance of reviewing financial plans

In spite of all the financial planning techniques available, the exact amount of funds needed in the future cannot be precisely determined. This amount is subject to various assumptions. Insurance agents will derive only an estimated amount and not the exact amount. Hence the financial plan needs to be reviewed once every 12 months or so to see if there are any changes in the client's needs and whether the investments are doing as expected. This is also a good way for the insurance agent to keep in regular contact with the client to show that he is concerned about the client's ongoing financial welfare.

Apart from the amount, the other aspect that the insurance agent needs to be concerned with is the **duration** of the policy. The exact duration for which a life insurance policy is needed cannot be pre-determined. Once again this figure is determined based on certain assumptions.

Example

Rahul Sharma is a 32-year-old civil lawyer. His wife Rekha is a housewife. He has two children aged 1 and 3 years respectively. Rahul wants to invest in a suitable insurance plan to provide for his children's education and marriage in case he dies prematurely.

His major concern is – what should be the duration of the policy? Rahul wants to use the funds for his children's education and marriage. But he does not know exactly when his children will get married and will require the funds. If he takes a policy for 10 years, then he would receive the funds before his children are ready to pursue their higher education. If he takes a policy for 20 years, then he would receive funds after his children have completed (or almost completed) their higher studies (children aged between 21 and 23 years) and would be a little early for their marriage.

Therefore Rahul will have to be very prudent in deciding the duration for which he wants to keep the funds invested.

Consider this…

What are the different factors which an insurance agent and client should use to determine the duration of investments? What would happen if a client is unable to withdraw their investments at the time of need, as funds invested may be locked-in for a specific period?

Key points

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

Who is your client?

- Any individual that an insurance agent meets who has any financial need is a potential client.

The typical life stages of a client

- The life stages of a client can be divided into the following: childhood, young unmarried, young married, young married with children, married with older children, pre-retirement and retirement.

Factors that affect the life stages

- The presence of several factors influences the life stages of an individual.
- Assets can be acquired by an individual through saving, inheritance or business. If an individual's assets are more than their liabilities, then they will have surplus money available for investment.

Client needs: real and perceived

- Real needs are the actual needs of an individual which should gain priority over others.
- Perceived needs are those imagined to be important by a client.

Typical client needs by life stages

- In a typical lifecycle all clients have two primary needs – protection and investment. However, needs can be added or deleted over time.

Communication, questioning and listening skills

- Effective communication skills are required at the beginning of the meeting and/or at the point when the client starts to lose interest in the process.
- An insurance agent needs to ask different questions in order to understand their financial planning needs. For this an insurance agent needs to have good questioning techniques.
- Open-ended questions encourage the client to talk freely and highlight issues of importance for them. Closed-ended questions are structured in a manner where the client only has to provide short specific answers.
- Developing good listening skills is important for an insurance agent so that they are able to interpret the answers of the client correctly.

Understanding priorities

- Having gathered client information via the fact-find, different needs should be prioritised depending upon the different stages of the client's lifecycle.
- If the client already has adequate insurance cover, then their priority moves to other needs.
- A client with sufficient funds available for investment might purchase different products based on diverse needs.

Confirming assumptions and agreeing objectives

- Needs-analysis should be done by an insurance agent after agreeing objectives with the client. During needs-analysis the assumptions made should be confirmed with the client.

Question answers

8.1 **Young married with children**

- Protection needs – income protection against illness or accident.
- Life cover for both spouses to compensate the income for other in case of their death.
- To provide for the children's future – education, marriage etc.
- Investment for retirement.

Married with older children

- Protection needs – financial protection of the family.
- To continue providing for children's future – education, marriage etc.
- Investment for retirement.

8.2 **Health issues**

Health risks increase as an individual gets older. Hence their chances of obtaining health and life protection will be reduced. There can be instances where an individual may suffer from continued bad health, irrespective of their age. In such cases, if life insurance companies do accept the risk, they might modify the conditions of acceptance and/or charge a higher premium as well.

Income and expenditure of an individual

Every individual's income and expenditure pattern is different based on their lifestyle and habits. Expenditure includes all outgoings, i.e. the amount spent on food, clothing, housing and leisure activities. It also includes the liabilities of an individual such as repayment of a home loan, car loan etc. For financial planning it is essential that an individual should have some surplus income after meeting all of their expenses.

If expenditure exceeds income then this will result in debt and no investment capacity.

Assets and liabilities of an individual

Assets are what an individual owns and liabilities are what they owe. Assets can be acquired by an individual through saving, inheritance or business. If an individual's assets are more than their liabilities, they will have surplus money available for investment. If liabilities exceed assets, then the individual needs to ensure that all due payments are met on time.

Assets which are no longer suitable or are earning fewer returns than expected can be cashed-in for investments into other assets. Similarly if an individual is in debt for a prolonged time owing to their liabilities, then they need to have sufficient life insurance cover for themselves and sufficient insurance cover against these liabilities, so that their debts can be repaid in event of premature death.

8.3 There are differences between real needs and perceived needs. Real needs are the actual needs of an individual which should gain priority over others. Whereas perceived needs are those imagined or thought to be important by the client.

Real needs are determined by the use of financial planning techniques and analysis. Perceived needs can be understood by analysing an individual's thoughts and desires.

Self-test questions

1.	Explain the difference between open-ended and closed-ended questions.
2.	Explain how divorce or separation can affect the life stage of an individual.
3.	List the different life stages of a typical lifecycle.

You will find the answers on the next page

Self-test questions answers

1.	Open-ended questions encourage the client to talk freely and highlight issues that hold importance for them. Closed-ended questions are structured in a manner where the client has to provide short specific answers.
2.	Marital breakups can adversely affect the financial planning for individuals. In the case of divorce or separation, financial objectives of the individuals change and also their investment capacity decreases (especially if both of the spouses are working). As a result, existing investments need to be reviewed accordingly. In the case of divorce and separation, financial planning for women who are housewives becomes extremely important as a woman may not have any financial arrangements other than those of her husband. Protection needs and retirement needs assume even greater importance. In the case of a widowed woman, she would become the custodian of her husband's financial assets. Her main concern would be to manage these assets and preserve their investment value.
3.	The life stages of a client can be divided into following stages: 1. Childhood 2. Young unmarried 3. Young married 4. Young married with children 5. Married with older children 6. Pre-retirement 7. Retirement

9
The fact-find and financial planning

Contents	Syllabus learning outcomes

Learning objectives

After studying this chapter, you should be able to:

- describe the fact-finding process;
- outline the objectives of fact-finding;
- use a fact-find;
- discuss the various sections of a fact-find;
- explain how to do the assessment and analysis of data collected during a fact-find;
- explain how to shortlist products for a client;
- describe how to make recommendations to a client;
- explain the use of benefit illustration documents at the time of making recommendations.

Introduction

An important part of the financial planning process is **fact-finding**. In this chapter you will learn how, as an agent, the fact-finding process will help you to identify the stage your clients have reached in achieving their financial goals in life. You will also learn how to:

- quantify the amount needed for the client's various goals;
- establish the provision (if any) already made to achieve those goals;
- determine the amount which still has to be provided;
- provide assistance to help the client to bridge the gap; and
- bring the client back on track in the financial planning process.

After looking at the fact-finding process itself we will discuss how to analyse the information collected and choose products which most satisfy your client's needs. We will also look at presenting the recommended products to your client and completing the final formalities of form-filling and collecting the required documents.

Key terms

This chapter features explanations of the following ideas:

Fact-finding	Cash flows	Structured interview	Personal details
Family details	Employment details	Financial details	Assets
Liabilities	Assessment	Analysis	Making recommendations
Needs	Priorities	Benefit illustration	Guaranteed benefits
Non-guaranteed benefits	Know your customer (KYC)		

A What is a fact-find?

Fact-finding is a process that enables the insurance adviser to:

- identify a client's financial planning needs;
- quantify them; and
- prioritise them based on the resources available for investment.

Completing a fact-find is the first step in the financial planning process. As we saw in chapter 8, a fact-find shows the current financial position of the person, where they stand today and also any anticipated changes in the future.

Good fact-finding is the key to successful financial planning. Without good fact-finding, you will have no means of knowing whether or not the products you recommend are suitable for your client's needs. Fact-finding consists of obtaining the answers to a series of questions about your client's profile, status, finances and ambitions for the future. Many questions require detailed factual answers; others seek statements of principle, such as a client's personal attitudes, feelings and concerns.

Traditionally, fact-finding has been carried out during interviews set up for this purpose and most agents wishing to provide a professional, personalised service still rely on this approach.

A1 Objectives of fact-finding

These are as follows:

Identify needs	The prime objective of fact-finding is to identify what needs, if any, the client has in the areas of protection, savings, health insurance etc. Good fact-finding must assemble the information to enable the adviser to quantify the total amount of each need, the provision that already exists to meet the need and, therefore, the amount which still has to be provided. **Example** Ram wants to accumulate money for his son's education. Through the fact-finding process the insurance agent, Ravi, can help him to identify this need, the date at which the amount will be required, quantify the amount required, and based on an assumed rate of return, calculate how much the monthly investment amount required to achieve the goal will be. If Ram is already investing a certain amount on a monthly basis, then the agent, Ravi, can help him assess whether he is investing the appropriate amount and in the right financial products. The agent can help him to identify the shortfall amount (if any) and how to provide for it.
Gathering client data	Such precise identification of needs requires knowledge of the personal details of each client, their dependants, finances and employment status. This process requires details of existing health and life insurances and any existing pension provision. It also requires an understanding of the client's personal aims, desires and objectives for the future. Good fact-finding will reveal not only practical needs, but also those caused by emotional considerations. **Example** If Ravi has to help Ram achieve his goal of accumulating the desired amount for his son's education he will need to know more details from Ram such as the number of earning members in the family, number of dependants, number of children Ram has(including their current ages), his current salary and his savings.
Analysing client cash flows	Another important fact-finding objective is to identify the client's available contribution to invest in financial planning products. This information is derived from a detailed analysis of the client's income from all sources and of the outgoings on which it is spent. It also requires a detailed review of the client's existing capital resources and the liabilities that must be offset against them. In both cases, a positive balance indicates the likely amount available for financial planning purposes. Where no surplus exists, little can be done unless the client is able to reschedule debts or reduce outgoings on other expenditure. **Example** Through the fact-finding process Ravi will analyse Ram's cash flows. He will consider all his cash inflows and cash outflows, his current assets and liabilities and arrive at the cash surplus/deficit. From the surplus available the agent can prepare a plan for Ram to invest for his son's education.
Provide for anticipated changes	Fact-finding also seeks to uncover any anticipated changes to the client's circumstances which will affect their current financial position. For example, is the client expecting a pay rise or an inheritance in the near future; or are they expecting to start a family, to buy a bigger house or to become unemployed? Each expected change in financial circumstances will have an effect on the contribution the client can continue paying in the future. This helps to define the amount to which clients can afford to commit themselves now. **Example** Ravi will discuss with Ram: • whether he plans to further extend his family; • if he plans to change his job in the near future; • whether he is expecting a salary increase in his current job; and • if he is planning to buy new assets like a home, car etc.

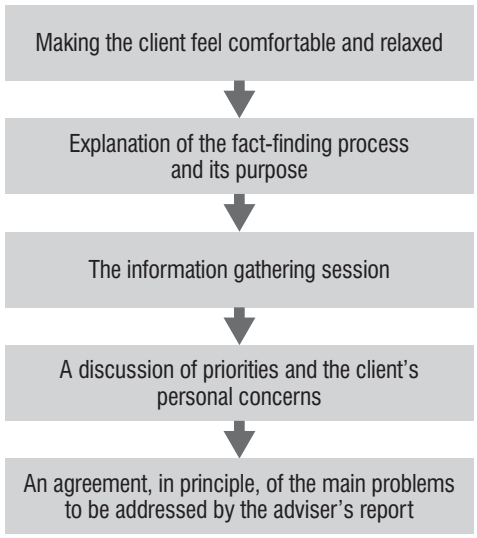
B Using a fact-find

The most common form of fact-finding record is a structured questionnaire. It is possible for these questionnaires to be completed without a formal interview with the client (for example by telephone interview or by corresponding with the client by post). However, we will consider their use in the interview situation.

B1 Structured interview

Typically, the interview structure moves through the following stages:

Figure 9.1



The fact-finding interview may take place at the agent's office or at the client's home. After the interview the agent may be required to prepare recommendations within a budget fixed by the client or, alternatively, there may be no cost constraints on recommendations.

After the interview, the agent will carry out a more comprehensive analysis of the information and, if necessary, seek any specialist guidance required. In this way the agent establishes the client's quantified needs, identifies the appropriate product(s) to meet each need and assesses the costs involved. The agent uses this information to finalise recommendations to be put to the client at a subsequent meeting.

Question 9.1

What are the objectives of carrying out a fact-find?

B2 Fact-finding forms

A fact-finding form is divided into separate sections covering the client's details. These sections include:

- personal details;
- family details;
- employment details;
- financial details;
- existing insurance and investments;
- monthly income and expenditure analysis;
- financial planning objectives and considerations; and
- future changes.

Be aware

Where joint financial plans are required for, say, husband and wife or two business partners, the same information will be required for each person.

Each section contains a series of questions. However, there are naturally some differences in the way in which they are used. Some companies also use computerised fact-finding forms where the agent inputs all the data into the system at the time of the interview or after the interview. The computer system then prints out the completed fact-find questionnaire, including information such as the client's priorities, risk profile, quantified needs, suitable products and cost-benefit analyses to clients on the screen.

In the following sections we will use the example of an insurance agent, Amit, who is advising his client, Kishore.

B2A Personal details

In this section Amit will record Kishore's personal details – his full name, address, telephone number and occupation etc. These details are required for the agent's own business records. Marital status will also be important as an indicator of family responsibilities and will point towards later questions on dependants.

The client's date of birth, place of birth and state of health, including smoking habits and/or drinking habits, will indicate eligibility for insurance policies and the premium rates to be paid.

B2B Family details

In this section Amit will record Kishore's family details.

The agent will normally ask for the names, ages, state of health and occupation of the client's:

- spouse;
- children;
- parents; and
- other dependants.

This information prompts questions on the extent to which clients need to provide protection against their own disability or death for their dependants' benefit. Also the information on dependants (such as elderly parents) will help the agent to advise on their health insurance needs. The cost of hospitalisation of elderly parents due to any illness will fall on Kishore in the absence of health insurance cover for his parents.

B2C Employment details

In the employment details section Amit will fill in details of Kishore's job and employer. If the client works for a business or a self-employed professional, the agent will record details accordingly. The client's job profile and workplace play an important role in deciding the insurance premium for a life insurance policy. An insurance company considers a person working in an IT company as low risk and a person working in an explosives factory as high risk.

The agent will record all the details of a client's earnings: basic salary, commission, performance bonus and any other additional benefits or any other sources of income. The agent will take into account this income and factor in annual growth in income during the remaining working years, and accordingly arrive at the income that needs to be protected against disability and death.

In the case of self-employed people, earnings from employment will be replaced by the client's profits and the amounts drawn from the business for family expenditure.

Be aware

The agent will take into consideration the employee benefits that the client is entitled to: provident fund, leave encashment, gratuity, superannuation, pension, life and health insurance provided by the employer and the amount of cover provided etc.

Be aware

An employee provident fund (EPF) is a fund into which the employee and the employer (on behalf of the employee) contribute regularly a certain portion of the employee's salary. The fund is managed by the Employees' Provident Fund Organisation (EPFO), a trust or is administered by the employer itself.

The EPFO invests the money collected in the fund on behalf of the members. The EPFO declares an annual return (annual interest rate payable) on the fund. The fund is governed by the rules and regulations of the **Employees' Provident Funds and Miscellaneous Provisions (EPF & MP) Act 1952**. The money together with the interest accumulated is paid to the employees when they leave the job or retire, or to the nominee on the employee's death.

The retirement benefits that Kishore is entitled to, such as the provident fund, leave encashment and gratuity will form a part of his retirement fund and after deducting this amount, the resulting gap is the amount for which Kishore now needs to start investing.

B2D Financial details

In this section Amit will record the details of Kishore's assets and liabilities. The **assets** section provides spaces to show the current value of each asset the client owns and the gross income, if any, it provides. Income from these assets must be added to income from employment to identify the client's total income and tax position.

Assets and liabilities

Assets	Liabilities
Main residence	Home loan
Other real estate like residential property, commercial property, plots of land	Credit card payments outstanding, bank overdrafts and personal loans
Investments in equity shares and mutual funds	Vehicle loan, educational loan, business loan
Investments, fixed income securities like bank fixed deposits, government securities, public provident fund, post office deposits and other debt instruments	Any other borrowings
Investments in gold, silver and other precious metals	
Any other assets	

Where the client has significant assets, this may point to a need for investment advice.

Where the client has limited assets, it is necessary to check that they match the client's needs and the extent to which they might be available to fund more advantageous financial plans. Where the assets have been bought personally by the client, the type of investments may well indicate the client's attitude to risk.

With this information, the agent can see what further savings are necessary to achieve the financial goals of clients and their families.

The **liabilities** section lists the amounts of all the client's debts. For most clients the major liability will be a home loan which goes on for 15–20 years in most cases. The other liabilities may include outstanding credit card payments, personal loans and other loans (if any). For all loans, the client should be asked to show what protection plans, if any, are in place to pay off the outstanding debt in the event of the client's death, or to keep up interest payments during long periods of disability or unemployment. Where such cover exists, there is no need to deduct the liability from the assets when calculating amounts that are yet to be provided for.

Housing situation: The client's current housing situation will be a major factor in determining their financial planning needs.

In this section Amit's discussion with Kishore will include the following areas:

- Is he currently staying in rented accommodation? If so then the monthly rent is a major necessary expense.
- Does he own his own house? If so this will create potential expenses – e.g. utility bills, property tax, repairs etc.
- Does he have a home loan? This is a major necessary expense. Is it protected against death or illness?
- Does he aspire to buy a larger house or extend the current one? This may involve a larger home loan.

B2E Existing insurance and investments

In this section Amit will make a note of existing insurance plans and investments that Kishore has made.

Be aware

Existing policies and investments help to reduce the amount of financial provision required to meet the client's financial objectives.

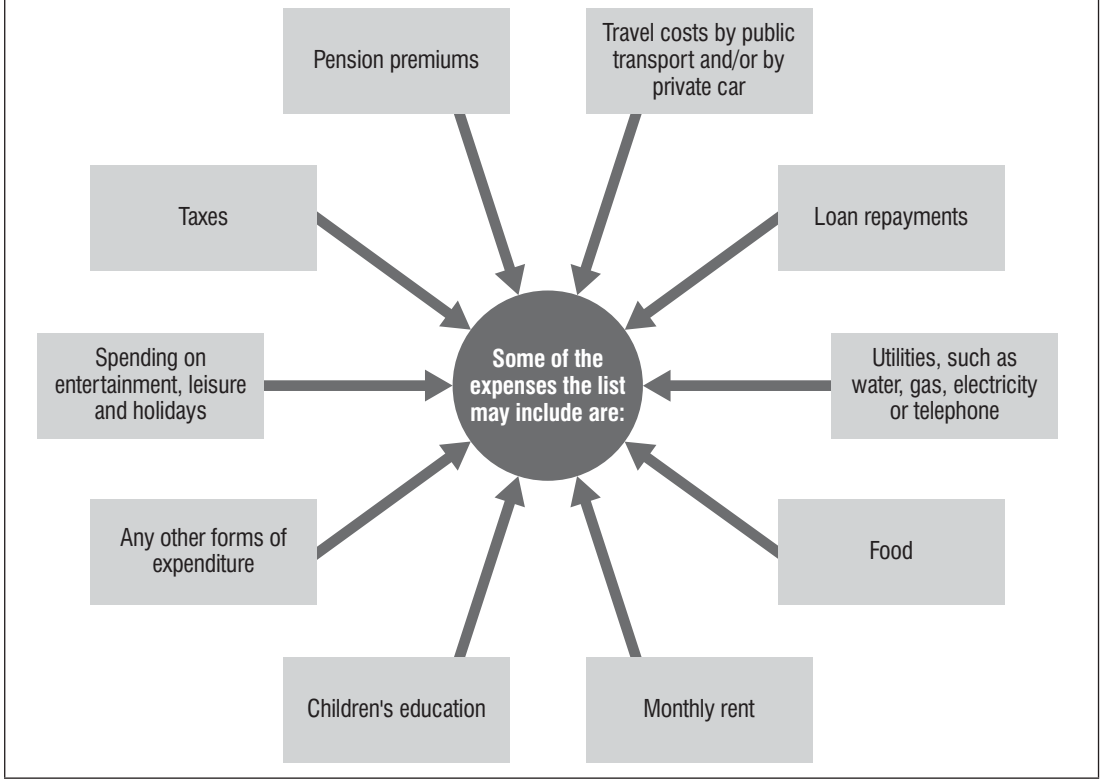
The agent will record the details of all the client's personal insurances, including life and health insurance, endowment policies, ULIPs and other forms of saving plans. For each insurance policy, this section requires the name of the insurer, the policy type, the nature and amount of the benefit, the premiums payable and the frequency of the payment. It will also ask for details of who pays the premiums, whose life is insured against disability or death and who are the beneficiaries under the policy. Any expiry or maturity date should also be noted.

B2F Monthly income and expenditure analysis

The purpose of the insurance agent doing a regular income and expenditure analysis is to identify the funds the client has available for contribution to financial planning products. An additional purpose is to enable clients to identify where they can best reduce existing expenditure, if this is necessary or desirable.

This section of the questionnaire will ask the client for total monthly income from all sources and, in the case of two earning members of the family, their joint incomes. The client will then be asked to list the main items of expenditure each month. Some of the likely expenses are:

Figure 9.2



B2G Financial planning objectives and considerations

In this section Amit will record Kishore's ambitions and concerns, both personal and for his family. The financial planning objectives section is one of the most important parts of all fact-finding questionnaires. The agent will record the client's specific longer-term plans, either personal and/or family.

The **existing provision** questions will ask how the client feels about the adequacy of their existing:

- life and health cover;
- disability insurance;
- spread of investments;
- level of regular saving; and
- retirement age and projected retirement fund.

A final question will ask which, if any, of the answers causes the client concern.

The other section asks what **plans and ambitions** the client has for their:

- family;
- children's education and marriage;
- changing homes in the future;
- career, occupation or business;
- investments and loan finance;
- retirement; and
- estate on death.

A supplementary question asking for any other aspirations will provide information on any unusual ambitions outside the standard range.

The objectives and considerations section will also provide space to list the client's financial planning priorities. Usually, priorities are indicated by a numerical ranking with one as the top priority. In practice, most people can only assess three or four priorities at a time. An attempt to prioritise a long list of needs is more likely to confuse than help them.

Be aware

One consideration that helps to determine the right choice of financial products to meet the client's needs is the client's ability to accept risk and withstand investment losses. Sometimes questionnaires provide space for the client's risk profile to be supplied in the client's own words. Increasingly, however, questionnaires offer a forced choice across a range of risk ratings. Typically, the risk rating range runs from zero to five, where zero represents an inability to take any risk and five indicates a willingness to take high risks.

This section will also record whether or not the client has written a will, the main provisions of any existing will, and any plans already made for tax-efficient disposal of the client's assets on death.

The objectives and considerations section of the questionnaire is not normally completed until the client and agent have discussed the purpose of objective-setting, the factors affecting the prioritisation of needs, and the relationship between investment risks and rewards. Only in this way can the client's answers be based on a clear distinction between real and perceived needs.

B2H Future changes

Whilst most of the information in a fact-find will be based on the current situation, possible future changes should not be ignored.

In this section Amit will ask Kishore about the possible future changes. These could include:

- inheritances (e.g. on death of a parent);
- birth of a child – leading to education costs and marriage costs;
- any plans to complete a professional, full qualification which may result in an increase in income;
- a possible change of career; and/or
- any other ambitions (e.g. foreign tours, accumulating a fund for charity or donations) which might require substantial expenditure.

C Assessment and analysis

The precise questions asked and the amount of information required varies considerably from one fact-find questionnaire to another. Equally, not all questions on a questionnaire will be relevant to the circumstances of every client.

In deciding which questions are relevant to any given client, the agent must keep the objectives of fact-finding clearly in mind. The purpose of seeking the information is to enable the agent to recommend financial products that meet the client's needs, objectives and personal profile.

For this purpose, Amit needs to be clear about the main categories of financial detail to be collected and summarised from his client Kishore. These will include:

- assets and liabilities;
- income, expenditure and savings;
- life and health insurance (including disability);
- retirement provision; and
- wills and inheritance plans.

This information determines how much existing provision there is to meet each major need and what resources are available to make up for any resulting gaps.

C1 Assessment

The key tasks of the agent include:

- identifying the amount to be provided for the needs of each client in each need area;
- identifying the client's affordable contribution;
- allocating this contribution to produce the best financial planning package currently available; and
- evaluating and reviewing the performance of the financial plan on a regular basis with the client.

The precise allocation of the available contribution among the different products will depend on the client's personal priorities.

C2 Analysis

To be of value the information on fact-finding questionnaires must be **properly recorded**. The diagnosis and quantification of needs requires the application of the agent's professional knowledge to the facts and opinions recorded on the questionnaire. At its simplest, needs analysis involves identifying whether or not the client has made sufficient financial provision to meet both predictable and unpredictable needs.

Example

After the fact-find has been completed, some of Kishore's predictable and unpredictable needs for which analysis is required by Amit include:

- Does Kishore have sufficient wealth or insurance cover to provide adequate income for dependants if he dies young?
- Is provision needed for a surviving spouse?
- Does Kishore have sufficient wealth, insurance cover or employer provision to maintain the same standard of living in the event of long periods of incapacity through illness, injury or even terminal illness?
- Does Kishore have adequate resources on which to live and to make interest payments on loans in the event of unemployment?
- How will medical treatment be paid for if Kishore, or members of his family, need expensive treatment, including hospitalisation?
- Has Kishore, or his employer, made adequate provision for his retirement income?
- What personal objectives does Kishore have for the future: provision of school or university fees for children, children's wedding costs, a new house, a trip round the world, starting his own business and plans for his retirement?
- If so, how much will the achievement of these personal ambitions cost and when is the money required?
- Does Kishore have any money set aside for these purposes already?

Many of the answers are on the fact-find form itself. For example, Kishore's current expenditure is a guide to the income needed on death, in ill-health and at retirement. A study of the existing insurance policies, assets and savings plans will show how much, or how little, provision has already been made. However, the fact-find form cannot tell us everything. Its content needs to be supplemented by knowledge of prices of the items the client wishes to provide or buy in the future, such as educational costs, house prices or travel costs.

Sometimes the duration of the period for which any life insurance will be required may be difficult to ascertain. The fact-find will show the ages of the children but not necessarily the period of their dependency. Typically, the policy needs to be in force until the youngest child is likely to complete their education. This age varies from one family to another. The 'objectives and considerations' section of the fact-find will indicate the client's aspirations for their children. It will also indicate whether or not continuing protection is needed for the surviving spouse after the children have grown up.

Question 9.2

List the various sections of a fact-find form.

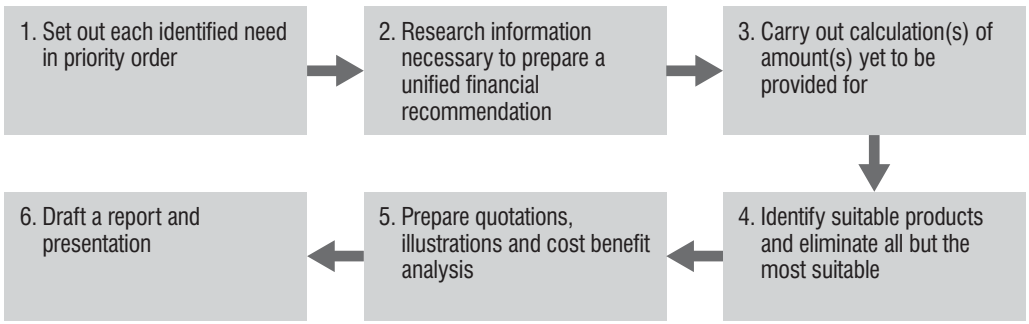
D Applying product features and benefits to a client situation

An additional objective of fact-finding is to identify products the client will need in the future and plan review dates to see when these can be funded. Without a full fact-find there is no way of knowing precisely what any individual's needs are. Even an individual who approaches an agent to buy a specific product should be offered a full fact-find to see if it is the type of product most suited to their specific needs. This is because perceived needs can be very different from real needs.

D1 Product shortlisting process

The process of analysing information and drafting recommendations for the client should be methodical and include a series of checks. After reviewing the client's fact-find questionnaire, the following stages are necessary:

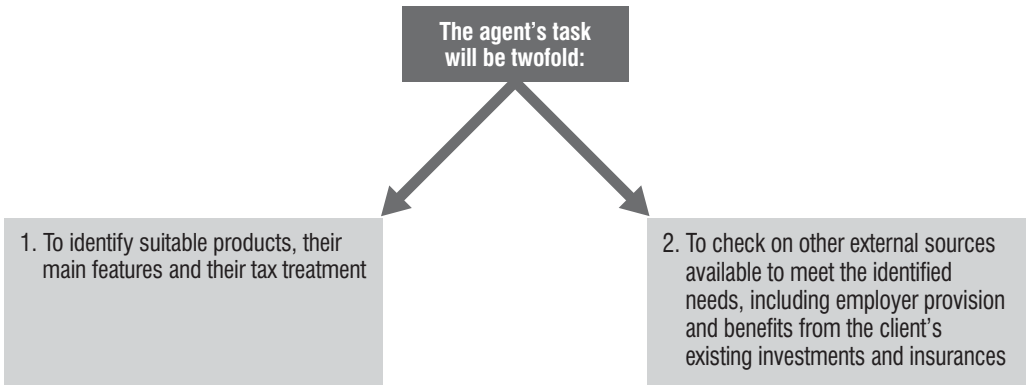
Figure 9.3



Professional conduct and expertise are required at each of these stages. Even the needs analysis has to identify the client's genuine and realistic needs from those that are only unattainable dreams. Each genuine need must have a sufficient value attached to it. If the value is overstated, the client will be paying for benefits that are not needed; if the value is understated, the benefit emerging will be insufficient to meet the need when it arises.

Agents may well have to amass and evaluate considerable volumes of information to find the most suitable solution for each separate need.

Figure 9.4

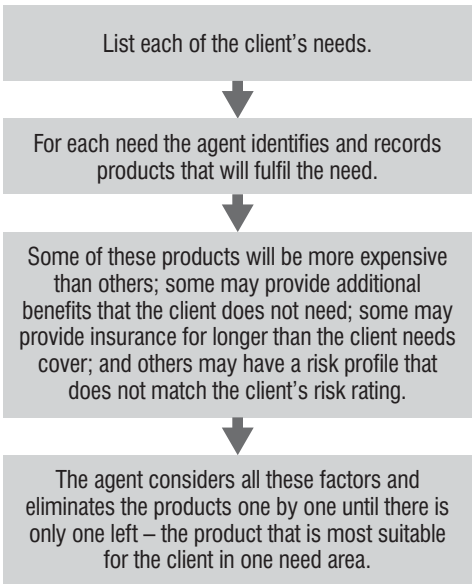


Much of this information is readily available. Indeed, the agent may already have the necessary brochures, charts and tables at hand to supplement the information on the fact-find.

D2 Product shortlisting for each need

One good method of selecting products for the client is to:

Figure 9.5



This process is repeated for each need area.

In preparing recommendations, agents will need to study quotations and product illustrations for the benefits their clients require. Where price is an important consideration, they have to locate the lowest cost product that will satisfy a given need. Only after studying the prices and benefits available is the agent in a position to select products and allocate the client's available resources in a balanced way across the product(s) recommended for each need area. The process is not easy; it requires great attention to detail and great professional care.

One of the agent's most difficult problems is what to recommend about the client's existing investments and insurances. The agent's final recommendation must certainly take existing provision into account, whether or not the client has been well-advised.

E Making recommendations

When all information has been assembled, discussed and analysed, the agent can fulfill the ultimate objective of fact-finding: to recommend the products or portfolio of products that best meets the client's needs for the contribution they can afford to pay now and sustain in the future.

As with fact-finding, good practice in making product recommendations requires a combination of efficient procedures and high ethical standards. What are the best solutions to the financial planning problems identified? Which alternative solutions are most cost-effective and tax efficient?

E1 Presenting recommendations to the client

Only when all the diagnostic work has been completed in a professional manner is the agent in a position to prepare a report for presentation to the client. Good practice principles apply both to the content of the presentation and to the skill with which it is delivered.

Be aware

Presentation skills are critical in securing acceptance of recommendations. Presentations need to be a two-way communication in which the client is fully involved by the agent.

Recommendations to clients are usually presented to the client orally at a meeting arranged especially for this purpose. During the meeting, the agent explains the proposals, shows the client the benefits and costs involved and, if the client accepts the proposals or revised proposals, helps the client to complete product application forms. For the agent to do this clearly and professionally, the presentation interview needs a structure.

E2 Recommendations: presentation structure

Once the client and agent have exchanged greetings, the normal structure of a presentation meeting should be as follows:

- check the client's commitment to the needs;
- outline the concept behind the detailed recommendations;
- outline the proposals in each need area;
- seek client authority to proceed; and
- complete the product documentation.

Checking the client's commitment to the needs is a simple but important procedure. It consists of reminding the client of the **needs** and **priorities** agreed, in principle, during fact-finding. The agent runs through each major need, in order, and asks the client to confirm that they are still areas of concern. Care needs to be taken to confine each need to a simple statement. Over-elaborate reminders will merely confuse the client, imply that changes may be necessary, or lead to another fact-finding session.

If, for any reason, the client's situation or concerns have changed, the agent may have to prepare a new set of proposals. Where, as usually happens, the agent has correctly interpreted the client's concerns and wishes, the agent can proceed with the planned presentation. Before explaining the recommendations in detail, the agent should **explain the concept** behind the proposals. This concept should be very closely linked to the client's needs and expressed concerns. Each item should be linked so that the client will subsequently appreciate how each detailed proposal fits into a single, coherent, overall plan.

Example

The concept for a family income provider with extensive protection needs and no existing insurance policies might be to ensure they keep a roof over their family's head in the event of their death or ill-health.

Or, for clients with large sums of money to invest, the concept might be to provide them with tax efficient income and capital growth through a balanced portfolio of guaranteed and risk investments.

It is important to confirm that the client agrees that the concept is the right approach before going into detail. At each stage of the presentation, the agent should show clearly how the detail fits in with the overall concept of the proposals. In outlining the **recommendation** for each need, the agent has a duty to see that the client understands the key features of the product recommended, why it is recommended and what limitations the product may have for the client.

Be aware

It is a failure of professionalism if the client is not aware of any restrictions or risks that may limit their right to benefits in the future or may involve them in an investment loss.

E3 Benefit illustration documents

In some circumstances there will be too much detail for it all to be covered in the main presentation. However, professional conduct requires that clients should understand the key features of each product recommended before a sale is completed. Many agents use **benefit illustration documents** (subject to IRDA guidelines) to show the client the nature of the product, its benefits and under what circumstances the benefit will be paid.

The benefit illustration also distinguishes between **guaranteed benefits** and **non-guaranteed benefits**. For non-guaranteed benefits, the benefit illustration shows the annual growth rate assumed (growth at the rate of 6% and 10% as per guidelines issued by the Life Insurance Council) for each projection and provides illustrations of investment values over different periods of time.

It is also usual to show the charges levied by the insurance company and the extent to which these reduce the investment return to the client during the period of the investment. It enables clients to make comparisons between one product and another.

E4 Know your customer

At the end of the presentation, the agent will sum up the proposals and seek the client's authority to proceed and complete the form filling and **know your customer (KYC)** formalities.

Know your customer (KYC)

Along with the completed form, the client needs to submit the premium cheque in the name of the insurance company and their identification documents as per the Know Your Customer (KYC) procedure. These include:

1. **photographs**;
2. **proof of identity** – some common documents accepted are a driving licence, passport, voter ID card, ID card for defence personnel, PAN card, any identification card issued by a government body etc; and
3. **proof of address** – some common documents accepted as proof of address are a driving licence, passport, electricity bill, telephone bill, premium receipt of any insurance company, ration card, bank passbook etc.

The list of documents accepted as proof of identify and address may vary among insurance companies.

Key points

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

What we need to know and why

- A fact-find shows the current financial position of the person, where they stand today and their anticipated future changes.
- A fact-find identifies a client's financial planning needs and points towards those needs that are the top priority for the client.
- Objectives of fact-finding include:
  - identifying needs;
  - gathering client data;
  - analysing client cash flows; and
  - providing for anticipated changes.

Using a fact-find

- A fact-finding form is divided into separate sections covering the client's details. These sections include:
  - personal details;
  - family details;
  - employment details;
  - financial details;
  - existing insurance and investments;
  - monthly income and expenditure analysis;
  - financial planning objectives and considerations; and
  - future changes.

Assessment and analysis

- Needs analysis involves identifying whether or not the client has made sufficient financial provision to meet unpredictable and predictable needs.
- During the assessment of a fact-find the key tasks of the agent include:
  - identifying the amount to be provided for the needs of each client in each need area;
  - identifying the client's affordable contribution;
  - allocating this contribution to produce the best financial planning package currently available; and
  - evaluating and reviewing the performance of the financial plan on a regular basis with the client.

Applying product features and benefits to a client situation.

- After analysing the fact-find information the agent applies product features to client needs and accordingly shortlists products that most suit the client's requirements.

Making recommendations

- When all information has been assembled, discussed and analysed, the agent can fulfill the ultimate objective of fact-finding: to recommend the products or portfolio of products that best meets the client's needs for the contribution they can afford to pay now and sustain in the future.
- Only when all the diagnostic work has been completed in a professional manner is the agent in a position to prepare a report for presentation to the client.
- The product recommendation presentation should have a proper structure.
- Once the recommendation presentation is over, the agent should sit with the client and clarify if they have any doubts. If not the agent should proceed with completing form-filling formalities.
- The agent can use the benefit illustration document to show the client the projected growth (at the rate of 6% and 10%) of investments.
- Along with the duly filled form the client needs to issue a cheque in the name of the insurance company and the KYC documents.

Question answers

9.1 The objectives of a fact-find are:

- identifying needs;
- gathering client data;
- analysing client cash flows; and
- providing for anticipated changes.

9.2 A fact-find form is divided into separate sections covering the client's details. These sections include:

- personal details;
- family details;
- employment details;
- financial details;
- existing protection and savings plans;
- monthly income and expenditure analysis;
- financial planning objectives and considerations; and
- future changes.

Self-test questions

1.	Explain the overall product shortlisting process.
2.	Explain briefly the structure of a meeting to present and recommend products to a client.
3.	According to Life Insurance Council guidelines, in a benefit illustration document what can be shown as the annual assumed growth rate for investment values?

You will find the answers on the next page

Self-test answers

1.	The process of analysing information and drafting recommendations to the client should be methodical and include a series of checks. After reviewing the client's fact-find questionnaire, the following stages are necessary: • set out each identified need in priority order; • research the information necessary to prepare a unified financial recommendation; • carry out calculations of the amounts yet to be provided for; • identify suitable products and eliminate all but the most suitable; • prepare quotations, illustrations and cost benefit analyses; and • draft a report and presentation.
2.	Once client and agent have exchanged greetings, the normal structure of a presentation meeting should be as follows: • check the commitment to the needs; • outline the concept behind the detailed recommendations; • outline the proposals in each need area; • seek client authority to proceed; and • complete the product documentation.
3.	For non-guaranteed benefits, the benefit illustration shows the annual growth rate assumed (growth at the rate of 6% and 10% as per Life Insurance Council guidelines) for each projection and provides illustration of investment values over different periods of time.

10
Good client practice

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Learning objectives

After studying this chapter, you should be able to:

- discuss the duties and responsibilities of an agent;
- describe the requirements of clients;
- describe the methods of remuneration for agents;
- explain why it is unethical to advise a client to switch between products or providers, unless it is clearly in their best interests to do so;
- discuss the need for building long-term relationships with clients.

Introduction

Insurance agents are some of the most important intermediaries for selling life insurance products. Agents have a duty to provide the best available product solutions to their clients based on the clients' needs and requirements. They also have a duty towards the insurance company to protect it from adverse selection, as they are in the best position to judge the risk profile of their own clients.

There is an increasing awareness that insurance agents must behave in a professional way towards their clients at all times. High standards of professional conduct are in the best interests of the insurance industry itself as well as in the interest of the public it serves.

The major characteristics of all professions are as follows.

Their members:

- are committed to behaving ethically towards clients;
- adhere to a professional code of conduct;
- adhere to minimum standards of professional competence; and
- show a commitment to continuous professional development.

These requirements are as essential for insurance industry professionals as they are for doctors, lawyers and accountants, and the IRDA has laid down the Code of Conduct to ensure that all agents behave in an ethical manner towards their clients. We will look at the Code in more detail in chapter 15.

In this chapter we will discuss the duties and responsibilities that an insurance agent has towards his clients and insurance company. We will also discuss the importance of building long-term relationships with clients.

Key terms

This chapter features explanations of the following terms and concepts:

Agent's duties and responsibilities	Client requirements	Agent remuneration	Disclosures
Recommendations	Acceptance and rejection of a policy	Churning	Switching
Persistency	Policy servicing	Client rights	Long-term relationships
Disclosure methods	Prioritisation of needs	Suitable products	Benefit illustration documents

A The duties and responsibilities of an insurance agent

Insurance agents are responsible for selling life insurance products to clients, and agents must obtain a licence from the IRDA. Section 42 of the **Insurance Act 1938** defines an insurance agent as:

> a person who is licensed under section 42 of the Insurance Act, in consideration of his soliciting or procuring insurance business, including business related to continuance, renewal or revival of policies of insurance.

An insurance agent's duties and responsibilities include establishing the client's needs and identifying the most suitable products to meet those needs. However, the agent's role does not end there. The agent has to see the policy through from inception until its maturity and/or from when a claim is made until it is settled.

An insurance agent acts as an intermediary between the insurance company and the client and has the responsibility of obtaining business for his company. An agent also represents his clients, and therefore he has to make sure that he does not mislead them in any way and that he always works in their best interests. The insurance agent is the insurance company's main contact point with clients, and he has to ensure that he collects all the necessary information about them that the insurance company will need.

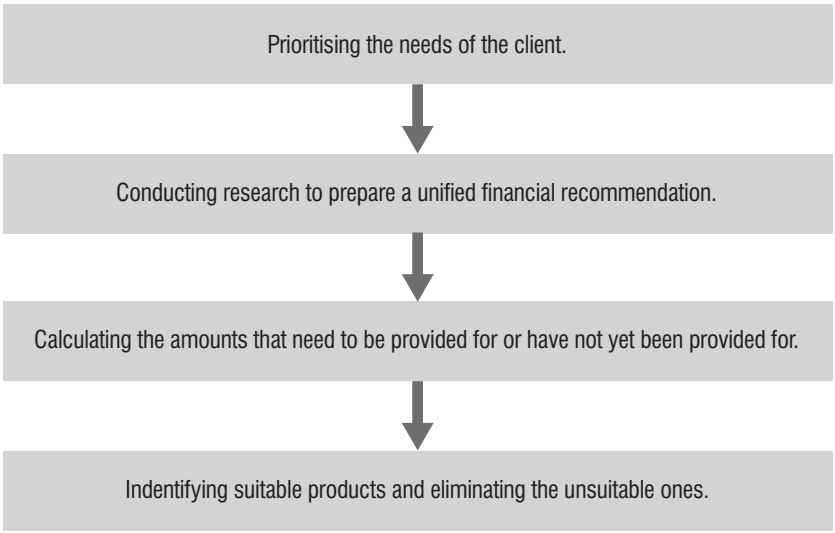
The main duties and responsibilities of an insurance agent can be summarised as follows:

- To identify prospective clients for the insurance company and to perform a needs analysis to identify their different needs.
- To have an excellent knowledge of the various insurance products offered by the insurance company and to understand the different benefits and features offered by each product.
- To suggest appropriate products to clients based on their needs and investment capacity.
- To ensure that the proposal form is correctly filled in and that all the information provided by clients is correct.
- To be responsible for collecting the necessary documents such as proof of age, identity and address, medical reports and any other documentation required for underwriting.
- To disclose to clients the premiums and various fees that will be charged for each of the insurance plans offered by the insurance company.
- To disclose the scales of commission in respect of the insurance product offered for sale, if asked for by the prospective client.
- To ensure the remittance of premiums by the policyholder within the stipulated time by giving notice both orally and in writing, and to collect the premiums from clients if they are authorised to do so by the respective insurers.
- To help underwriters in assessing the risk presented by the proposer by providing information about any adverse habits, income inconsistencies and other material facts that are contained in the agent's confidential report.
- To help clients to make any necessary changes on the proposal form such as address, nomination etc.
- To help legal beneficiaries and nominees with the claims settlement process when a claim arises.

B Requirements of the client

We have already seen in chapter 8 that the insurance agent must recommend suitable products for the client, and that before he does this he should have a clear understanding of the client's needs and requirements. The process of identifying and analysing the client's information and suggesting suitable products should be methodical and involve a series of checks. After the fact-find, the following stages are necessary:

Figure 10.1



C Agent remuneration and upfront disclosure methods

In this section we will discuss agent remuneration and disclosure methods as recommended by the IRDA.

C1 Remuneration methods

The remuneration of life insurance agents is governed by IRDA regulations. A life insurance agent receives his remuneration by way of commission. This commission is a certain percentage of the premium that is collected by the insurance company. The **Insurance Act 1938** stipulates the maximum amount that can be paid to an insurance agent by way of commission or any other form, the details of which are as follows:

- An insurance agent can receive a maximum of 35% of the first year's premium, 7.5% of the second and third year's renewal premium, and 5% of the subsequent years' renewal premium. (This does not apply to immediate or deferred annuities.)

- During the first ten years of the insurer's business, an insurance agent can be paid a maximum of 40% of the first year's premium, instead of the stipulated 35%.
- Commission on renewal premiums due to the agent must not exceed 4% in any case. The Insurance Act, section 44, states the following conditions on agents (whose agency has been terminated) for receiving commission on the renewal premium:
  - the agent should have been working with the insurer for more than five years and policies of not less than Rs. 50,000 sum insured are in force at least one year before the termination of the agency; or
  - the agent should have been working with the insurer for at least ten years and, after ceasing to act as an agent, are not directly or indirectly soliciting or procuring insurance business for any other person.

In the case of an agent's death, the commission is payable to his legal heirs.

An insurance company can make payments to its agents within the prescribed limits. Generally, commission rates for term plans are lower than those for other plans such as whole life plans. Also, polices with shorter term periods provide less commission compared to policies with longer term periods. Under single premium plans, annuity and pension plans the commission rates are lower.

C2 Disclosures

An insurance agent must disclose the amount of remuneration and commission he receives as a result of effecting insurance for a client, on demand.

With effect from 1 July 2010 all insurers have to disclose explicitly in the benefit illustration document, the commission they pay to their agents for ULIPs. This circular was issued by the IRDA in which it was made mandatory for the agent to obtain a signed copy of the benefit illustration document together with the proposal form from the client.

The benefit illustration documents show the details of charges and growth of the fund expected over the duration of the policy as per the Life Insurance Council's assumed growth rate of 6% and 10%.

According to the IRDA, disclosure will help in increasing the transparency in the selling of life insurance products by providing clients with details regarding the exact amount of commission that is being paid to insurance agents as well as charges applicable on the policy.

?

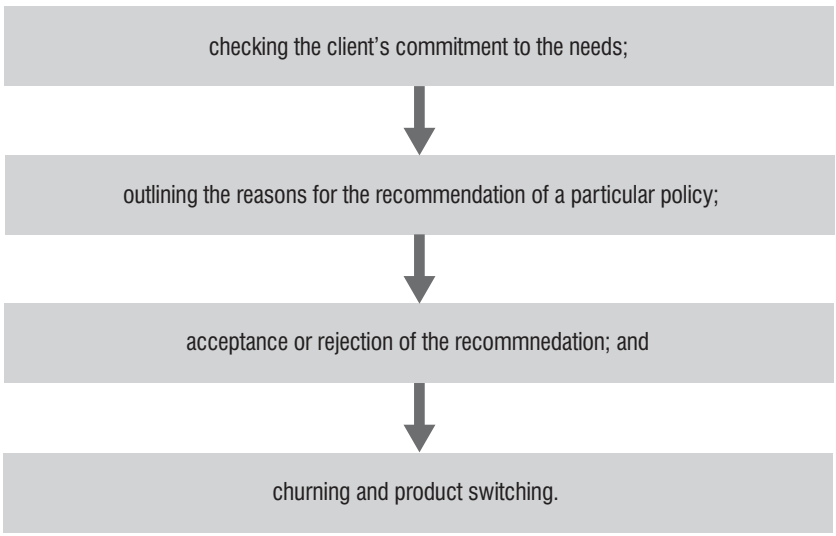
Question 10.1

List three duties or responsibilities of an insurance agent.

D Recommending suitable policies

Once the insurance agent has identified suitable products for the client's respective needs, he can recommend selected policies to them. In this section we will discuss the different issues that may arise on the recommendation of suitable policies to clients with regard to:

Figure 10.2



D1 Checking the client's commitment to their needs

Checking the client's commitment to their needs is an important procedure. This involves reminding the client of the needs that were agreed during the fact-finding process. The agent should go through each need and ask the client to confirm that they are still areas of concern.

If the client disagrees with the prioritised needs, the agent will have to revise the financial plan. If the client agrees with the set of needs, then the agent can go ahead with the recommendation of suitable products and policies.

D2 Outlining the reasons for the recommendation of a particular policy

Before explaining the recommendation in detail, the agent must explain the reasons for recommending a certain policy. The reasons should be closely linked to the client's needs and concerns as expressed during the fact-find process.

The agent should ensure that the client is able to understand the key features and benefits provided by the policy. He also needs to present a chart comparing the policy with other available policies so that the client is able to compare the recommended policy against others.

Client feedback should be taken at each stage of the recommendation. Once a policy has been recommended and its features and benefits have been explained, the agent should ensure that the client agrees with it. Where the client is apprehensive or has certain concerns, they must be addressed immediately.

D3 Acceptance or rejection of the recommendation

If the client accepts the recommendation, then the agent should ask the client to fill in the proposal form.

If the client disagrees with the recommendation, the agent must ask further questions to find out the reasons for the refusal. Recommendations can be rejected for the following reasons:

Figure 10.3

The client does not wish to proceed with financial planning at the moment and wants to take time to consider their options before making an investment. In this case the agent can ask to contact the client at a future date.	The client is not satisfied with the recommended products. In this case, the products will have to be reviewed according to needs of the client.

Good questioning techniques (which we looked at in chapter 8) can help agents in finding out the real reasons for why a recommendation has been rejected, and may help in resolving the issue thus leading to the recommendation being accepted. Failing this, the agent must respect the client's right to decline and should seek permission to re-approach the client at a future date.

The agent can also ask for some references from the client such as the names and contact details of any relatives, friends and acquaintances who might be interested in financial planning. These references are important selling opportunities for the insurance agent.

D3A What should an agent do if a client accepts some but not all of their recommendations?

There can be cases where the client may tell the agent to ignore a large protection need and instead invest the money available into a savings plan; or the client may reject advice to invest capital in a low risk investment product and instruct the agent to buy a high risk investment product that is performing well at the moment (but that may not do so in the future).

In this case the agent should try to convince the client to follow his recommendation by elaborating on the reasons as to why that product has been selected. However, if the client still wishes to act against the agent's advice, the agent should express his readiness to carry out the client's instructions, although it should be made clear that the transaction is not recommended by the agent.

The client's decision to act differently from the agent's recommendations may emerge at two different stages:

- during the presentation; or
- during the fact-finding interview;

and the agent needs to address the client's apprehensions as and when they arise.

D4 Churning and product switching

There has been increasing concern in the insurance sector about product switching, though this is now being brought under control by the proactive efforts of the Regulator (the IRDA) and with the growth of professionalism among intermediaries.

D4A Churning

Repeatedly encouraging clients to switch policies or investments from one to another is known as churning. Insurance churning is a practice in which agents recommend that clients surrender their existing policy and use the funds to purchase a new policy, thereby allowing agents to earn a higher commission on the new policy. It is an unprofessional and unethical practice that results in clients suffering losses in the form of surrender charges and reduced long-term benefits if their policies are not kept held until maturity.

Case study

Sunder Singh is a 38-year-old self-employed businessman, who owns an electronics shop. His wife is a homemaker and they have two sons. Five years ago he purchased an endowment insurance plan with a sum insured of Rs. 10,00,000.

One day he is approached by an insurance agent who recommends that he should invest in the latest savings insurance plan that has been launched by his company, which provides a guaranteed return along with life insurance cover. Sunder declines the offer and tells the agent that he has already invested in an endowment insurance plan which provides him with insurance cover.

On hearing this, the agent asks for more details about Sunder's existing product. He then carries out a needs analysis and calculates that Sunder's need for insurance cover is higher. He tells Sunder that the product that he is offering is also an endowment insurance plan which will provide a sum insured of Rs. 15,00,000.

The agent advises Sunder to surrender the existing endowment policy and to use the funds to invest in the policy that he has recommended as it will provide a higher sum insured. Sunder eventually agrees with the agent's recommendation and surrenders his existing policy to invest in the new one.

This is a case of insurance churning where:

- the insurance agent did not tell Sunder that for a higher sum insured he would be paying a higher premium as well;
- Sunder's age has increased so the premium for the same term will be higher than before; and
- Sunder will have to bear the surrender charges for surrendering the existing policy.

So in order to achieve his short-term sales target, the insurance agent has not given Sunder good advice and this has resulted in Sunder incurring losses.

D4B When product switching is suitable

There will sometimes be situations where clients have been mis-sold policies that do not match their needs. There will also be times when clients are holding products that are not good value for money, and others where clients are facing financial difficulties and may desperately need to reduce expenditure or reschedule their debts. Unfortunately in these situations clients are often all too willing to cancel existing policies and they may even volunteer to do so. In such circumstances it may be acceptable, as a last resort, to advise a client to surrender a product and, possibly, take out a more appropriate one. **However, such advice should only be given where a switch is clearly in the client's best interest**. Even then, no surrender or switch should ever be recommended until the agent has explained what the client will lose as well as what the client may gain from the change.

Case study

Omi Shrivastava is a 31-year-old individual working for a multinational company (MNC). Omi is married and has a three-year-old daughter, Deepika; his wife is a housewife. Omi and his family are staying in a rented apartment although he has been planning to buy a house for some time now. He is in the process of accumulating money for the down payment but has had little success so far. Omi also wants to start investing for Deepika's higher education and marriage. He has been planning to do this for some time now but again has not able to make a head start on this.

Omi is in a dilemma. He has been working since the age of 23 and in the past eight years he has been approached by several insurance agents and under the pretext of saving tax he has been mis-sold several endowment, term and money-back policies which he actually doesn't need. Omi has six life insurance policies for which the total annual premium is Rs. 1,10,000. These six life insurance policies together give Omi a total cover of only Rs. 50 lakhs. Considering Omi's age, his income protection needs and his other responsibilities (such as buying a house and saving money for Deepika's education and marriage) he needs an insurance cover of at least Rs. 1 crore. Also the total annual premium of Rs. 1,10,000 is putting tremendous pressure on Omi's cash flows in the following ways:

- Omi doesn't have the required amount of protection cover that he actually needs even after making such a large premium payment.
- At the same time, the large premium payment is deterring Omi from proceeding with his other essential financial goals like buying a house and investing for Deepika's education and marriage.

One day he is approached by an insurance agent to review his current investment and protection needs and to make a customised financial plan for him. Omi agrees and provides all necessary information to the agent. The insurance agent does a fact-find with Omi and after a preliminary analysis concludes that the six policies that Omi has are not providing him the required protection and they are also deterring him from meeting his important financial goals.

The agent advises Omi to do the following:

- Hold on to the two money-back policies which are going to mature in the next two years and to continue paying premiums for them. He also advises him to use the maturity proceeds of the policies for the down payment on the house. Once the policies mature the money that will be freed from premium payment can be utilised towards paying the EMI for the home loan.
- Continue with the term policy as normal. The agent advises him to buy one more term policy with a cover of 75 lakhs so that he can have a total cover of Rs. 1 crore.
- Convert the remaining three endowment policies into paid-up policies. The money that will be freed up from the premium payments can be used to buy a child ULIP (unit-linked investment plan) for Deepika's education and marriage. Through a ULIP Omi can get exposure and participate in the growth of the capital markets which can give him good capital appreciation in the long term.

The insurance agent presents a full illustration to Omi regarding the pros and cons of rearranging his investments. He also informs him that his existing money in the three paid-up endowment plans will be locked-in until maturity but at the same time he will be free from the obligation of having to pay high premiums for these three plans. The agent also produces a comparative chart of the returns that Omi will receive after 15-20 years from the ULIP. The agent makes a benefit illustration document as per the Life Insurance Council guidelines and presents it to Omi.

Omi realises that he has indeed made a wrong investment choice by choosing to make tax savings over his other important needs. He decides to go ahead with the new financial plan made by the insurance agent based on his protection needs and financial goals.

E The long-term benefit of retaining policies and avoiding short-term cancellations (persistency)

Persistency refers to the amount of business that insurance companies are successful in retaining without lapse or surrender of the policy. It can be calculated as follows:

$$\text{Persistency} = \frac{\text{The number of policies remaining in force at the end of the year}}{\text{The total number of policies in force at the beginning of the year}}$$

Agents play an important role in maintaining a high persistency ratio.

A low persistency ratio affects the whole insurance industry adversely:

- **for the insurance company** it means that a large number of policies have lapsed or have been surrendered, resulting in a loss of profits and a reduction in the accumulation of reserves;
- **for clients** it means fewer benefits than originally expected and a loss of insurance cover; and
- **for agents** it means the loss of renewal commission.

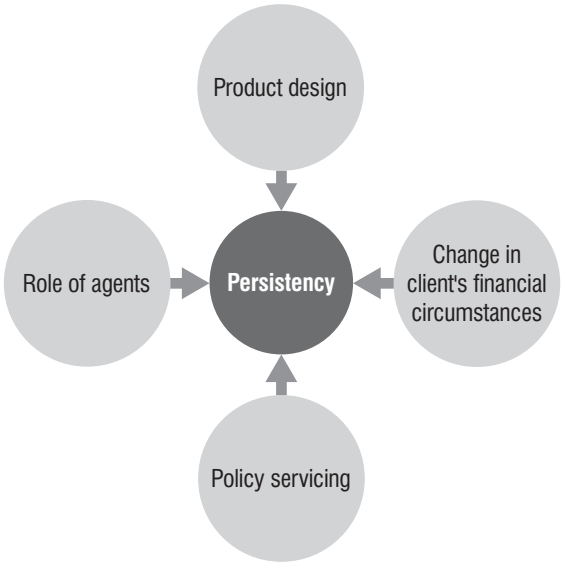
E1 Benefits of persistency

The insurance company, agent and client all benefit by retaining policies and avoiding early surrenders for the following reasons:

Helps the client in achieving goals	Keeping the policy in force until maturity helps the client in achieving the ultimate goal for which the policy was bought, such as meeting children's education expenses or marriage expenses or building the required retirement fund.
Increased revenues	Higher persistency helps the insurance company in earning higher revenues and maintaining profitability.
Reduction in costs	Administrative costs and other expenses are high in the initial years of the policy for the insurance company. The company tries to spread this cost over the term of the policy. If the client surrenders a policy in the initial years, then the insurance company will not be able to recover its expenses. Hence maintaining a high persistency ratio helps the insurance company to reduce its costs.
Increased client satisfaction	Higher persistency results in increased client satisfaction which helps to develop a positive brand value for the company.

E2 What are the different factors that can affect persistency?

Figure 10.4



We will discuss each of these factors in turn.

- **Product design**
  If the client is unsatisfied with the benefits and returns they are getting from their policy then they might decide to surrender it. Insurance companies must design products based on the real needs of their clients to avoid policy lapses and surrenders.
- **Change in the financial circumstances of the client**
  There can be a change in financial circumstances of the client due to unemployment, disability or health-related issues. As a result of this they may not be in a position to pay the premiums on time and so this will result in a policy lapse.
- **Policy servicing**
  Insurance agents should ensure that they maintain regular contact with clients and remind them when premium payments are due. In cases where the client is unable to pay the premium on time, then they should be asked to pay the premium within the grace period. The insurer has to ensure that the benefits that were promised are actually delivered to the client. If the insurer fails to do so, then the client can become dissatisfied with the service and can choose to surrender the policy.
- **Role of agents**
  Agents play the most important role in maintaining high persistency. Insurance agents should build a good rapport with their clients and should place emphasis on recommending products that are the most suitable for their clients' needs, and not on the basis of the amount of commission they are likely to receive.

E3 What are the different methods for maintaining high persistency?

The different methods that can be used by an insurance company for maintaining high persistency are as follows:

Flexibility in premium payment	Clients should be provided with the choice of different premium payment methods such as: cheque, cash, demand draft, online transfer of funds, electronic clearing system (ECS), credit/debit card, collection of premiums by authorised insurance agents/advisers, e-seva centres etc.
Constant reminder of due premium dates	This is especially important in the case of an annual premium payment, as the client may forget due to the long gap between the payment dates. Clients should be reminded in advance about their premium due dates by sending them emails, reminder letters by post, telephone calls, SMS/text message or a combination of these. The insurance company can also provide a pick-up service by sending its representative to collect the premium cheque from the client's home or office.
Continuous contact with clients	The agent should be in continuous contact with the clients by way of informing them of new products launched in the market that could be purchased to cater for their different needs. It is important that the agent develops a good relationship with the client so that high persistency can be maintained.
Policy servicing	Continued communication with the client should be maintained by way of policy servicing if the client needs any assistance, for example to make a change to the nominated beneficiary, changing the contact address, frequency of premium payments etc.

Question 10.2

Briefly explain what churning means.

F Clients' rights and complaints procedures

When a client purchases a life insurance plan, they purchase it with the intention of receiving certain benefits promised by the insurance company at the time of purchase. Where the client does not receive these benefits during the tenure of the policy or on maturity and is dissatisfied with the service, or has a query or problem which has not been addressed, they have the right to raise a grievance/complaint.

This is clearly a very important area for insurance companies and their agents, and we will look at it in detail in chapter 14 when we discuss the issue of customer protection.

Question 10.3

What are the benefits of high persistency?

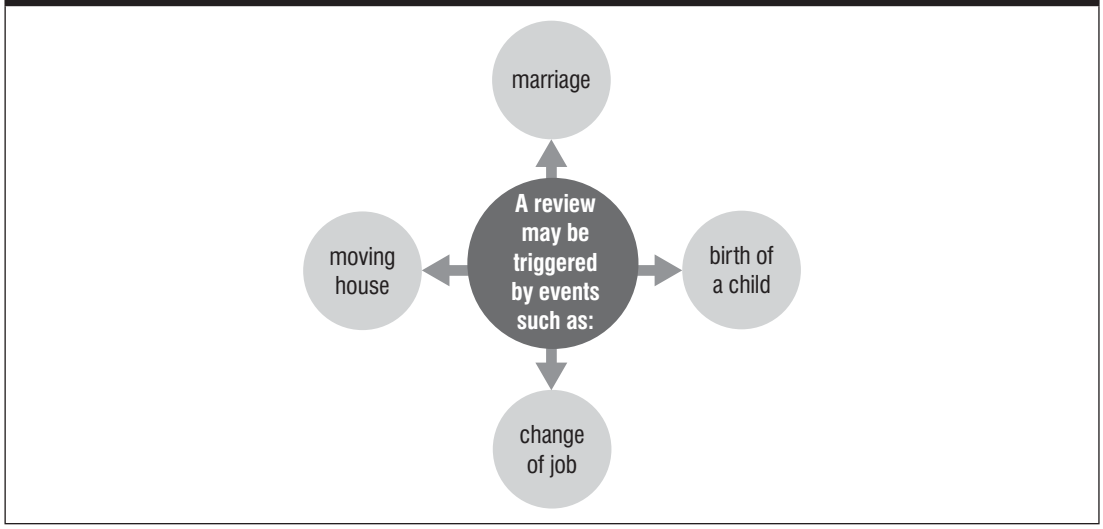
G Building long-term relationships with clients

Insurance companies should aim to build long-term relationships with their clients instead of focusing on short-term sales. A satisfied client may be the source of other potential clients as they will speak positively about the agent and the insurance company.

Once recommendations have been made and the relevant transactions carried out, it should not be the end of the matter for an insurance agent. It is much better to have an ongoing relationship with the client that is beneficial for both parties. Thus many agents have an ongoing system to review their clients' financial needs and financial planning.

Reviews could be irregular but triggered by relevant events, such as tax or legal changes, the introduction of a new insurance product or a change in a client's circumstances.

Figure 10.5



These changes could lead to recommendations to:

- take out new protection contracts;
- increase existing levels of protection;
- switch investments; or
- alter existing tax saving plans.

Consider this

What changes in a client's circumstances may generate the need to review their financial planning? What recommendations can be suggested in response to these changed circumstances?

Key points

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

Insurance agent's duties and responsibilities

- An insurance agent's main duties and responsibilities include establishing the client's needs and identifying the most suitable products to meet those needs. At the same time he should ensure that there is no adverse selection for the insurer.

Requirements of the client

- Once the fact-finding process for the client is complete, the insurance agent has to suggest suitable products to the client. In order to do this he should have a full understanding of the client's needs and requirements.

Agent remuneration and disclosure

- Remuneration of life insurance agents is governed by the Insurance Act 1938 regulations.
- A life insurance agent receives his remuneration in the form of commission.
- An insurance agent must disclose the amount of remuneration/commission he receives as a result of effecting insurance for a client, on demand.
- With effect from 1 July 2010, for ULIPs, all insurers have to disclose explicitly the commission they pay to their agents in the benefit illustration documents.

Recommending suitable policies

- Before recommending policies to clients, the agent should confirm their list of needs to check that they are still areas of concern for the client. Once the needs are agreed upon, suitable products along with their benefits should be explained to the client.
- Repeatedly encouraging a client to switch policies or investments is known as churning. This is unethical practice and should be avoided.

The long-term benefits of retaining policies and avoiding short-term cancellations (persistency)

- Persistency refers to the amount of business that insurance companies are successful in retaining without policy lapses and surrenders.
- Higher persistency helps the company in maintaining profitability and reduces administrative costs.

Clients' rights and complaints procedures

- Clients have the right to raise grievances/complaints about the service they have received from life insurance companies and their agents.

Building long-term relationships with clients

- Insurance companies should aim to build long-term relationships with clients instead of focusing on short-term sales.

Question answers

10.1 Any three from the following:

- To find prospective clients for the insurance company and to perform a needs analysis to identify their different needs.
- To have sufficient knowledge of the various insurance products offered by the insurance company and to understand the different benefits and features offered by each product.
- To suggest appropriate products to clients based on their needs and investment capacity.
- To ensure that the proposal form is correctly filled in and all the information provided by clients is correct.
- To be responsible for collecting the necessary documents such as proof of age, identity and address, medical reports and any other documentation required for underwriting.
- To disclose the scales of commission in respect of the insurance product offered for sale, if asked for by the prospective client.
- To ensure the remittance of premiums by the policyholder within the stipulated time by giving notice both orally and in writing, and to collect the premiums from clients, if they are authorised to do so by the respective insurers.
- To help underwriters in assessing the risk of the proposer by providing information about any adverse habits, income inconsistency and other material facts that are contained in the agent's confidential report.
- To help the clients in making any changes in the form such as address, nomination etc.
- To help the legal beneficiaries and nominees with the claim settlement process when a claim arises.

10.2 Repeatedly encouraging clients to switch policies or investments from one to another is known as churning. Insurance churning is a practice followed by agents, in which they suggest that clients surrender their existing policy and use the funds to purchase a new policy, thereby allowing agents to earn higher commission on the new policy. It is an unprofessional and unethical practice followed by agents with the result that the clients suffer losses in the form of surrender charges and reduced long-term benefits if their policies are not kept in force until maturity.

10.3 The insurer, agent and client all benefit from retaining policies and avoiding short-term surrenders.

- **Helps the client in achieving goals**. Keeping the policy in force until maturity helps the client to achieve the ultimate goal for which the policy was bought, such as meeting their children's education and/or marriage expenses or building the required retirement fund.
- **Increased revenues**. Higher persistency helps the insurance company in earning higher revenues and maintaining profitability.
- **Reduction in costs**. Administrative costs and other expenses are high in the initial years of a policy for the insurance company. The company tries to spread this cost over the tenure of the policy. If the client surrenders the policy in initial years, then the company will not be able to recover its expenses. Hence maintaining a high persistency ratio helps the insurance company to reduce its costs.
- **Increased client satisfaction**. Higher persistency results in increased client satisfaction which helps to develop a positive brand value for the company.

Self-test questions

1.	List three changes to a client's circumstances that may generate the need to review their financial planning.
2.	Under what circumstances can the surrender of a policy be recommended by an agent?

You will find the answers on the next page

Self-test question answers

1.	Three from: • marriage; • birth of a child; • change of job; or • moving house.
2.	The circumstances where policy surrender can be recommended are as follows: • There may be situations in which clients have been mis-sold policies that do not match their needs. • There may be times when clients are holding products that are not good value for money. • There may be times when clients are facing financial difficulties and so they may desperately need to reduce expenditure or reschedule their debts.

11
Claims

Contents	Syllabus learning outcomes
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D Settling claims	11.5
E Fraudulent claims	11.6, 11.7
F Void and voidable contracts	11.8
Key points	
Question answers	
Self-test questions	

Learning objectives

After studying this chapter, you should be able to:

- define a claim;
- identify the different types of claims;
- discuss the requirements of a valid claim;
- recognise invalid claims;
- list the documents required to be submitted to settle a death claim;
- describe early death claims;
- explain the process of settling maturity, survival and death claims;
- recall the IRDA guidelines pertaining to the settlement of claims;
- state the consequences of settling a fraudulent claim;
- distinguish between contracts that are void and voidable;
- explain the indisputability clause in life insurance.

Introduction

When making a decision on buying life insurance, clients will take a number of factors into account. These include the:

- pricing of the product;
- features of the product;
- likely returns that will be offered by the product compared to other insurance and investment products;
- flexibility offered in terms of plan term, premium payments, liquidity etc.;
- tax benefits offered by the product; and
- level of customer service provided by the company.

All these factors play an important role, but one very important aspect, which few people pay attention to, is how the insurance company handles and settles claims. What good is an insurance product during the lifetime of a policyholder, if the nominee/beneficiary/assignee is not able to receive the claim from the insurance company in a reasonable time and with ease? The real test of an insurance company and an insurance policy comes when the policy becomes a claim. People take out insurance because they worry about the possibility of misfortune. Ultimately, the 'value' of insurance will be judged, by most individuals, on the way in which their claim is handled.

While the IRDA has laid down broad guidelines for claims settlement, it depends on individual companies and their claims handling staff how quickly and efficiently they respond to a claim when it arises and how soon they settle it. The claims settlement ratio (how many claims are settled to every 100 claims arising) is also one of the benchmarks on which an insurance company is judged. So claims handling and settling assumes a great deal of significance.

In this chapter you will learn all about claims, their types and their settlement. You will learn about valid and invalid claims and what you should do when one of your clients' policies becomes a claim.

Key terms

This chapter features explanations of the following terms and concepts:

Claims	Maturity claims	Survival benefit payments	Death claims
Valid claims	Policy not in force	Breach of policy condition	Fraudulent claims
Claim documents	Early death claims	Presumption of death	Void contracts
Voidable contracts	Indisputable contracts	Claimant's statement	Rider benefits
Return of premium (ROP)	Terminal bonus		

A Requirements for a valid claim

Before discussing the requirements for a valid claim let's look at what a claim is and what the different types of claims are.

A1 What is a claim?

A claim is a demand that the insurer redeem the promise made in the contract. The insurer then has to perform its part of the contract, i.e. settle the claim, after satisfying itself that all the conditions and requirements for the settlement of the claim have been complied with.

We will look at three main types of claim in this section – **maturity claims**, **death claims** and **rider benefits**.

A2 Maturity claims

Some life insurance plans, such as endowment plans and whole life plans, promise to pay the insured a specific amount at the end of the plan, if they survive for the plan's entire term. This amount is known as the maturity benefit amount or the maturity claim amount. The amount payable on maturity is the sum insured plus any accumulated bonuses, minus any outstanding premiums and interest thereon.

In some cases the premiums paid over the tenure of the plan are returned on maturity. These plans are termed as '**return of premium**' (**ROP**) plans by some insurers.

Example

Ajay has bought a participating endowment plan with a sum insured of Rs. 25 lakhs that will run for 30 years. Under the terms of this plan, if Ajay survives until the end of the 30 years, and has paid all the premiums, the insurance company will pay him the maturity benefit amount or maturity claim of Rs. 25 lakhs along with the accumulated bonuses (if any).

On maturity the insurance company may also pay Ajay a one-time terminal bonus in addition to the accumulated bonuses that are declared year after year. This bonus is paid to encourage policyholders to continue with the policy for the full term and to pay the premiums regularly on time.

The terminal bonus is also known as the final additional bonus (FAB) or loyalty or persistency bonus. It may be fixed by some insurance companies at the beginning of the policy, or alternatively it will depend on the financial performance of the insurance company over the life of the policy. It is paid provided the premiums have been paid for a specified period (usually at least 15 years).

In the case of ULIPs, the insurance company pays the fund value (or in some cases the fund value and sum insured) as the maturity claim, at the end of the plan's term or, in the case of a money-back policy, minus the survival benefits received during the term of the policy.

A2A Survival benefit payments

For money-back policies the insurance company makes specific payments to the policyholder at specific times during the term of the policy. These payments are known as survival benefits.

Example

Ajay has bought a money-back policy with a sum insured of Rs. 20 lakhs for 20 years, which promises to pay 25% of the sum insured every five years as survival benefit. In this case the insurance company will pay Ajay Rs. 5 lakhs at the end of the 5th, 10th, 15th and 20th years, as a survival benefit. If the policy is a participating policy, the insurance company will also pay the accumulated bonuses along with the last payment at the end of the 20th year.

Consider this…

How is a survival claim different from a maturity claim? Think of some examples of the types of policies in which the two claims arise.

A2B Reduced sum insured (paid-up value)

Sometimes during the tenure of a policy the policyholder may face financial problems and may not be in a position to continue paying the premiums. During such times rather than surrendering the policy, the policyholder has the option to convert it into a paid-up policy. On the maturity of such policies, the proportionate reduced sum insured is paid out by the insurance company.

A2C Discounted claims

Discounted claims are those options which are exercised by the policyholder within one year of the maturity date of the policy.

A2D Commutation of instalments

For annuity plans, before receiving regular/periodic annuity payments, the individual can make a lump sum withdrawal. This is known as commutation. Insurance companies normally allow 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.

A2E Annuity payments at the time of vesting

In the case of annuities, on vesting, the regular annuity payments start to be made by the insurance company to the annuitant. The payments may be made to the annuitant on a monthly, quarterly, semi-annual or annual basis depending on the plan's terms and conditions.

A3 Death claim

A death claim is where the life insurance company pays the sum insured to the nominee/ beneficiary on the death of the insured during the term of the plan. For whole life policies, the benefit is paid on death, regardless of when this occurs, i.e. there is no fixed term. If the policy is a participating policy, the insurance company will also pay the bonuses accumulated until then. If the policyholder had taken out any loans, then the outstanding amount of the loan, the interest and any outstanding premium and interest thereon will be deducted before the final amount is paid.

Example

Ajay has bought a term insurance plan with a sum insured of Rs. 25 lakhs for 25 years. He dies in the 13th year of the policy. In this case the insurance company will pay Ajay's nominee/beneficiary Rs. 25 lakhs as a death claim.

Be aware

In the case of an ULIP, should the insured die, the insurance company pays the higher of the sum insured or the fund value (or, in the case of some insurance companies, both the fund value and the sum insured is paid).

There are certain policies where the benefit is not paid on death but on a specified date as chosen by the life insured when taking out the policy. For example, for a policy where the objective is to provide for a lump sum amount for a daughter's marriage or a son's higher education, the amount is not paid on the death of the life insured but becomes payable on the date specified, for example:

- when the son/daughter reaches the age of 18 or 21.

This is, of course, as per the terms and conditions of the policy and the option exercised by the proposer.

A4 Rider benefit

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

- under an **accidental death benefit (ADB)** rider, in the event of the death of the insured, the additional sum insured under this rider is paid;
- under a **critical illness (CI)** rider in the event of diagnosis of a critical illness, a specified amount is paid as per the rider terms and conditions. The illness should be covered in the list of CIs specified by the insurance company (the list may differ among insurers);
- under a **'hospital care'** rider the insurance company pays the treatment costs in the event of hospitalisation of the insured, subject to the terms and conditions of the rider.

To refresh your knowledge of riders, refer back to chapter 7, section B3.

A5 Valid claim

Once an insurance company receives notification of a claim it will want to be sure that the claim is valid before it makes a payment. It will do this by checking the following:

- Was the insurance policy in force when the event occurred?
- Has the insured event taken place?
- Have the original policy document, a completed claim form and all the other required documents been submitted?
- Has the policyholder performed their part with regards to age admission and the disclosure of material facts relevant to the policy? These will be investigated by the insurance company as part of its claim settlement process.

Example

The insurance company will investigate whether the policyholder declared their correct age and supported it with valid age proof documents. If it is an early claim (death happening within 2 to 3 years of buying the policy or revival of the policy) the insurance company will investigate whether the insured suppressed any material facts (for example something related to their health or about a pre-existing illness) in order to get insurance on better terms. (If you want to refresh your knowledge of material facts, we discussed these in chapter 3, part 1.)

- Did the claim demand come from the right person(s), i.e. the person(s) who is entitled to receive the claim amount? This can be the nominee, the legal heir or the assignee etc.
- Have all the other formalities that are required for a claim to be valid been fulfilled?

Suggested activity

Find out from your family or friends if any of them has ever made a claim on a life insurance company. Ask them about the claims procedure and the documents that they were required to submit to settle the claim.

Question 11.1

What are the three main types of claim?

B Why a claim may be invalid

Once an insurance company has completed its investigations it may conclude that it does not need to make a claim payment because the claim is invalid. There are three main circumstances in which this may arise:

The policy is not in force:	If the policy was not in force when the event occurred, the insurance company will reject the claim.	Example: Ajay has taken out a term plan for 20 years. He pays the annual premium on the 1st of April every year. In the 3rd year he suffers a severe heart attack. Due to financial problems because of huge hospital bills, Ajay is not able to pay the premiums on time. His financial problems continue for a longer time than expected and he is not able to pay the premium even during the grace period. At the same time Ajay's health deteriorates and he dies on 15th May. Ajay's nominee files a claim with the insurance company but the company rejects the claim as the policy was not in force due to premiums not being paid, even during the grace period.
Excluded conditions apply:	If the death is caused by something excluded from cover under the policy, the claim will not be met.	Example: Insurance policies exclude death due to suicide in the first year of the policy, therefore the death claim for a policyholder who commits suicide during that first year, will be rejected by the insurance company.
The claim is fraudulent:	If, during its investigations, the insurance company finds out that a material fact was deliberately suppressed by the insured then it will reject the claim.	Example: If the insurer finds out that the age declared by the insured at the time of taking out the policy was wrong or the insured was suffering from some illness that was deliberately not disclosed, then the insurer can reject the claim on the grounds of misrepresentation.

Suggested activity

Search the internet and find out about some life insurance cases where the insurance company rejected the claim because it was of the opinion that the claims were invalid due to various reasons. Study those cases.

C Duties after death and documentary evidence

Clearly, unless the insurance company knows about the death, it will not pay out the sum insured. Therefore the first thing that must happen, after the death of the life insured, is for the insurance company to be advised that the death has taken place. The notification may be sent by the nominee, assignee, relative, the individual's employer or the insurance agent. However, notification of the death is not enough – the insurance company will need proof, not just that the death actually took place, but that the life was insured by the company. Therefore, the next duty for the claimant is to ensure that the insurance company receives the following documents:

- The policy document (see section E on lost policies).
- Deeds of assignments/reassignments: if the policy has been assigned, then the insurance company needs to know this so that it can make the payment to the correct person. (See chapter 3, part 2, section H4B to refresh your knowledge of assignment.)
- Proof of age, if age is not already admitted.
- The death certificate (proof of death).
- The claimant's statement.
- Legal evidence of title, if the policy is not assigned or nominated.
- The discharge form, sent by the insurance company, must be executed and witnessed and returned to the insurance company.

C1 Early death claims

If the claim occurs within three years from the date of risk, or from its revival, insurance companies normally classify it as an early death claim. In such cases insurance companies will carry out a detailed investigation. Additional documents may be called for in order to make certain that material facts were not suppressed at the time of proposal/revival. These documents include:

- a statement from the last medical attendant to attend the deceased before death, giving details of their last illness and the treatment given;
- a statement from the hospital, if the deceased had been admitted to a hospital;
- a statement from the person who attended the last rites and had seen the dead body; and/or
- a statement from the employer (if the deceased was employed) showing details of leave taken.

If the life insured had an unnatural death, such as an accident, by suicide or by an unknown cause, the following will also be looked into:

- Police first information report (FIR);
- panchanama (inquest);
- forensic report;
- post mortem report; and
- Coroner's report.

Depending on the initial evidence, a special inquiry may be ordered.

Example

Ajay has bought an endowment insurance plan with a cover of Rs. 25,00,000 for a term of 25 years. Let's see how the claim will be handled in various scenarios:

a) Ajay dies within the first three years of buying the policy. His death is treated as an early death claim by the life insurance company. The insurance company carries out a more detailed investigation than usual before settling the claim. In addition to seeing the usual required documents and the completed claim form, in order to settle the claim it may ask for information from the last doctor who treated Ajay before his death.

b) Ajay pays all the premiums regularly on time and he dies in the 7th year of the policy. The life insurance company will treat his death as a normal claim. Ajay's nominee/legal beneficiary will be required to submit the regular set of documents along with the completed claim form. The insurance company will settle the claim in a reasonable period of time without going into a detailed investigation, provided the claim is valid.

c) Ajay is unable to pay the premium in the 5th year of the policy and the policy lapses. He revives the policy in the 6th year and dies in the 7th year. The treatment of the claim will be different from a normal death claim. Even though death has happened in the 7th year of the policy, the life insurance company will still treat the claim as an early death claim as death happened one year after the policy's revival. The insurance company will carry out a more detailed investigation than normal before settling the claim as in scenario a).

D Settling claims

In section A we looked at maturity and death claims and in this section we will look at how these are settled in more detail. Before we do so, however, we will consider the guidelines laid down by the IRDA about how all claims should be handled, as these provide the framework.

D1 IRDA guidelines for claim settlement

In the introduction to this chapter we stated that the IRDA has laid down guidelines for the settlement of claims. These are included in the **IRDA (Protection of Policyholders' Interests) Regulations 2002** and are as follows:

Claims procedures in respect of a life insurance policy

1. A life insurance policy shall state the primary documents which are normally required to be submitted by a claimant in support of a claim.
2. A life insurance company, upon receiving a claim, shall process the claim without delay. Any queries or requirement of additional documents, to the extent possible, shall be raised all at once and not in a piecemeal manner, within a period of 15 days of the receipt of the claim.
3. A claim under a life policy shall be paid or be disputed giving all the relevant reasons, within 30 days from the date of receipt of all relevant papers and clarifications required. Where in the opinion of the insurance company the circumstances of a claim warrant an investigation, it shall initiate and complete such investigation at the earliest, in any case not later than 6 months from the time of lodging the claim.
4. Subject to the provisions of section 47 of the Act, where a claim is ready for payment but the payment cannot be made due to any reasons of a proper identification of the payee, the life insurer shall hold the amount for the benefit of the payee and such an amount shall earn interest at the rate applicable to a savings bank account with a scheduled bank (effective from 30 days following the submission of all papers and information).
5. Where there is a delay on the part of the insurer in processing a claim for a reason other than the one covered by sub-regulation (4), the life insurance company shall pay interest on the claim amount at a rate which is 2% above the bank rate prevalent at the beginning of the financial year in which the claim is reviewed by it.

Now that we have established the framework within which all claims must be handled, we can go on to consider the individual types of claim.

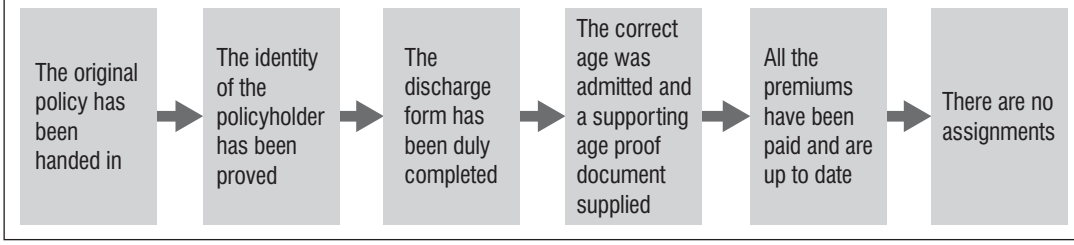
Question 11.2

What documents are required in support of a death claim?

D2 Maturity claim

Action on maturity claims is normally initiated by the insurance company itself. It will know from its records which policies will mature each month and will normally send an advance notification to the person insured. The insured will then take the steps described in section C. Then, before making the payment, the insurer will satisfy itself that:

Figure 11.1



The insurer is expected to make the payment on the maturity date. Post-dated cheques are usually sent a few days in advance of the maturity date, provided a signed discharge form has been received.

If the policy is reported lost, then the insurer may settle on the basis of indemnity (see section E). This is possible because no further obligations remain under the policy.

Assigned policies

Be aware

In the case of an absolute assignment, the claim payment will be made to the assignee.

If the assignment is conditional, reverting to the policyholder on maturity, the insurance company can make the payment to the policyholder. It will be prudent, however, to first check that the assignee has no outstanding claims.

Be aware

Settlement option: Some maturity claims (for example in case of ULIPs) may be payable, not on the date of maturity as chosen by the policyholder, but later and in instalments, not as a lump sum. This is known as the settlement option. The policyholder needs to exercise such an option in advance before the policy matures for payment. While the decision to settle may be taken before the maturity date, the settlement process will continue for a few years after the maturity date.

D3 Survival benefit payments

When it comes to making survival benefit payments, the procedure is similar to the payment of maturity claims. Action will be initiated by the insurer and post-dated cheques will be sent in advance.

If the policy is reported to be lost, a duplicate policy may be provided on which an endorsement will be made regarding the settlement of the survival benefits. See also section E below on fraudulent claims.

D4 Death claims

Unlike the first two types of claim, the process here is started by the claimant, who will advise the insurance company of the death of the life insured. The insurance company will then wait for the relevant documentation (see section C), check it, and carry out any further investigations that it deems necessary. Once it is satisfied that the claim is a valid one, it will send the sum insured to the nominee or beneficiary within a reasonable timeframe, i.e. it will settle the claim.

Question 11.3

According to IRDA guidelines, how long does an insurance company have to complete its investigation of a claim?

E Fraudulent claims

Insurance fraud is a deliberate attempt to use insurance for unjustified financial gain. Insurance fraud includes bogus claims and the misrepresentation of facts.

Be aware

Loss of policy

Insurance companies take the utmost care when settling maturity claims. Sometimes the original policy is reported as lost. Caution must be exercised to ensure that there is no attempt to defraud, for example it could have been pledged elsewhere for a loan. But if the loss of policy is genuine, it is possible to settle the claim on the basis of an indemnity accompanied, as a precaution, by an advertisement in the newspapers.

The indemnity is in the form of a statement, signed by the claimant, stating that should the original policy come to light and evidence of ownership by another party is provided, then the claimant will reimburse the insurance company for any claim payments made to them.

E1 Consequences of fraud

If fraud is not detected and a fraudulent claim is paid, there are direct consequences for the insurer, their insureds and on the fraudulent claimant, as follows:

Consequences of fraud from the insurer	• Individual insurers that do not take the detection and prevention of fraud seriously will see the result of this in a fall in their profits. Their claims costs will rise and this will have an impact on premiums, making them less competitive in the market. • In addition, by word of mouth it may become known among fraudsters which insurers do not carry out adequate checks before paying claims, leading to even more claims of this sort.
Consequences of fraud for the insured	• Insured people who do not act fraudulently will also suffer as a result of fraudulent claims being paid. • This happens because the increase in premiums will affect all policyholders, not just those who have made fraudulent claims. You will remember that the insurer tries to make sure that each insured person brings a fair premium to the pool for the risk presented. This will be distorted by fraudulent claims.
Consequences of fraud for the fraudulent claimant	• The consequence on the claimant of a fraudulent claim being paid is clear. If the claimant has succeeded in receiving monies in respect of a fraudulent claim, there will be a temptation to continue this practice in future.

E2 Caution points at the time of handling death claims

Death claims are where most fraud occurs, and therefore insurers tend to be more cautious when handling them. The following are some indications that a death claim may be fraudulent:

- If the notification of death is received from a stranger, there is reason to ask: 'Why has it not come from a family member or a relative?'
- Too many enquiries about progress in the settlement of the claim should raise doubts.
- If the notification of death is received three years after the date of death, there is reason to be suspicious. In such a scenario, investigation in the same way as for an early death claim would be desirable in all cases, to rule out the possibility of a fraud. If the reasons for the delay in making the claim are not fully satisfactory, the plea that the claim is 'time barred' can be made.

While insurers, as a matter of good faith, should expedite claims settlement, as a trustee of the policyholder's premiums and their company's finances they should always act to prevent fraud. This balance has to be maintained.

E3 Presumption of death

Proof of death is essential for a claim to be settled. However, sometimes a person is reported missing without any information about their whereabouts. What happens to the life insurance of such an individual – can a claim be made or would an insurance company be suspicious that all such claims were fraudulent?

Sections 107 and 108 of the **Indian Evidence Act 1872** deal with presumption of death; under this Act if an individual has not been heard of for seven years they are presumed to be dead. This has the following effect on the actions of the life insurance company:

- If the nominee or heirs claim that the life insured is missing and must be presumed to be dead, insurers insist on a decree from a competent court.
- However, the insurer may also act on its own, without a decree of the court, if reasonably strong circumstantial evidence exists to show that the life insured could not have survived a fatal accident or hazard.
- It is necessary that the premiums should be paid until the court decrees presumption of death; although insurers may, as a concession, waive the premiums during the seven year period. This is at the discretion of the individual insurance company.

F Void and voidable contracts

One reason why a claim may be rejected by an insurance company is because the original contract of insurance has been found to be invalid, or **void**, or has become **voidable** and the insurance company chooses to set it aside for some reason. We will describe what these two terms mean, and the difference between them, in this section.

A contract may not be valid or fully valid in law for a number of reasons. A void contract has no binding effect on either party because a void contract is no contract at all (the expression is really a contradiction in terms). Circumstances that will render a policy void include the following:

Mistake	If there is a fundamental mistake that goes to the root of the contract, there has been no meeting of minds and, therefore, no valid contract exists.	Example: A life insurance contract entered into with a drunken person or person who is not of sound mind at the time of entering into the contract, will not be valid as the person is not in a state of mind to understand the contract's terms and conditions.
Illegitimate/unlawful circumstances	If the insurance has been taken out in support of some illegitimate (unlawful) activity, it will be void.	Example: A person taking out life insurance with the intention of committing suicide or a husband taking life insurance on his wife's life with the intention of killing her and claiming the money from the insurance company.
Lack of insurable interest	If there is no insurable interest attaching to a policy, it would be declared null and void.	

A voidable contract is binding unless and until one of the parties chooses to set it aside. Insurance contracts may be voidable on a number of different grounds. Examples are:

- **Breach of good faith** – misrepresentation or non-disclosure will allow the insurer to treat the policy as void.
- **Breach of warranty** – this will entitle the insurer to treat the policy as void.

However, in Indian law there is an exception to the insurance company's right to declare a policy void on the grounds of misrepresentation or non-disclosure. This is important, so we will consider it now.

F1 Indisputable contracts

As we have just seen, if the proposer has made any untrue or incorrect statements at the time of proposal, either in the proposal form or in the personal statement, or they have not disclosed some material information, the policy contract becomes void *ab initio*. This means that all the benefits under the policy cease and all monies paid in premiums are forfeited.

Be aware

Ab initio is a Latin term which means 'from the beginning'. A policy contract which is declared void *ab initio* means that the policy was null and void from the beginning and since the contract is not legally enforceable, the insurer is not required to pay the claim.

However, this penalty is subject to section 45 of the Insurance Act 1938. Under this section, a policy which has been in force for two years cannot be disputed on the grounds of incorrect or false statements in the proposal and other documents, unless it is shown to be on a material matter and was fraudulently made. This provision is meant to protect policyholders from suffering for minor inaccuracies on stated facts.

Section 45

No policy of life insurance shall after the expiry of two years from the date on which it was effected be called in question by an insurer on the ground that statement made in the proposal or in any report of a medical officer, or referee, or friend of the insured, or in any other document leading to the issue of the policy, was inaccurate or false, unless the insurer shows that such statement was on a material matter or suppressed facts which it was material to disclose and that it was fraudulently made by the policyholder and that the policyholder knew at the time of making it that the statement was false or that it suppressed facts which it was material to disclose.

Key points

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

Requirements for a valid claim

- A claim is the demand that the insurer should redeem the promise made in the contract.
- A maturity claim is the sum insured, plus any accumulated bonuses. It is paid to the insured or the proposer (if the proposal is on the life of another person, say, key man insurance, partnership insurance etc.) or the assignee if the policy was assigned absolutely for valuable consideration, at the end/maturity of the plan, if they survive the entire term of the plan.
- A terminal or final additional bonus may be paid.
- In money-back policies the insurance company makes specific payments to the policyholder at specific periods during the term of the policy. These payments are known as survival benefits.
- The sum insured paid by a life insurance company to the nominee/beneficiary/assignee in the event of the death of the insured during the term of the plan, is known as death claim.

Why a claim may be invalid

- An insurer may refuse to pay the claim because:
  - the policy is not in force;
  - an exclusion condition applies; or
  - the claim is found to be fraudulent.

Duties after loss and documentary advice

- The claimant needs to inform the life insurance company of the death of the life insured and submit the necessary documents to settle the claim.
- In the case of an early death claim, additional documents are required over and above the documents usually required for a normal death claim.

Settling claims

- For maturity claims the process is initiated by the insurance company well in advance of the maturity date.
- In cases of absolute assignment the payment is made to the assignee.
- For survival benefit payments the action is initiated by the insurance company and post-dated cheques are sent to the policyholder well in advance.
- The IRDA has laid down guidelines for the settlement of claims in **IRDA (Protection of Policyholders' Interests) Regulations 2002**.

Fraudulent claims

- Insurance fraud is a deliberate attempt to use insurance for unjustified financial gain.
- If fraud is not detected and the fraudulent claim is paid, there are direct consequences for the insurer, their insureds and the fraudulent claimant.

Void and voidable contracts

- A void contract has no binding effect on either party.
- Circumstances that will render a policy void include the following:
  - a mistake;
  - illegitimate/unlawful circumstances; or
  - a lack of insurable interest.
- A voidable contract is binding until one of the parties chooses to set it aside.
- Under section 45 of the **Insurance Act 1938**, a policy which has been in force for two years cannot be disputed on the ground of incorrect or false statements in the proposal and other documents, unless it is shown to be on a material matter and was fraudulently made.

Question answers

11.1 Claims can be of three main types:

- maturity claims;
- death claims; and
- rider benefits.

11.2 The documents required in support of a death claim include the following:

- The policy document.
- Deeds of assignments/reassignments.
- Proof of age, if age is not already admitted.
- The death certificate.
- Claimant's statement.
- Legal evidence of title, if the policy is not assigned or nominated.
- The discharge form, sent by the insurance company, must be executed and witnessed and returned to the insurance company.

11.3 According to IRDA guidelines, an insurance company must complete its investigation of a claim no later than six months from the time the claim was lodged.

Self-test questions

1.	What are the requirements of a valid death claim?
2.	What are the circumstances in which the insurer may refuse to pay the claim?
3.	What are the circumstances that can render a policy void?
4.	Briefly explain the consequences of paying a fraudulent claim.

You will find the answers on the next page

Self-test answers

1.	The requirements for a valid death claim are: • an insured event took place; • the policy was in force when the insured event occurred; • all the necessary documentation has been provided, including the original policy, a completed claim form and a death certificate etc.; • the policyholder had provided proof of age and disclosed all material facts relevant to the policy; • the claim has come from the individual entitled to receive the claim amount; and • all other formalities required have been completed.
2.	An insurer may refuse to pay the claim because: • the policy was not in force when the event occurred; • an excluded condition applied to the loss; or • the claim was fraudulent.
3.	Circumstances that will render a policy void include the following: • **Mistake** – if there is a fundamental mistake that goes to the root of the contract, there has been no meeting of minds and, therefore, no valid contract exists. • **Illegal/unlawful circumstances** – if the insurance has been affected in support of some illegal/unlawful activity, it will be void. • **Lack of insurable interest** – if there is no insurable interest attaching to a policy, it would be declared null and void.
4.	If fraud is not detected and the fraudulent claim is paid, there are direct consequences on the insurer, their insureds and on the fraudulent claimant. **a) Consequences of fraud on the insurer** Individual insurers that do not take seriously the detection and prevention of fraud will see their profits affected. Their claims costs will rise and this will have an impact on premiums, making them less competitive in the market. In addition, they will gain a reputation for not carrying out thorough checks when paying claims, making them vulnerable to more fraudulent claims. **b) Consequences of fraud on the insureds** The premiums will rise for everyone, not just for those making the fraudulent claims, as the insurer's ability to ensure that each insured brings a fair premium to the pool will be distorted. **c) Consequences of fraud on the fraudulent claimant** The consequence on the claimant of a fraudulent claim being paid is clear. If the claimant has succeeded in receiving monies in respect of a fraudulent claim, there will be a temptation to continue this practice in future.

12
Legislation and client advice

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Learning objectives

After studying this chapter, you should be able to:

- explain the provisions of key legislation relevant to life insurance agents in providing client advice.

Introduction

At this point in your studies you will have a good understanding of:

- how insurance works;
- the range and detail of the products that you will be advising on and selling;
- how best to provide a professional service to your clients; and
- what happens in the event of a claim.

The final section of the course is concerned with explaining the legal and regulatory measures that exist, focusing on the impact they have on your role as a life insurance agent in providing client advice.

In this chapter we will consider key legislation, starting with the Insurance Act 1938, and focusing on the provisions that have an impact on agents.

Key terms

This chapter features explanations of the following terms and concepts:

Remuneration	Prohibition of rebates	Licensing of insurance agents	Beneficiary
Solvency	Money laundering	Financial Intelligence Unit (FIU)	High and low risk customers
Trust	Trustor	Trustee	Know your customer (KYC)

A Insurance Act 1938

This is the most important legislation passed in India relating to insurance business and, as stated in chapter 1, it came into effect from 1 July 1939. The Act consolidates the law relating to the business of insurance and it was the first piece of legislation to govern all forms of insurance, providing state control over insurance business. The original 1938 Act was amended in 1950, 1956, 1968, 1972, and also in 1999 and 2002 following the establishment of the IRDA (see section D). The Act broadly contains provisions relating to the:

- registration of insurers and renewal of registration;
- manner of investment of premium;
- maintenance of insurers' solvency levels (see 'Be aware' below);
- appointment of staff;
- amalgamation and transfer of insurance business;
- assignment or transfer of policies and nominations;
- rural and social sector;
- control over management;
- licensing of agents and their commission;
- prohibition of rebates;
- power of investigation and inspection by the regulatory authority;
- protection of policyholders' interests; and
- constitution of the Insurance Association and Insurance Councils.

Be aware

In this context, solvency – in simple terms – means whether the insurer has sufficient resources to satisfy the IRDA that they are able to pay all claims at any point in time.

Until 1999 the Controller of Insurance (a person appointed by the Central Government to exercise all the powers, discharge the functions and perform the duties of the Authority) was responsible for administration of the Insurance Act 1938. The Controller was replaced by the IRDA.

A1 Provisions with specific relevance to agents

The following sections of the Act are particularly important for agents to understand, as they lay down the guidelines that must be followed regarding the:

- licensing of agents;
- commission payable to them; and
- prohibition of rebates.

A1A Section 40(1) – Prohibition of payment by way of commission or otherwise for procuring business.

Section 40(1) of the Insurance Act 1938 prohibits any form of remuneration for soliciting or procuring insurance business in India to any person other than a licensed insurance agent or an insurance intermediary.

Section 40(1)

No person shall after the expiry of six months from the commencement of this Act, pay or contract to pay any remuneration or reward whether by way of commission or otherwise for soliciting or procuring insurance business in India to any person except an insurance agent or an intermediary or insurance intermediary.

Example

Prashant has appeared for the prescribed pre-recruitment examination in life insurance, but has failed to score the minimum required mark to pass the examination and therefore is still not certified and still not licensed by the IRDA to solicit or procure life insurance business. So Prashant cannot be paid for soliciting or procuring insurance business as he is neither a licensed insurance agent nor an insurance intermediary. In fact, Prashant is not authorised to solicit or procure any life insurance business for any life insurance company until he is awarded the licence to do so from the Authority.

Section 40A(1) stipulates the limits on the remuneration or reward by way of commission or otherwise that can be paid to an insurance agent, the details of which have already been discussed in chapter 10.

Section 40B(1) also prescribes limits for expenses of management of life insurance business. All insurers have to comply with this and provide statements in the prescribed format, certified by an actuary, within a given time limit.

A1B Section 41(1) – Prohibition of rebates

Section 41(1) of the Insurance Act 1938 prohibits any insurance agent/intermediary from offering any commission/premium rebate as an inducement to any person to take out or renew or continue a policy of insurance. The section also prohibits any person from accepting any such rebates offered for taking out insurance.

Section 41(1)

No person shall allow or offer to allow, either directly or indirectly, as an inducement to any person to take or renew or continue an insurance in respect of any kind of risk relating to lives or property in India, any rebate of the whole or part of the commission payable or any rebate of the premium shown on the policy, nor shall any person taking out or renewing or continuing a policy accept any rebate, except such rebate as may be allowed in accordance with the published prospectuses or tables of the insurer.

Example

Santosh is a licensed life insurance agent with ABC Insurance Company. Santosh approaches Karan to buy life insurance based on his lifecycle needs. Similarly Karan has been approached by agents of other life insurance companies to consider their products.

In this case, as per section 41 of the Insurance Act 1938, Santosh cannot offer any rebates from the commissions he will receive from ABC Insurance Company to Karan as an inducement to buy life insurance from him and ignore the products of other companies.

Similarly Karan cannot ask for any rebates from the agents of any company as an inducement to buy life insurance from them.

Any person not complying with the provisions of this section shall be punishable with a fine up to Rs. 500.

A1C Section 42 – Licensing of insurance agents

Section 42 of the Insurance Act 1938 stipulates the conditions for issuing a licence to a person or company to act as an insurance agent for soliciting or procuring insurance business. The section covers the following:

Figure 12.1

The specific details of the procedure for issuing a licence to agents will be discussed in chapter 13.

A1D Section 44 – Prohibition of cessation of payments of commission

As we saw in chapter 10, under section 44 of the Insurance Act 1938, no insurance agent can be refused payment of renewal commission due to him on renewal premium, in respect of life insurance business conducted in India under the agreement. Even after the termination of agency the renewal commission is payable, except for fraud, provided that:

(a) the insurance agent has served the insurer continually and exclusively in respect of life insurance business for at least five years, and policies insuring a total sum of not less than Rs. 50,000 effected through him for the insurer were in force for one year before his ceasing to act as an agent for the insurer, and that the commission on renewal premiums due to him does not exceed 4%;

or

(b) the agent has served the insurer continually and exclusively for at least ten years and after his ceasing to act as an agent he does not directly or indirectly solicit or procure insurance business for any other person.

Be aware

In the event of the death of an agent, any commission payable to him under the above points (a) and (b), is payable to his heirs for so long as such commission would have been payable had he been alive.

B Indian Life Assurance Companies Act 1912

The first statutory measure in India to regulate life insurance business was introduced in 1912 when the **Indian Life Assurance Companies Act** was passed. Prior to 1912, there had been no legislation to regulate insurance business in India.

As we saw in chapter 1, India's life insurance business in its present form owes its origins to other countries, in particular England, and the first insurance company established in India was the Oriental Life Insurance Company in Kolkata in 1818.

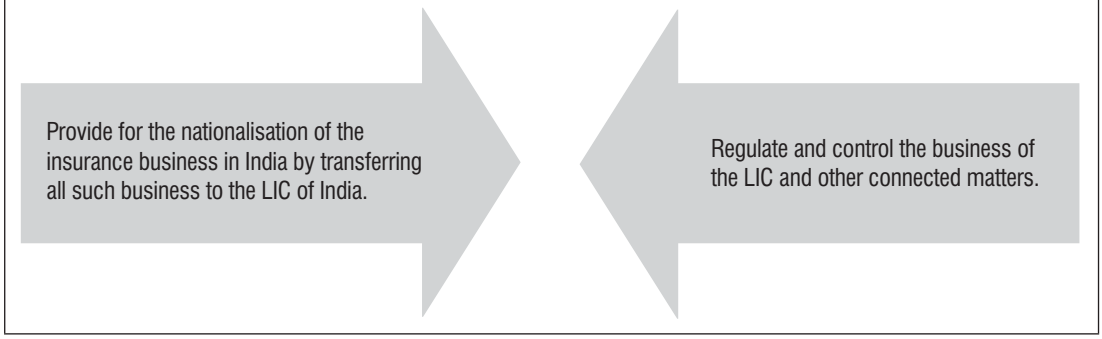
However, all the insurance companies established at this time catered to the needs of the European community and Indians were charged a higher premium than other policyholders. The Indian Life Assurance Companies Act 1912 stipulated for the first time in India that premium rate tables and periodical valuations of companies had to be certified by an actuary. However the Act discriminated between foreign and Indian companies in many areas, putting the Indian companies at a disadvantage.

C Life Insurance Corporation Act 1956

The Life Insurance Corporation Act 1956 was passed on 19 June 1956 and subsequently the Life Insurance Corporation (LIC) was formed on 1 September 1956.

The Life Insurance Corporation Act 1956 was passed to:

Figure 12.2



Be aware

The Life Insurance Corporation of India was formed in 1956 with the merger of 245 Indian and foreign insurers in total (154 Indian, 16 non-Indian and 75 provident societies).

The LIC Act was passed with the objective of nationalising life insurance business in India and also to provide for the regulation and control of the business of the LIC and for all connected matters.

Section 30 of the Act gave the LIC an exclusive privilege to transact life insurance business in India. In 1999 this exclusive privilege was revoked by way of an amendment to the Act as part of the Government's policy of economic reforms.

D Insurance Regulatory and Development Authority (IRDA) Act 1999

The Insurance Regulatory and Development Authority (IRDA) Act 1999 was passed by Parliament in December 1999. The Act provided for the establishment of the IRDA as a corporate body:

- to protect the interest of holders of insurance policies;
- to regulate, promote and ensure orderly growth of the insurance industry; and
- for other related matters.

As mentioned in section A, the IRDA Act 1999 led to amendments in the Insurance Act 1938, the Life Insurance Corporation Act 1956, and also the General Insurance Business (Nationalisation) Act 1972.

Question 12.1

List the section 42 provisions related to the licensing of insurance agents.

As we have seen, the IRDA replaced the 'Controller of Insurance' in administering the provisions of the Insurance Act including registration, licensing and laying down regulations for the proper conduct of the business and the protection of the interests of policyholders.

Be aware

Section 4 of the IRDA Act 1999 specifies the composition of the IRDA. It consists of a Chairperson, not more than five whole-time members and not more than four part-time members. All the members are appointed by the Government of India. Section 14 of the Act lays down the duties, powers and functions of the IRDA.

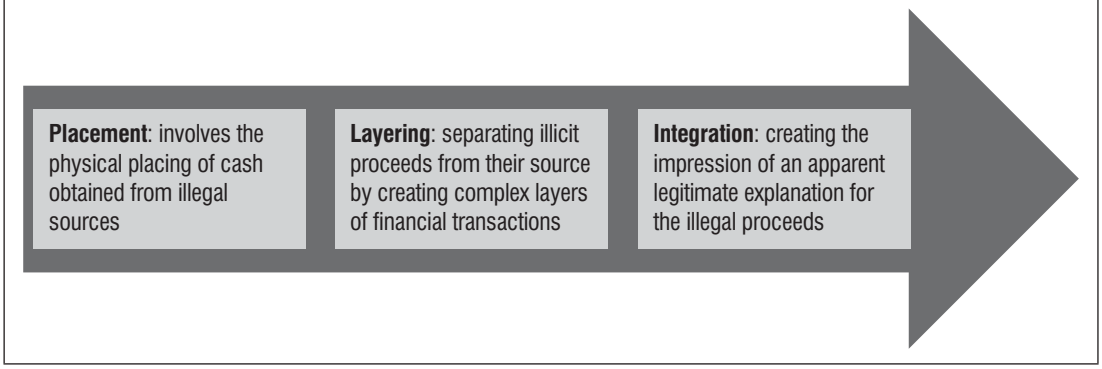
E Prevention of Money Laundering Act (PMLA) 2002

Before we explain the provisions of this important piece of legislation and the impact it has on life insurance agents, we shall explain what money laundering actually means.

Money laundering is the process of bringing illegal money into the financial system by hiding its illegal origin so that it appears to be legally acquired. Money laundering is the term used to describe the process of turning dirty money into clean money. Illegal or 'dirty' money is put through a cycle of transactions so that it comes out 'washed' at the other end as 'legal' or 'clean' money.

There are three common stages of money laundering:

Figure 9.3



The **Prevention of Money Laundering Act (PMLA) 2002** came into effect from 1 July 2005 to control money laundering activities as well as to combat the financing of terrorism. Guidelines on anti-money laundering (AML) for insurance companies were issued on 31 March 2006 which require all insurers to establish an anti-money laundering program. Each company is required to have an AML policy and accordingly file a copy with the IRDA.

Insurance companies offer a variety of products through trained agents and other intermediaries. Hence these guidelines are of importance to insurance agents to the extent indicated in the guidelines.

Compliance with the PMLA is applicable to all financial institutions regulated by the Reserve Bank of India (RBI) – the banking regulator, the Securities Exchange Board of India (SEBI) – the capital markets regulator, and the Insurance Regulatory Development Authority (IRDA) – the insurance regulator and all other financial intermediaries.

The IRDA made it mandatory for all life insurance companies to follow the AML guidelines from 1 August 2006. The guidelines require every insurer to have an AML program which at a minimum should include:

- internal policies, procedures and controls;
- the appointment of a principal compliance officer;
- recruitment and training of insurance agents/employees on AML measures; and
- internal audit/control.

Be aware

You should be aware that the following must be adhered to in respect of the AML guidelines while conducting your business.

Know your customer (KYC)

Insurers need to determine the true identity of their customers, and agents have a major role to play in this. Agents should make sure that their clients submit the necessary identity and address proofs. KYC needs to be carried out at all stages – issue of policy, top-ups and at the time of claim payment.

Information on customers must be collected from all sources including insurance agents, and agents need to educate their clients on the importance of adhering to KYC requirements. The IRDA has provided an indicative list of documents that can be obtained from the customer for customer identification, residence proof and income proof. See chapter 9, section E4 for more details.

Risk profile of the customer

Individuals whose identity and source of funds can be easily identified are categorised as **low-risk customers**. However, even in such cases, if the customer profile is inconsistent with the policies/investments taken out, proper diligence is to be conducted through enquiry and by obtaining all the necessary documents.

High net worth individuals (HNIs), politically exposed persons (PEPs), Non-Governmental Organisations (NGOs), Non-resident Indians (NRIs) are all categorised as **high-risk customers**.

Insurance agents must be very careful while dealing with high-risk customers. Agents need to make sure proper screening of such people is carried out and that all KYC and AML requirements have been adhered to while dealing with these clients.

Example

Low-risk customers include:

- salaried employees; and
- Government employees.

Other high-risk customers apart from the ones mentioned above include:

- money changers;
- arms and explosives dealers;
- film personalities;
- persons dealing with real estate; and
- antique dealers.

Sources of funds

The customer's source of funds (from which the premium is being paid) and their estimated net worth needs to be verified and properly documented. Insurance agents must obtain suitable income proofs to establish the customer's need for insurance cover. If the customer is paying a single premium, which is of a substantial amount, insurance agents need to obtain suitable documents to establish the source of funds.

Threshold for payment of premium in cash

To ensure that the premiums are being paid out of a legitimate source of funds, payment of premiums by cash cannot exceed Rs. 50,000. Premiums of Rs 50,000 and above can be paid only by cheque, demand draft, credit card or any other banking channels.

Insurance agents therefore need to educate their clients about AML provisions.

Be aware

- The services of defaulting agents who expose insurers to AML-related risks on multiple occasions should be terminated and details are to be reported to the IRDA for further action.
- If faced with a non-compliant agent, the insurance company must take all necessary actions to secure compliance. This can include termination of the business relationship with the agent.

F Married Women's Property (MWP) Act 1874

Section 6 of the Married Women's Property (MWP) Act 1874 provides that a life insurance policy that has been taken out by a married man on his own life, for the benefit of his wife and children, shall be deemed to be a trust and will be outside the control of the life insured, his creditors, court attachments etc.

Be aware

A trust is a legal agreement, which has three parties associated with it – a trustor, a trustee and a beneficiary.

- The trustor, or author of the trust, is the person who forms the trust.
- The trustee can either be a person or an entity, who/which is responsible for managing the assets, the ownership of which is entrusted to them as a 'trust' by the trustor.
- The beneficiary is an individual/entity who receives the benefits from the trust.

The proposer can appoint:

- a person (or failing him, another person) as a trustee;
- two or more persons (or survivor(s) of them) as trustees; or
- a corporate trustee, such as a bank transacting trustee business.

A trustee must be a major (18 years and above) and their consent to act as a trustee should be taken and added to the policy as an endorsement. If a trustee is not appointed or not existing, Official Trustees will be appointed by a competent Government Authority.

The beneficiaries of a life insurance policy affected by the MWP Act can be:

- the wife alone;
- one or more children; or
- the wife and one or more children jointly.

The main features of this Act are listed below:

- The proposer should be a married, divorced or widowed man. Only his wife and children can be beneficiaries. Children include sons and daughters. In the case of Hindus, adopted sons and daughters are also included.
- The policy must be on his own life.
- Each policy will remain a separate trust.
- The policy is insured as a trust. Either his wife or child (if over the age of 18) can be appointed as a trustee. The individual has the choice of revoking the trustee(s) and appointing new ones at any time.
- Two or more trustees can be appointed.
- Insurance under the MWP Act is free from court attachments, tax attachments, and creditors, and even the life insured does not have any right to deal with the policy.
- When a claim arises, the policy monies will be paid to the trustees according to the policy. The trustees hold the policy money for the beneficiaries.
- The policy cannot be amended or surrendered.
- It should not have been formed to defraud creditors.
- Nomination and assignment are not allowed.

Mohammedan Law

A non-Mohammedan proposer can specify equal shares or unequal shares for the beneficiaries and provide that the benefit should go to them jointly or the survivors or survivor of them and can specify the beneficiaries by class.

In the case of Mohammedan proposers, the beneficiaries have to be named as it is 'Persona Designata'. The name of the wife and children as beneficiaries should be stated in the policy and they must be existing at the time the policy is taken out. In circumstances where there are more than two beneficiaries, the proposer needs to mention the respective share for each beneficiary.

Question 12.2

What are the key aspects of the AML guidelines that are relevant to an agent?

G Other key legislation

We will look at other key pieces of legislation and regulations that have an impact on your role as an insurance agent in this section.

G1 Redressal of Public Grievance Rules 1998

The Governing Body of Insurance Council (GBIC) was established under the Redressal of Public Grievances Rules 1998 (RPG rules 1998) to set up and facilitate the Institution of Insurance Ombudsman in India.

Be aware

The GBIC consists of one representative each from all insurance companies. The representative should be either the Chairman or Managing Director or a Director of the company.

The RPG rules contain provisions regarding:

- the appointment and office term for the Insurance Ombudsman;
- stipulations in respect of staffing and administration of the Ombudsman centre;
- the powers of the Ombudsman; and
- the manner of lodging complaints and disposing of complaints by the Ombudsman either by way of 'recommendation' or 'award'.

We shall return to the role of the Insurance Ombudsman in protecting customers' interests and how this impacts on the role of an agent in chapter 14.

G2 Insurance Regulatory and Development Authority (Insurance Advertisement and Disclosure) Regulations 2000

The IRDA (Insurance Advertisement and Disclosures) Regulations 2000 define 'insurance advertisement' as:

> any communication directly or indirectly related to a policy and intended to result in the eventual sale or solicitation of a policy from members of the public. It includes all forms of printed and published materials or any material using the print and/or electronic medium for public communication.

Unfair or misleading advertisement includes any advertisements that:

- fail to be identified as an insurance product;
- make claims beyond the ability of the policy; or
- describe such benefits that do not match policy provisions.

Advertisement by insurance agents

An advertisement by an insurance agent that affects an insurer must, before it is issued, be prior approved by the insurer in writing. The insurer needs to ensure that the advertisement is not deceptive or misleading before granting such approval.

An agent is not required to obtain the prior approval of the insurer before placing an advertisement if the advertisement:

- has been developed by the insurer itself and is provided to its agents;
- is generic and information is limited to the agent's name, logo, address and phone number; or
- contains only statements that mention the experience, service and qualifications of the agent and makes no reference to specific policies, benefits or costs.

G3 Insurance Regulatory and Development Authority (Manner of Receipt of Premium) Regulations 2002

These Regulations define the manner in which premium can be paid by a policyholder for purchasing an insurance policy as follows:

- cash;
- any negotiable instrument such as cheques, demand draft, pay orders, bankers cheque drawn on any scheduled bank in India;
- postal money orders;
- credit or debit card held in the policyholder's name;
- bank guarantee or cash deposits;

- internet;
- E-transfer;
- direct credit, via standing instructions of the proposer or the policyholder or the life insured through bank transfers; and
- any other method of payment as may be approved by the IRDA from time to time.

The insurer has the option to recover the collection charges of the payment instrument from the proposer.

Be aware

Except where the premium has been paid in cash, the risk will commence only after receipt of the premium by the insurer.

G4 Insurance Regulatory and Development Authority (Licensing of Corporate Agents) Regulations 2002

In October 2002 the IRDA issued a notification under the IRDA (Licensing of Corporate Agents) Regulations 2002. The Regulations deal with the issue of licensing and other matters related to corporate agents such as companies, firms, banks, co-operative societies etc. who are not individuals and can still become agents.

G5 Foreign Exchange Management (Insurance) Regulations 2000

These Regulations, notified by the Reserve Bank of India, prohibit resident Indians from taking out life/general insurance policies issued by an insurer outside India.

The Foreign Exchange Management (Insurance) (Amendment) Regulations 2002 subsequently added the following: 'Provided further that the prohibition against taking a general insurance policy issued by an insurer outside India shall not apply to a unit located in Special Economic Zone'.

G6 Foreign Exchange Management (Insurance) Regulations 2000 – Life Insurance Memorandum (LIM)

This sets out exchange control regulations that govern issues relating to the issue of life insurance policies in Rupees and in foreign currencies to non-residents, collection of premium and settlement of claims and other related matters.

- **Issue of policy and collection of premium** – in the case of resident individuals with Indian nationality, life insurance policies can be issued in foreign currency, provided that the premium is being paid out of remittances from foreign currency funds held by them abroad, or from their resident foreign currency accounts with authorised dealers in India.

  In the case of non-residents, life insurance policies denominated in foreign currency by insurers, through their offices, either in India or abroad, provided that the premium is collected in foreign currency from abroad or out of NRE/FCNR accounts of the insured or their family members held in India.
- **Claim settlement** – in cases where the claimant is a resident outside India, for rupee life insurance policies, payment in foreign currency will only be in proportion to the amount of premium paid in foreign currency. In the case of non-resident beneficiaries, settlement in foreign currency can be made in their NRE/FCNR account.
- **Commission to overseas agents** – commission by insurance companies can be paid to their agents who are permanently resident outside India, notwithstanding that the part of the business booked by them has been for resident Indians with premiums paid in rupees in India.

G7 Consumer Protection Act (COPA) 1986

- Under this Act, a consumer, as an individual, can approach the various forums prescribed under the Act for redressal if they are not satisfied with the goods or service provided.
- COPA applies to the insurance industry as well.
- Policyholders have the right to seek redress against unfair trade practices or unsatisfactory service from insurers and from agents.
- The majority of disputes relating to insurance arise out of repudiation and delays in claims.

Consumer dispute redressal forums are established in each district and for each State. The forum at the district level will hear complaints up to the value of Rs. 20,00,000, and the forum at the State level will hear complaints up to the value of Rs. 1,00,00,000. The National Commission will attend to matters beyond the jurisdiction of the State forums and also appeals against the decisions of a State forum.

The following are basic consumer rights:

- Right to Protection against marketing Goods & services.
- Right to Information.
- Right to be Safe.
- Right to Choose.
- Right to be Heard.
- Right to Seek Redressal.
- Right to Consumer Education.

The complaint should be filed within two years from the date on which the cause of action has arisen, unless otherwise condoned by the competent consumer Forum.

There are various other measures taken by all insurance industry stakeholders, including the IRDA, for the protection of policyholders. We will look at these measures in more detail in chapter 14.

Key points

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

- The Insurance Act 1938 is the most important insurance legislation passed in India.
- Section 40(1) of the Insurance Act 1938 prohibits the payment of any remuneration for procuring insurance business to any person other than a licensed insurance agent.
- Section 41(1) of the Insurance Act 1938 prohibits any insurance agent from offering any rebate as an inducement to buy insurance. The section also prohibits any person from accepting any such rebates offered for taking insurance.
- Section 42 of the Insurance Act 1938 stipulates the conditions for issuing a licence to a person or company to act as an insurance agent for soliciting insurance business.
- Subject to certain conditions, under section 44 of the Insurance Act 1938, no insurance agent can be refused payment of renewal commission due to him in respect of life insurance business conducted in India.
- The first statutory measure to regulate life insurance business in India was the Indian Life Assurance Companies Act 1912.
- The LIC Act 1956 was passed to provide for the nationalisation of life insurance business in India by transferring all life insurance business to the LIC.
- The LIC was formed with the merger of more than 200 life insurance companies and provident societies.
- The IRDA Act 1999 was passed to regulate, promote and ensure orderly growth of the insurance industry.
- The IRDA replaced the 'Controller of Insurance' in the registration, licensing and laying down of regulations for the proper conduct of the business and the protection of interests of policyholders.
- Money laundering is the process of illegally bringing money into the financial system by hiding its origin so that it appears to be legally acquired. There are three stages: placement; layering; and integration.
- All insurers must have an AML program in place and which must be adhered to by all agents in the course of their business.
- Section 6 of the MWP Act 1874 provides that a life insurance policy that has been taken out by a married man on his own life, for the benefit of his wife and children, shall be deemed to be a trust and will be outside the control of the life insured, his creditors, court attachments etc.
- The beneficiaries of the life insurance policy can be the wife alone, one/more children alone, or the wife and one/more children jointly.

Other legislation:

- The Governing Body of Insurance Council (GBIC) was established under the Redressal of Public Grievances Rules 1998 (RPG rules 1998) to set up and facilitate the Institution of Insurance Ombudsman in India.
- The Insurance Regulatory and Development Authority (Insurance Advertisement and Disclosures) Regulations 2000 govern issues related to unfair advertisements and advertisements by insurance companies and insurance agents.
- The Insurance Regulatory and Development Authority (Manner of Receipt of Premium) Regulations 2002 define the manner in which premium can be paid by a policyholder for purchasing an insurance policy.
- The Insurance Regulatory and Development Authority (Licensing of Corporate Agents) Regulations 2002 deal with the issue of licences and other matters related to corporate agents who are not individuals and can still become agents.
- The Foreign Exchange Management (Insurance) Regulations 2000 prohibit resident Indians from taking out life/general insurance policies issued by an insurer outside India.
- The Foreign Exchange Management (Insurance) Regulations 2000 – Life Insurance Memorandum (LIM) set out exchange control regulations that govern issues relating to the issue of life insurance policies in rupees and in foreign currencies to non-residents, the settlement of claims and other matters.
- Under the Consumer Protection Act (COPA) 1986 an individual can approach various forums for redressal if they are not satisfied with the goods or services provided to them. Accordingly policyholders have the right to seek redress against unfair trade practices or unsatisfactory service from insurers and their agents.

Question answers

12.1 Section 42 of the Insurance Act 1938 stipulates the conditions for issuing a licence to a person or company to act as an insurance agent for soliciting or procuring insurance business. It covers the following points:

- The qualification criteria for becoming an agent.
- The fee payable with the maximum limit.
- The validity of the licence for three years, after which it needs to be renewed.
- The application for renewal along with the renewal fee should reach the authority at least 30 days before the expiry date of the licence.
- If a licence is lost, damaged or destroyed a duplicate licence may be issued on payment of the prescribed fee.
- Any person who acts as an insurance agent without holding a licence shall be punished with a fine.
- Disqualification.
- Specified training.
- Pass in specified test.

The section also lays down the guidelines for registration, regulation of principal agents, chief agents and special agents.

12.2 The key aspects of the AML guidelines that are relevant to an agent are the need to:

- ensure that their clients submit the necessary identity and address proofs at all stages (e.g. issue of policy, top-ups and at the time of claim payment);
- establish the risk profile of their clients and ensure that it is consistent with their investment;
- obtain suitable income proofs to establish the need for insurance cover; and
- establish the source of funds and to only accept payment of premiums of Rs. 50,000 or above by cheque, demand draft, credit card or any other banking channels.

Self-test questions

1.	What are the objectives of the IRDA Act 1999?
2.	To whom is the PMLA 2002 applicable?
3.	Under the MWP Act 1874 who can be the beneficiaries of a life insurance policy?

You will find the answers on the next page

Self-test answers

1.	The objectives of the IRDA Act 1999 are: • to protect the interest of holders of insurance policies; • to regulate, promote and ensure orderly growth of the insurance industry; and • for other related matters.
2.	Compliance with the PMLA is applicable to all financial institutions coming under the: • Reserve Bank of India (RBI) – the banking regulator; • Securities Exchange Board of India (SEBI) – the capital markets regulator; • Insurance Regulatory Development Authority (IRDA) – the insurance regulator; and • all other financial intermediaries.
3.	For a policy under the MWP Act the beneficiaries can be: • the wife alone; • one or more children; or • the wife and one or more children jointly.

13
Regulation and client advice

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B Key Indian and international insurance bodies	13.3
C Duties, powers and functions of the IRDA and other regulators	13.1
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Learning objectives

After studying this chapter, you should be able to:

- describe the role played by the Indian Government in promoting the growth of the insurance industry;
- outline the role of various Indian and international insurance bodies in the insurance industry;
- explain the duties, powers and functions of the IRDA as the insurance regulator;
- describe the key features of the IRDA (Licensing of Insurance Agents) Regulations 2000.

Introduction

We have discussed the Insurance Regulatory and Development Authority (IRDA) already in the course of our studies, and in the previous chapter we were reminded about how it was established by the **Insurance Regulatory and Development Authority (IRDA) Act 1999**. We know that the IRDA is the insurance regulator in India and that it was formed with a mission to protect the interests of policyholders and to regulate, promote and ensure the orderly growth of the insurance industry. In this chapter we will study the duties, functions and powers conferred upon the IRDA to accomplish this mission. This chapter will also make you aware of the provisions of the **IRDA (Licensing of Insurance Agents) Regulations 2000**, which cover the issue and renewal of licences to insurance agents.

We will start by learning about the role played by the Indian Government and various other key bodies in the promotion and penetration of insurance in India.

Key terms

This chapter features explanations of the following terms and concepts:

Insurance Regulatory and Development Authority (IRDA)	Foreign direct investment (FDI)	Life Insurance Council (LI Council)	Institute of Actuaries of India (IAI)
Insurance Brokers Association of India (IBAI)	Insurance Institute of India (III)	Tariff Advisory Committee (TAC)	De-tarrification
IRDA (Licensing of Insurance Agents) Regulations 2000	Cancellation of licence	Practical training	Issue of licence
Code of conduct	Duplicate licence		

A The role of Government

As the ultimate source of law, the Government has a key role to play in the regulation of the insurance industry in India. It has powers to act to ensure that the industry is properly regulated and takes action from time to time to promote the spread of insurance throughout India.

A1 Power of the Central Government to supersede the IRDA

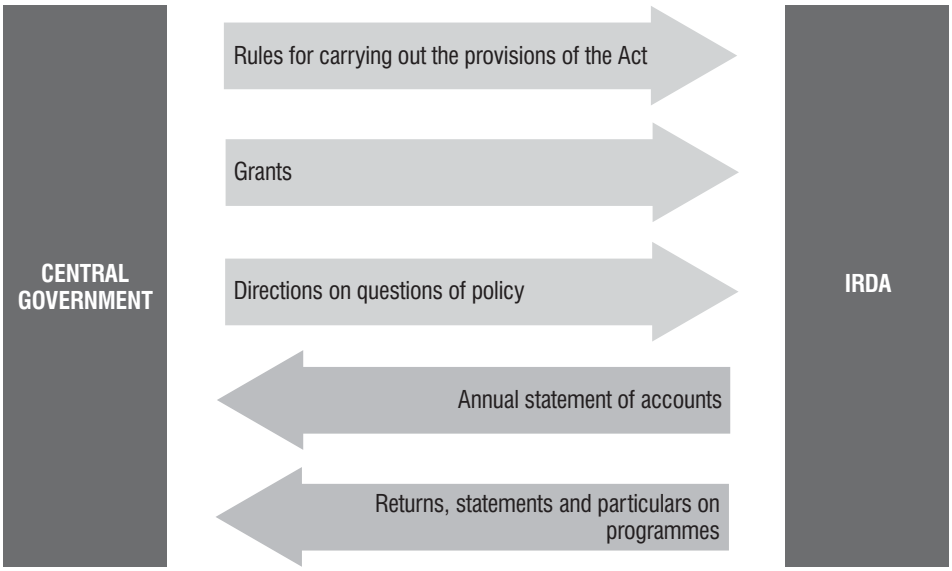
The IRDA Act 1999 gives the Central Government of India the power to supersede the IRDA by issuing a notification. The Government may exercise this power if it is of the opinion that the IRDA is unable to discharge its functions or duties (for reasons beyond the control of the IRDA), or that it has persistently defaulted on its duties and responsibilities, or where circumstances exist which render action necessary in the public interest.

A2 Relationship of the Central Government with the IRDA

The IRDA Act specifies the role that the Central Government has in relation to the IRDA. We can sum this up as follows:

- To issue grants to the IRDA after due appropriation made by Parliament by law, for the IRDA to use for the purpose of the Act.
- The annual statement of accounts of the IRDA must be audited and certified by the Comptroller and Auditor-General of India and then forwarded to the Central Government. These account statements will then be presented before each House of Parliament by the Central Government.
- The Central Government can issue directions to the IRDA on questions of policy, other than those relating to technical and administrative matters. The Central Government may give these directions in writing from time to time and the IRDA is bound by them.
- The IRDA should supply returns, statements and other particulars regarding any proposed or existing programme for the promotion and development of the insurance industry to the Central Government as required.
- The Central Government has the power to make rules for carrying out the provisions of the Act, and may do this by issuing a notification.

Figure 13.1: Relationship between the IRDA and Central Government



A3 Role of the Government in the growth of the industry

The Central Government introduces various provisions from time to time to promote the growth of the insurance industry. One of the major provisions that Central Government has made is to allow foreign investment in the insurance sector. This is known as foreign direct investment (FDI).

A3A Foreign direct investment (FDI)

Prior to 2000 the Life Insurance Corporation (LIC) had the exclusive privilege of transacting life insurance business in India.

Insurance is a very capital intensive business with long break-even periods and requires a great deal of expertise. When the Government wanted to open up the insurance industry to private participation, the prospective participants had neither the technical expertise nor the required capital for insurance business. Therefore, to facilitate the smooth opening up of the insurance market to private participation, and to ensure the industry's orderly growth, the Government allowed 26% foreign direct investment (FDI) in the insurance sector.

Be aware

Under prevailing FDI laws for insurance at the time of writing, domestic private companies are allowed to form joint ventures (JVs) with foreign partners, in which the foreign partner can hold a 26% stake.

Since the opening up of the insurance sector to private participation in 2000, the penetration of insurance has much improved in the country. Customers have benefitted greatly in terms of the availability of innovative and customised products which cater to their requirements and are offered at competitive premiums. In order to sustain this growth, the Government proposes to increase the FDI limit in the insurance sector to 49%. At the time of writing the Bill for this is pending approval in Parliament. Once this is approved, the foreign partners will be able to increase their ownership to 49% in the joint ventures with the private domestic players. You are encouraged to keep up to date with developments in this area.

Suggested activity

Make a list of any five private life insurance companies and from the internet or company product brochures find out about the shareholding pattern of these companies. Find out how much is owned by the domestic partner(s) and how much by the foreign partner.

A3B Income tax incentives

We have seen in earlier chapters how the Government offers various tax incentives to encourage individuals to invest in life insurance. This has helped the take-up and spread of life insurance in India.

Question 13.1

What can the Central Government do if it is of the opinion that the IRDA is failing to carry out its functions?

B Key Indian and international insurance bodies

In this section we will look at some of the key bodies that play a role in the Indian insurance industry.

B1 Insurance Regulatory and Development Authority (IRDA)

We saw in chapter 1 that in 1999 the Insurance Regulatory and Development Authority (IRDA) was constituted as an autonomous body to regulate and develop the insurance industry following the recommendations of the Malhotra Committee report. The key objectives of the IRDA include promoting competition, so as to enhance customer satisfaction through increased consumer choice and competitive premiums, while ensuring the financial security of the insurance market. The IRDA has the duty to regulate, promote and ensure the orderly growth of insurance and reinsurance business in India.

Be aware

The IRDA was incorporated as a statutory body in April 2000.

We will look at the duties, powers and functions of the IRDA later in this chapter.

B2 Life Insurance Council (LI Council)

The Life Insurance Council was constituted under section 64A of the **Insurance Act 1938**. It functions through the Executive Committee and several sub-committees, and includes all life insurance companies in India. It develops and coordinates all discussions on behalf of the industry with the Government, the IRDA and the public. In short, it is the face of the life insurance industry.

The objective of the Life Insurance Council is to play a significant and complementary role in transforming India's life insurance industry into a vibrant, trustworthy and profitable service that helps people in their journey to prosperity.

The functions of the Life Insurance Council are as follows:
• Maintaining high standards of ethics and governance.
• Creating a positive image of the industry and enhancing consumer confidence.
• Promoting awareness of the role and benefits of life insurance.
• Organising structured and proactive discussions with the Government, lawmakers and regulators.
• Conducting research in life insurance and contributing to the development of the sector.
• Acting as a forum of interaction with other organisations within the financial services sector.
• Playing a leading role in insurance education, training and conferences.
• Providing help and guidance to members when necessary.
• To be an active link between the Indian life insurance industry and the global markets.

B3 General Insurance Council (GI Council)

The General Insurance Council represents the collective interests of the general (non-life) insurance companies in India. The Council speaks out on issues of common interest, participates in discussions related to policy formation, and acts as an advocate for high standards of customer service in the insurance industry.

B4 Insurance Brokers Association of India (IBAI)

The Insurance Brokers Association of India (IBAI) is the IRDA recognised apex body for all licensed insurance brokers in India. Insurance brokers have been introduced into the Indian market by the IRDA as professionals who represent and service the interests of insurance buyers. The insurance broker represents the insurance buyer and **not** the insurance company, although the broker is remunerated by the insurance company.

Be aware

There is no additional cost to the policyholder for placing business through an insurance broker.

B5 Institute of Actuaries of India (IAI)

The Institute of Actuaries of India (IAI) (formally the Actuarial Society of India – ASI) was formed in 1944 and was registered as a member of the International Actuarial Association in 1979.

Be aware

An actuary is an expert who applies mathematical and statistical methods for assessing the risk associated with certain events in insurance. For example, in chapter 4 we saw how actuaries prepared the mortality tables used by life insurance companies. An actuary should be a fellow of the Institute of Actuaries of India (IAI).

The IAI was started with the objectives of:
• advancing the actuarial profession in India;
• providing opportunities for interaction among members of the profession;
• facilitating research and arranging lectures on relevant subjects; and
• providing facilities and guidance to those studying for the actuarial exams.

B6 Tariff Advisory Committee (TAC)

The Tariff Advisory Committee (TAC) was established by section 64U of the Insurance Act 1938 to control and regulate the rates, advantages, terms and conditions offered by insurers in respect of general insurance business. Consequently, in the past the pricing of many insurance products was based on rates prescribed by the TAC. The TAC has been designated by the IRDA as the data repository for the non-life insurance industry.

The IRDA is in the process of implementing, in a phased manner, the de-tariffication of rates; this has been completed for some classes of non-life insurance but not yet for others.

Be aware

De-tariffication is the process of freeing the pricing of insurance so that insurers can price their products on the basis of their risk assessment and as driven by the market, rather than having a price imposed upon them.

While the pricing of insurance products is no longer dictated by the TAC, the standard policy wordings framed by the TAC are still being used by insurers.

B7 Insurance Institute of India (III)

The Insurance Institute of India (III) was formed in 1955 as the Federation of Insurance Institutes, becoming the III in 1987. Its purpose is to promote insurance education and training in India, and it is closely associated with all the segments of the insurance industry, including the IRDA and both public and private sector insurance companies.

The institute conducts examinations at various levels and works with other international insurance bodies in Canada, the USA and the UK, including the Chartered Insurance Institute (see section B9).

B8 National Insurance Academy (NIA), Pune

The NIA was set up in 1980 by the Government with support from the LI Council, GI Council and the four PSU general insurers. The main objective of NIA, Pune is to design, implement and operate an insurance training architecture that will engage the participating executives, faculty and staff in assisted learning, research, management and communications. It is an apex institution for research, training, education, consultancy, publication and leadership development in insurance and risk management. The NIA has produced numerous competent insurance executive practitioners through cognitive development programmes.

B9 Chartered Insurance Institute (CII)

The Chartered Insurance Institute (CII) was formed in the UK by Royal Charter in 1912 and, with over 95,000 members in more than 150 countries and is the largest insurance and financial services professional body in the world. The CII is committed to the adoption of consistent professional global standards and works with local regulators, educational partners and industry organisations to improve the professionalism, skills and behaviour of insurance and financial service staff and agents working in their local markets.

B10 Institute of Insurance and Risk Management (IIRM), Hyderabad

The Institute of Insurance and Risk Management (IIRM) is an international education and research organisation. The Institute was set up jointly by the IRDA and the State Government of Andhra Pradesh in 2002, as per the provisions of section 14(f) of the IRDA Act 1999 for the promotion of International Post Graduate Diploma Courses in insurance and risk management (regular and distance learning courses).

The IIRM aims to serve the learning and development needs of emerging markets in the context of their contemporary challenges in the insurance sector.

?

Question 13.2

What are the functions of the Life Insurance Council?

C Duties, powers and functions of the IRDA and other regulators

C1 IRDA

The duties, powers and functions of the IRDA are laid down by section 14 of the IRDA Act 1999. The IRDA Act gives the IRDA the power to:

a)	issue to applicants (companies) a certificate of registration and renew, modify, withdraw, suspend or cancel such registration;
b)	protect the interests of policyholders in matters concerning the assigning of the policy, nomination by policyholders, insurable interest, settlement of insurance claims, the surrender value of the policy and other terms and conditions of contracts of insurance;
c)	specify the requisite qualifications, code of conduct and practical training for intermediaries and agents;
d)	specify a code of conduct for surveyors and loss assessors;
e)	promote efficiency in the conduct of insurance business;
f)	promote and regulate professional organisations connected with the insurance and reinsurance business;
g)	specify the percentage of premium income to come from insurance companies to finance schemes for promoting and regulating the professional organisations referred to in clause (f);
h)	levy fees and other charges for carrying out the purposes of this act;
i)	call for information from, undertake the inspection of, conduct enquiries in, investigate and audit insurance companies, intermediaries and other organisations connected with the insurance business;
j)	control and regulate the rates, advantages, terms and conditions that may be offered by insurers in respect of general insurance business that is not controlled and regulated by the Tariff Advisory Committee (TAC) under section 64U of the Insurance Act 1938 (see section B6);
k)	specify the form and manner in which books of accounts are to be maintained and the statement of accounts are to be rendered by insurance companies and intermediaries;
l)	regulate the investment of funds by insurance companies;
m)	regulate the maintenance of the margin of solvency the law requires of each insurance company (note: the margin of solvency is the amount by which an insurance company's assets must exceed its liabilities);
n)	adjudicate in disputes between insurance companies and intermediaries;

o)	supervise the functioning of the Tariff Advisory Committee (TAC) (see section B6);
p)	specify the percentage of life insurance business and general insurance business to be undertaken by the insurance company in the rural or social sector; and
q)	exercise such other powers as may be prescribed.

C2 Reserve Bank of India (RBI)

The Reserve Bank of India is the Central Bank of India and was set up on 1 April 1935 in accordance with the provisions of the Reserve Bank of India Act 1934. The RBI is the regulator, supervisor and monetary authority of the financial system in India. It provides guidelines for banking operations within which the country's banking and financial systems operate. The RBI formulates, implements and monitors the monetary policy of the country and ensures that price stability is maintained.

C3 Securities and Exchange Board of India (SEBI)

The SEBI was established on 12 April 1992 in accordance with the provision of Securities and Exchange Board of India Act 1992. The SEBI is the regulator for the securities market in India and protects the interests of all investors in the securities market. It is also responsible for promoting the development of the securities market through appropriate measures as required from time to time.

Question 13.3

What are the key objectives of the IRDA?

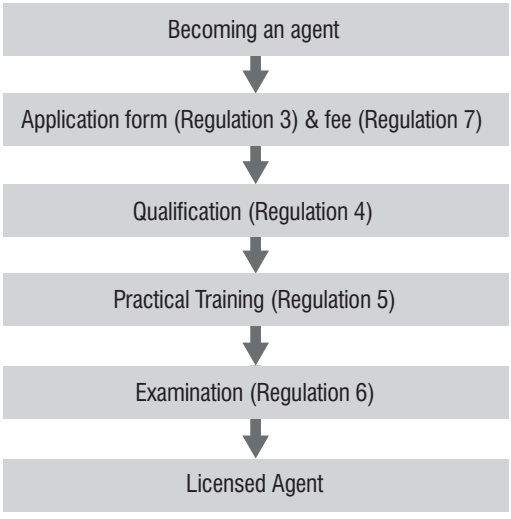
D IRDA (Licensing of Insurance Agents) Regulations 2000

In July 2000 the IRDA issued the Insurance Regulatory and Development Authority (Licensing of Insurance Agents) Regulations. This is a key piece of legislation for you to know about as it relates to the issue and renewal of licences for insurance agents.

D1 Becoming an agent

There are a number of steps that you as an individual need to take, and a number of criteria that you will need to fulfil, if you wish to become a life insurance agent.

Figure 13.2



D1A Application

Firstly, a person who wishes to obtain a licence to act as an insurance agent must make an application, in the required format, to a designated person as specified in Regulation 3. The application must be accompanied by the fee of Rs. 250, payable to the authority as specified in Regulation 7.

D1B Qualification

The applicant must possess the necessary qualification, as specified under Regulation 4, as follows.

An applicant living in a place that has a population of 5,000 or more as per the last census:	An applicant living anywhere else:
• a minimum 12th standard pass; or • an equivalent examination provided by any recognised board or institution.	• a minimum 10th standard pass; or • an equivalent examination provided by any recognised board or institution.

D1C Practical training

The applicant needs to receive practical training, as specified under Regulation 5. When seeking a licence for the first time, the applicant needs to have completed at least 50 hours (75 hours in case of a composite agency) of practical training in the life insurance business by an approved institution. However, the requirement for practical training is relaxed somewhat where the applicant has additional educational qualifications (as specified under sub-regulation (1)).

D1D Examination

An applicant also needs to pass the pre-recruitment examination in life insurance business as specified under Regulation 6. The examination may be conducted by the Insurance Institute of India (III) or any other approved examination body.

D1E Issue of licence

The designated person may grant the licence on being satisfied that the applicant:

- is in compliance with Regulation 4 (is properly qualified);
- is in compliance with Regulation 5 (has had practical training);
- is in compliance with Regulation 6 (has passed the necessary examination);
- has supplied an application, complete in all respects;
- has the knowledge necessary to be able to seek and gain insurance business; and
- is capable of providing the necessary service to policyholders.

D1F Renewal of licence

Before seeking a renewal of their licence to act as an insurance agent, the applicant needs to have completed at least 25 hours of practical training in life insurance business from an approved institution as specified in Regulation 5(3).

D1G Cancellation of licence

The designated person may cancel the licence of an insurance agent if the agent suffers from any of the disqualifications mentioned in sub-section (4) of section 42 of the Act.

The disqualifications mentioned in this sub-section that are applicable to an individual agent are as follows:

- The individual is a minor.
- The individual is found to be of unsound mind by a court of competent jurisdiction.
- The individual is found guilty of criminal misappropriation, breach of trust, cheating, forgery, or of abetting or attempting to commit such an offence by a court of competent jurisdiction.
  - However, if at least five years have passed since the completion of the sentence imposed for such an offence, ordinarily the conviction ceases to operate as a disqualification.
- The individual is found guilty of, or is found to have knowingly participated in any fraud, dishonesty or misrepresentation against an insurer or an insured.
- The individual does not possess the necessary qualifications or has not undergone the necessary training for a period not exceeding twelve months as specified by the Regulations.
- The individual has violated the Code of Conduct (see section D2).

?

Question 13.4

How many hours of practical training does a new life insurance agent need to undergo?

D1H Issue of duplicate licence

The authority may issue a duplicate licence to replace a licence lost, destroyed, or mutilated on payment of a fee of Rs. 50.

D1I Operating without a licence

An individual who acts as an insurance agent without holding a licence will be fined up to Rs. 500.

D2 Agent Code of Conduct

Along with the licence regulations, the Regulator has also laid down a code of conduct that is to be followed by every insurance agent. We will discuss the Code of Conduct in Chapter 15.

Question 13.5

What steps do you need to take to become an insurance agent?

?

Key points

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

The role of the Government

- The IRDA Act 1999 gives the Central Government of India the power to supersede the IRDA by issuing a notification.
- The Act gives power to the Central Government to issue directions, in writing from time to time, to the IRDA on questions of policy, other than those relating to technical and administrative matters.
- Under prevailing laws the Government allows 26% FDI in the insurance sector.
- The Government offers various tax incentives to encourage people to invest in insurance.

Key Indian bodies

- The Life Insurance Council (LI Council) develops and coordinates all discussions between the Government, the IRDA and the public. It is the face of the life insurance industry.
- The Insurance Brokers Association of India (IBAI) is the IRDA recognised apex body for all licensed insurance brokers in India.
- The Institute of Actuaries of India (IAI) aims to advance the actuarial profession in India.
- The Tariff Advisory Committee (TAC) was established to control and regulate the rates, advantages, terms and conditions that may be offered by insurers in respect of general insurance business.
- The Indian Insurance Institute (III) was established to promote insurance education and training in India.
- The Chartered Insurance Institute (CII) works with local regulators, educational partners and industry organisations to improve the professionalism, skills and behaviour of insurance and financial service staff and agents working in their local markets.

Duties, powers and functions of the IRDA and other regulators

- The IRDA was constituted as an autonomous body to regulate and develop the insurance industry.
- Section 14 of the IRDA Act 1999, lays down the duties, powers, and functions of the IRDA.
- The IRDA has the duty to regulate, promote and ensure the orderly growth of insurance and reinsurance business.

IRDA (Licensing of Insurance Agents) Regulations 2000.

- In July 2000 the Authority issued the IRDA (Licensing of Insurance Agents) Regulations relating to the issue and renewal of licences for insurance agents.
- To become an agent the applicant needs to submit the duly filled application form and fee to a designated person. They need to be appropriately qualified, undergo the required training and pass the examination before the licence will be issued.

Question answers

13.1 The Central Government has the power to supersede the IRDA if it is of the opinion that the IRDA is failing to carry out its functions, either through reasons beyond its control or because it has persistently defaulted on its duties and responsibilities. It can do this by issuing a notification.

13.2 The functions of the Life Insurance Council are as follows:

1. Maintaining high standards of ethics and governance.
2. Creating a positive image of the industry and enhancing consumer confidence.
3. Promoting awareness of the role and benefits of life insurance.
4. Organising structured and proactive discussions with the Government, lawmakers and regulators.
5. Conducting research in life insurance and contributing to the development of the sector.
6. Acting as a forum of interaction with other organisations in the financial services sector.
7. Playing a leading role in insurance education, training and conferences.
8. Providing help and guidance to members when necessary.
9. Acting as a link between the Indian life insurance industry and the global markets.

13.3 The key objectives of the IRDA include promoting of competition so as to enhance customer satisfaction through increased consumer choice and lower premiums, while ensuring the financial security of the insurance market.

13.4 A new life insurance agent needs to undergo 50 hours of training, though this is relaxed somewhat if they have additional educational qualifications.

13.5 There are a number of steps and a number of criteria to fulfil if you wish to become a life insurance agent.

1. You need to make an application in the required format to a designated person (Regulation 3), enclosing a fee of Rs. 250. (Regulation 7).
2. You must possess the necessary qualification: minimum 12th standard pass or equivalent if you live in a place with a population of 5,000 or more, or a minimum 10th standard pass or equivalent if you live anywhere else (Regulation 4).
3. You must undergo the 50 hours of practical training (less if you have additional educational qualifications) (Regulation 5).
4. You must pass the pre-recruitment examination in life insurance business (Regulation 6).

You will be issued with your licence if you have fulfilled all the above and are deemed to have the necessary knowledge and skill to seek and gain insurance business and provide the necessary service to policyholders.

Self-test questions

1.	What is the minimum qualification of an insurance agent?
2.	List seven powers and functions of the IRDA.
3.	What is the role of Central Government as specified by the IRDA Act 1999?
4.	How much is the current FDI allowed in insurance in India?

You will find the answers on the next page

Self-test question answers

1.	The applicant needs to possess the necessary qualification, as specified under Regulation 4. If the applicant lives in a place with a population of 5,000 or more (as per the last census), then they need a minimum 12th standard pass or equivalent examination provided by any recognised Board or Institution. If they live anywhere else, the minimum requirement is a 10th standard pass or equivalent examination provided by any recognised Board or Institution.
2.	Your answer should contain seven of the following. The powers and functions of the IRDA are to: a) issue applicants with a certificate of registration and renew, modify, withdraw, suspend or cancel such registration; b) protect the interests of policyholders in matters concerning the assigning of the policy, nomination by policyholders, insurable interest, settlement of insurance claims, the surrender value of the policy and other terms and conditions of contracts of insurance; c) specify the requisite qualifications, code of conduct and practical training for intermediaries and agents; d) specify a code of conduct for surveyors and loss assessors; e) promote efficiency in the conduct of insurance business; f) promote and regulate professional organisations connected with the insurance and reinsurance business; g) specify the percentage of premium income to come from insurance companies to finance schemes for promoting and regulating the professional organisations referred to in clause (f); h) levy fees and other charges for carrying out the purposes of this act; i) call for information from, undertake the inspection of, conduct enquiries in, investigate and audit insurance companies, intermediaries and other organisations connected with the insurance business; j) control and regulate the rates, advantages, terms and conditions that may be offered by insurers in respect of general insurance business that is not controlled and regulated by the Tariff Advisory Committee (TAC) under section 64U of the Insurance Act 1938; k) specify the form and manner in which books of accounts are to be maintained and statements of accounts are to be rendered by insurance companies and other insurance intermediaries; l) regulate the investment of funds by insurance companies; m) regulate the maintenance of the margin of solvency; n) adjudicate in disputes between insurers and intermediaries; o) supervise the functioning of the Tariff Advisory Committee (TAC); p) specify the percentage of life insurance business and general insurance business to be undertaken by the insurer in the rural or social sector; and q) exercise such other powers as may be prescribed.
3.	The IRDA Act specifies the role of the Central Government which can be summed up as follows: • To issue grants to the IRDA after due appropriation made by Parliament which should be utilised for the purpose of the Act. • The annual statement of accounts of the IRDA shall be audited and certified by the Comptroller and Auditor-General of India and shall be forwarded annually to the Central Government. These account statements will then be presented before each House of Parliament by the Central Government. • The Act also provides power to the Central Government to issue directions to the IRDA on questions of policy, other than those relating to technical and administrative matters. The Central Government may give these directions in writing from time to time and the IRDA shall be bound by these directions. • The IRDA needs to furnish returns, statements and other particulars in regard to any proposed or existing programme for the promotion and development of the insurance industry as required by the Central Government from time to time. • The Act provides the Central Government with the power to make rules for carrying out the provisions of this Act. The Central Government may do so by issuing a notification.
4.	The Government currently allows 26% foreign direct investment (FDI) in the insurance sector. Domestic private companies were allowed to form joint ventures (JVs) with foreign partners in which the foreign partner can have up to a 26% share.

14
Customer protection

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Learning objectives

After studying this chapter, you should be able to:

- recognise the importance of customer protection;
- discuss the IRDA (Protection of Policyholders' Interests) Regulations issued by the IRDA in 2002;
- outline the matters to be included in a life insurance policy;
- discuss the internal grievance redressal mechanism of insurance companies;
- discuss the role of the Insurance Ombudsman in settling insurance disputes;
- describe the ways in which complaints received by the Ombudsman are handled;
- describe the typical complaints made against insurers and insurance agents;
- discuss the various measures taken by the IRDA to handle customer complaints effectively;
- describe the Grievance Redressal Cell of the IRDA;
- state the circumstances in which the IRDA can renew an agent's licence.

Introduction

As with any business, insurance companies aim to make a profit. However, there is an increasing awareness within all types of businesses that profits should not be made at the expense of customers' interests and that a business has a responsibility to take the interests of all its stakeholders (including its customers) into consideration when making decisions about how it operates. This includes communicating clearly and in a manner that will be easily understood by customers.

In the field of financial services, and insurance in particular, the more financially literate a customer is, the easier it will be to protect their interests. In many parts of India this is not the case and all stakeholders, including life insurance agents, have a responsibility to ensure that their dealings with customers are as transparent as possible; providing relevant information as accurately and concisely as possible.

In support of this, various measures have been taken by key industry stakeholders (IRDA, insurers, insurance councils etc.) on an ongoing basis to provide insurance customers with the best service possible and to ensure that their interests are protected. We shall discuss the following key measures in this chapter:

- regulations issued by the IRDA for the protection of policyholders' interests;
- insurers' internal grievance redress cells;
- the Insurance Ombudsman;
- the role of the Consumer Affairs Department of the IRDA;
- the IRDA's Grievance Redress Cell; and
- other measures taken to protect the policyholder.

Key terms

This chapter features explanations of the following ideas:

Customer protection	Prospectus	Proposal for insurance	Grievance redressal procedure
Claim procedure	Policyholders' servicing	Insurance Ombudsman	Settlement
Award	Recommendation	Typical complaints	Grievance management system
Grievance Redressal Cell of the IRDA	Key features document	Consumer Affairs Department	Renewal of licence

A The importance of customer protection

Customer protection in the insurance industry is of great significance for a number of reasons. As mentioned in the introduction, in some parts of India financial literacy levels are still low compared to many other countries. As a result, customer protection measures play an important role in safeguarding customers' interests should they have a problem with an agent or insurance company at any stage; during the selling process, at renewal or at the point of making a claim, for example.

Be aware

Many people still do not appreciate the importance of having insurance cover and prefer to live with the risk rather than transferring it to an insurance company. This explains the low penetration of life insurance in India which is still less than 10% of the population. Of these, many do not have the adequate level of protection they should ideally have.

Of those who do have insurance cover, many have complaints about claims settlement, premiums, policy servicing, policy terms and conditions; a significant proportion of which result in legal disputes. This trend is detrimental to customers, individual agents and insurers alike, in addition to the overall growth of the insurance industry. Therefore, it is important for agents and insurance companies to focus on satisfying their customers and placing their interests at the heart of how they perform their roles and carry out their operations.

Be aware

An informed and satisfied customer is a brand ambassador for the industry. Therefore, it is it is in the interests of all industry stakeholders to protect the customer.

The agent should make sure that he gives all possible product information and makes proper disclosures to the potential client at the time of fact-finding so that there is no scope for potential future grievances. However if, after buying a policy, a customer still has a grievance then the agent should guide the customer in a proper manner through the appropriate channel. The agent, as an intermediary between the customer and the insurance company, should try to get the issue resolved as quickly as possible. This would add a personal touch to the process and help considerably in mitigating customer dissatisfaction.

B IRDA (Protection of Policyholders' Interests) Regulations 2002

In October 2002 the IRDA, in consultation with the Insurance Advisory Committee, issued the following Regulations for the protection of policyholders' interests.

B1 Point of sale

1. A prospectus of any insurance product will clearly state:
   - the scope of benefits;
   - the extent of insurance cover;
   - the exceptions and conditions of the insurance cover in a straightforward manner;
   - whether the product is participating (with-profits) or non-participating (without-profits);
   - the premium on all the riders relating to health or critical illness, in the case of term or group products, shall not exceed 100% of the premium of the main policy;
   - that the allowable rider or riders on the product will be clearly spelt out with regard to their scope of benefits, and under no circumstance will the premium relatable to all the other riders put together exceed 30% of the premium of the main product; and
   - the benefits arising under each of the riders shall not exceed the sum insured under the basic product.
2. An insurer or its agent or other intermediary shall provide all material information in respect of a proposed cover to the potential client to enable them to decide on the most appropriate cover for them.
3. Where the potential client is reliant upon the advice of the insurer or an agent or an insurance intermediary, such a person must recommend product(s) based on the need(s) of the prospective client.
4. Where, for any reason, the proposal and other connected papers are not completed by the potential client, a certificate may be incorporated at the end of the proposal form that the contents of the form and documents have been fully explained to them and that they have fully understood the significance of the proposed contract.

Be aware

In the process of a sale, the insurer or its agent or any intermediary shall act according to the code of conduct prescribed by:

- the Authority;
- the Life Insurance Council; and
- the recognised professional body or association of which the agent or intermediary or insurance intermediary is a member.

B2 Proposal for insurance

Figure 14.1

A proposal for grant of cover must be evidenced by a written document. It is the duty of an insurer to provide the insured with a complimentary copy of the proposal form within 30 days of the acceptance of a proposal.

↓

Forms and documents used in the grant of cover may, depending upon the circumstances of each case, be made available in languages recognised under the Constitution of India.

↓

Where a proposal form is not used, the insurer will record the information obtained orally or in writing, confirm it within a period of 15 days thereof with the proposer and incorporate the information in its cover note or policy. The onus of proof rests with the insurer in respect of any information not recorded, where the insurer claims that the proposer suppressed any material information or provided misleading or false information on any matter material to the grant of a cover.

↓

Wherever the benefit of nomination is available to the proposer, the insurer will draw the attention of the proposer to the terms of the Insurance Act 1938, or the conditions of the policy, and encourage the potential client to utilise the nomination facility.

↓

Proposals will be processed by the insurer with speed and efficiency and all decisions thereof shall be communicated in writing within a reasonable period not exceeding 15 days from receipt of proposals by the insurer.

Be aware

In filling out the proposal form, the potential client is to be guided by the provisions of section 45 (Indisputability Clause) of the **Insurance Act 1938**. Any proposal form seeking information for the grant of life cover may prominently state therein the requirements of section 45 of the Act.

B3 Grievance redressal procedure

Every insurer must have proper procedures in place to address the complaints and grievances of policyholders efficiently and with speed. This also applies to the information in respect of the Insurance Ombudsman which will be communicated as necessary to the policyholder along with the policy document.

Be aware

The internal grievance redress mechanism to be followed by every insurer and the role of the Insurance Ombudsman will be discussed in detail in section E of this chapter.

B4 Matters to be stated in a life insurance policy

1. A life insurance policy will clearly state the following:
   - the name of the plan governing the policy, including its terms and conditions;
   - whether it is participating in profits or not;
   - the basis of participation in profits such as cash bonus, deferred bonus, simple or compound reversionary bonus;
   - the benefits payable and the contingencies upon which these are payable and the other terms and conditions of the insurance contract;
   - the details of the riders attached to the main policy;
   - the date of commencement of risk and the date of maturity or date(s) on which the benefits are payable;
   - the premiums payable, period of payment or grace period allowed for payment of the premium, the date of the final instalment of premium, the implications of discontinuing the payment of an instalment(s) of premium and also the provisions of a guaranteed surrender value;

- the age at entry and whether this has been admitted;
- the policy requirements for:
  (i) conversion of the policy into a paid-up policy,
  (ii) surrender,
  (iii) non-forfeiture, and
  (iv) revival of lapsed policies;
- contingencies excluded from the scope of the cover, both in respect of the main policy and the riders;
- the provisions for nomination, assignment and loans on security of the policy and a statement that the rate of interest payable on such loan amount shall be as prescribed by the insurer at the time of taking the loan;
- any special clauses or conditions, such as first pregnancy clause, suicide clause etc.;
- the address of the insurer to which all communications in respect of the policy shall be sent;
- the documents that are normally required to be submitted by a claimant in support of a claim under the policy; and
- along with the policy document the insurer should also include information on how to contact the Insurance Ombudsman. In the event that the policyholder is not satisfied with the insurer in any aspect and the insurer has not resolved the issue within a reasonable timeframe, the policyholder can approach the Insurance Ombudsman with their grievance.

Suggested activity

Ask your family members or friends if any of them have bought a life insurance policy. If yes, then compare the policy with the above mentioned points and see how these points are mentioned in the policy.

2. In accordance with Regulation 6(1) of the above referred Regulations, in forwarding the policy to the insured, the insurer will inform the policyholder by letter that they have a period of 15 days from the date of receipt of the policy document to review the terms and conditions of the policy. Where the insured disagrees with any of the terms or conditions of the policy, they have the option to return the policy stating the reasons for their objection. The policyholder is entitled to a refund of the premium paid, subject only to a deduction of a proportionate risk premium for the period on cover, the expenses incurred by the insurer on medical examination of the proposer and stamp duty charges. This 15 day period is also known as the free-look period or the cooling off period.
3. In respect of a unit-linked policy, in addition to the deductions under sub-regulation (2) of this Regulation, the insurer shall also be entitled to repurchase the unit at the price of the units on the date of cancellation.
4. In respect of cover, where premium charged is dependent on age, the insurer will ensure that the client's age is admitted as early as possible before the policy document is issued. If their age has not been provided by the time the policy is issued, the insurer will make efforts to obtain proof of age as soon as possible.

Question 14.1

What details should the prospectus of an insurance product clearly state?

B5 Claims procedure

In the Protection of Policyholders' Regulations the IRDA has also laid down various procedures to be followed pertaining to settling life insurance claims. We have already studied these guidelines in chapter 11 where we discussed claims in detail.

Each insurer will periodically inform the insured of their own responsibilities (with regards to policy terms and procedures) when lodging a claim throughout the claims process. This is in order for the insurer to streamline the process and settle the claim promptly.

B6 Servicing of policyholders

Figure 14.2

Suggested activity

Ask your family or friends if they have ever had to contact their life insurer for any of the above points. If yes, ask them how the company went about addressing their request and how quick and friendly the company's service was.

B7 What does this mean for life insurance agents?

Insurance agents are the face of the insurance company to its policyholders and they interact directly with the policyholders. Therefore, it is the duty of an insurance agent to serve the customer in the best possible manner, as outlined below:

- Good customer service enables you to promote yourself to your customers as an insurance agent who is going to work for them.
- Lack of transparency and disclosures would lead the customer to conclude that you do not care about them and their needs. As a result, they would not give you repeat business or references.
- This would deprive you of 'word of mouth' publicity, a reliable form of marketing which will help to make your career successful.
- There is also a possibility that customers would not want to continue their policies. This, while depriving you of a continuous income stream, may also impact upon your confidence.

Therefore, as an agent you should always place your customers' interests above everything else and serve your customers in the best possible manner.

C Typical complaints

In this section we will look at some of the typical complaints lodged by policyholders. The intention of this section is to make you aware of these complaints so that as an agent you don't falter on your commitments and can help these complaints be avoided.

Analysis of complaints indicates that a common complaint associated with agents is that of not disclosing all facts to the client and, at times, overstating the benefits of a product in their anxiety to close the deal. Not making extensive enquiries about a potential client and recording incorrect responses on the proposal form can lead to the rejection of a claim at a later stage which is likely to result in a complaint from the customer.

Another associated concern is the effectiveness of an after-sales service. This is an important feature of the Indian insurance market and is something that the customer expects. Consequently, agents need to ensure that they are constantly in touch with their customers, providing them with the much needed confidence that they are at their service when required.

Some of the typical complaints and issues faced by policyholders are listed below.

C1 Complaints against insurance companies

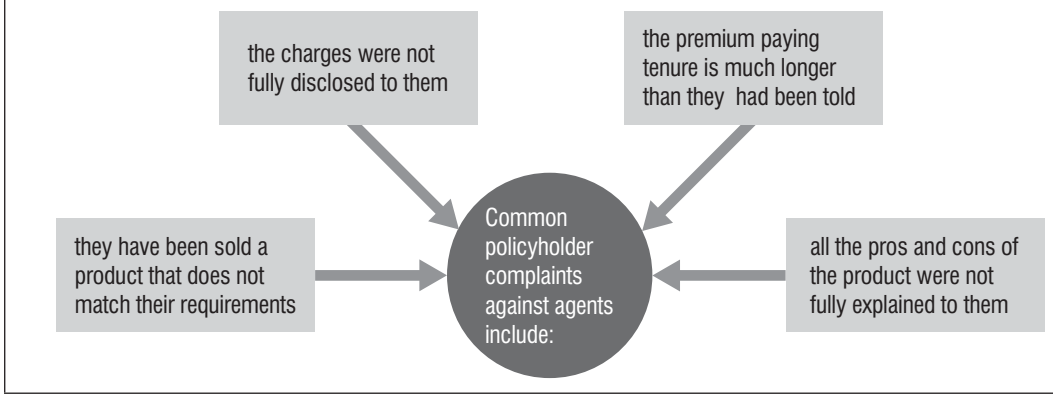
Some of the most common complaints registered against insurers are:

Claim-related complaints	• repudiation of the claim; • survival benefit not being paid; • non-settlement of maturity payment; • non-payment of annuities; • claim amount not correct; and • penal interest not being paid.
Policy servicing-related complaints	• non-receipt of policy bond; • cancellation of policy; • error in policy schedule; • issue of duplicate policy; • alterations in policy; • nomination/assignment of policies; • partial withdrawal-related; • non-receipt of statement of account/bonus; • NAV-related in case of ULIPs; and • free-look refund.
Policy lapse-related complaints	• revival of lapsed policies; • non-payment of surrender value; • correct surrender value not being paid; and • the consequence of non-payment of interest on loans in a lapsed policy causing foreclosure of a policy.

C2 Complaints against agents

Some of the common complaints registered against agents include the following:

Figure 14.3



Be aware

As a new agent you should pay careful attention to your client's needs and requirements to be sure of the policy's suitability before you sell it to them. Look back at sections B and D of chapter 10 to remind yourself of how to go about recommending the correct policy for a client's needs.

D Handling customer complaints effectively

In this section we will look at some of the initiatives taken by the IRDA to protect the interests of policyholders and the grievance redressal mechanisms available to the policyholder. As an agent you will need to understand the obligations set out in the regulations and guidelines and position your behaviour and conduct appropriately.

Whilst an agent must make their clients aware of their rights and the processes involved in making a complaint, they are also responsible for alerting their clients to their own obligations. These include making honest disclosures about their health, habits, personal information, history etc., all of which are crucial for acceptance of the risk.

The IRDA has established the Consumer Affairs Department to make sure that customer complaints are handled effectively.

D1 Consumer Affairs Department

Be aware

The objectives of the Consumer Affairs Department are to:

- give a special focus to and oversee the compliance by insurers of the IRDA Regulations for Protection of Policyholders' Interests; and
- empower consumers by educating them about the details of the procedures and mechanisms that are available for redressing grievances.

Policyholders must be provided with inexpensive and speedy mechanisms for complaints disposal. The IRDA (Protection of Policyholders Interests) Regulations 2002 require insurance companies to have effective internal grievance redressal mechanisms in place. The IRDA has also issued Guidelines for Grievance Redressal, which lay down specific timeframes and turnaround times (TATs) for response, resolution, etc., and will further strengthen the redressal systems insurers already have in place.

D2 Integrated Grievance Management System (IGMS)

The effectiveness of the grievance redressal mechanism needs to be monitored by the Regulator. To enable the creation of a central repository of industry-wide insurance grievance data, the IRDA is on the verge of implementing the Integrated Grievance Management System (IGMS).

IGMS will create a gateway for policyholders to register complaints with insurance companies first and, if needs be, to escalate them to the IRDA Grievance Cell. IGMS is a comprehensive solution which not only has the ability to provide centralised and online access to the policyholder, but also complete access and control to the IRDA for monitoring market conduct issues of which policyholder grievances are the main indicators.

IGMS will have the ability to classify different complaint types based on pre-defined rules. The system will be able to assign, store and track unique complaint IDs and notify various stakeholders as required within the workflow. The system will enable defining of target turn around times (TATs) and measure the actual TATs on all complaints. The system will set up alerts for pending tasks nearing the planned turn around time and will therefore automatically trigger activities at the appropriate time through rule-based workflows.

A complaint registered through IGMS will flow simultaneously to the insurer's system as well as the IRDA repository. Status update by the insurers would automatically be mirrored in the IRDA system. IGMS will be able to generate reports on all criteria such as status, nature of complaint and any other parameter that is defined. Thus, IGMS will provide a standard platform to all insurers to resolve policyholder grievances and will provide the IRDA with a tool to monitor the effectiveness of insurers' own grievance redressal systems.

D3 Internal grievance redressal cell of the insurer

As per the guidelines provided by the IRDA under the Regulations for Protection of Policyholders' Interests, every insurance company will have a grievance redressal system to address the complaints of clients. An internal grievance redressal system helps to provide a speedy resolution to clients. On 28 July 2010 the IRDA issued detailed guidelines on the grievance redressal procedures to be adopted by all insurance companies. Insurers' grievance redressal systems normally involve the following two-tier system.

D3A Grievance registration mechanism

Customers can register their complaint with the insurance company either by calling up its customer care department, writing an email to the company's helpdesk , or by registering a complaint with the officer at a branch office.

Most insurance companies normally provide the helpline number and grievance redressal contact email address on their website, proposal forms, product brochures and policy documents. The insurance company has to acknowledge receipt of the complaint within three working days and has to provide a resolution in a specified number of days. Turn around time for resolution is normally stated by the company during registration of the complaint.

D3B Grievance redressal officer

If the customer is dissatisfied with the reply/explanation or solution provided by the customer care cell, or if the customer care cell fails to resolve the grievance in the specified turn around time the customer can escalate the complaint to the next level. In such cases the customer can approach the grievance redressal officer named by the insurance company at the branch location/divisional, regional or zonal area/central or corporate office to address the complaint. This grievance redressal officer is also called a nodal officer by some insurance companies.

If the customer is still not satisfied or the grievance redressal officer is unable to provide a resolution, they can approach the next highest officer in the hierarchy named by the insurance company who may be called as the appellate authority (or the person responsible for appealing to a higher authority) for redressal of their complaint.

This hierarchy is company-specific and details of it can be found on the insurance company's website.

Be aware

The IRDA has stipulated the turn around time for specific grievances such as:

- the client has asked for the cancellation of the policy, but the insurance company has failed to do so; and
- the client has paid an additional premium for additional cover, but the insurance company did not issue endorsements.

In both the above cases, the insurance company must respond within 10 working days of the complaint being registered.

Be aware

If the insurance company rejects a complaint, it needs to provide a valid reason for doing so.

Each insurance company must advise the client/claimant, particularly in the case of death claims, that they can approach the Insurance Ombudsman, by stating the address, contact number, email address etc. of the Ombudsman, if they are not satisfied with the decision of the insurer.

D4 Other initiatives by the IRDA to protect policyholders

A number of initiatives have been taken by the IRDA recently to protect the interests of policyholders. These initiatives include:

D4A Key features document

One of the recent initiatives of the IRDA, to ensure that clear information regarding products is given to the policyholder in a way they can understand, is the proposal to introduce a key features document in simple language. The test of a key features document is whether or not the target customer for a particular product understands its main features and is able to take a decision as to whether the product is suitable for them. A key features document would also ensure disclosure by insurers of other important information such as premium details, payment modes, various charges, risks involved and what happens in the event of discontinuance etc.

D4B Needs analysis or suitability

Needs analysis or suitability is another initiative identified by the IRDA as a step in curbing inaccurate advice and mis-selling. An exposure draft on the subject has been issued. The Authority is currently working on putting a system in place to ensure that proposals go through a prospect product matrix before the sale is actually effected. This is to ensure that mis-selling does not take place.

D4C Guidelines for direct marketing

The guidelines addressing issues relating to distance marketing are proposed to focus on new challenges of mis-selling that have occurred with the advancement of technology. While the benefits of having new and faster channels need to be reaped, the gaps created by them also need plugging.

Be aware

The IRDA as a regulator takes various initiatives from time to time to protect the interests of policyholders. However, the IRDA is not vested with the power of adjudication. It can only facilitate the resolution of grievances by taking them up with the insurance companies concerned.

E The role of the Insurance Ombudsman

E1 The Insurance Ombudsman's objective

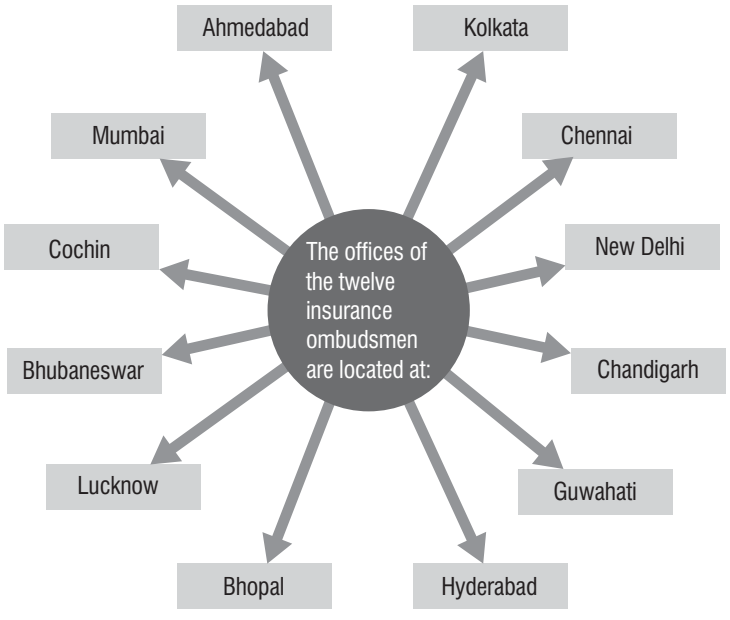
The Institution of Insurance Ombudsman was created by the Government of India Notification dated 11 November 1998 with the purpose of resolving insured customers' grievances quickly and to mitigate the problems involved in redressing these grievances. This Institution is of great importance and relevance for protecting policyholders' interests and also in building confidence in the system. The Institution has helped to generate and sustain confidence amongst both customers and insurers.

The main objective of the Ombudsman's office is to resolve complaints relating to claims, disputes with regard to terms of policy or premium paid, and the non-issue of policy documents in a cost-effective, impartial and efficient manner. With regards to a complaint, if any client is dissatisfied with the action taken by the insurance company in the mentioned areas, they can approach the Insurance Ombudsman.

E2 Territorial jurisdiction of ombudsmen

The governing body has set up twelve ombudsmen offices across the country. Each ombudsman office has been allotted a different geographical area as their area of jurisdiction and they may hold sittings at various places within their area of jurisdiction in order to expedite the disposal of complaints.

Figure 14.4



E3 Functions of the Ombudsman

The Insurance Ombudsman has two types of function to perform:

- conciliation; and
- making awards.

The Insurance Ombudsman is empowered to receive and consider complaints in respect of personal lines of insurance from any person who has a grievance against an insurer. The nature of the complaint may relate to any grievance against the insurer. Examples include:

- any partial or total repudiation of claims by the insurance companies;
- any dispute with regard to premium paid or payable in terms of the policy;
- any dispute on the legal construction of the policy wording in the case that such a dispute relates to claims;
- a delay in settlement of claims; and
- non-issue of any insurance document to customers after receipt of premium.

Insurance companies are required to honour the awards passed by the Insurance Ombudsman (which must be made within three months) within 15 days.

Be aware

The Ombudsman's powers are restricted to insurance contracts of value not exceeding Rs. 20 lakhs.

E4 Manner of lodging a complaint

The aggrieved person's complaint must be in writing and addressed to the relevant Insurance Ombudsman in the jurisdiction under which the office of the insurer falls. The complaint can also be lodged through the legal heirs of the insured.

Before lodging a complaint:

- the complainant should have made a representation to the insurer named in the complaint and the insurer has either rejected the complaint, failed to respond within a period of one month, or the customer is dissatisfied with the insurer's response; and
- the same subject of complaint should not be pending before any court, consumer forum or arbitrator.

The complaint must be made within one year of the insurer's response.

E5 Complaints resolution process

The complaints received by the Ombudsman are dealt with in the following manner:

Withdrawal/ settlement	• It is the duty of the Ombudsman to promote a settlement by agreement between the complainant and the insurance company through mediation or conciliation. To achieve this, the Ombudsman may follow such procedures as it considers appropriate. If there is an agreement between the two parties and the issue is settled, the two parties may go ahead with it and the case may be withdrawn.
Recommendation	• If there is no agreement or settlement between the two parties within what the Ombudsman feels to be an appropriate timeframe, then the Ombudsman may make a recommendation to what is, in his opinion, fair to both the parties. • Such a recommendation shall be made no later than one month following receipt from the complainant and copies will be sent to the complainant and the insurance company concerned. The recommendation is binding on the complainant if they accept all terms of the recommendation in full and final settlement of the complaint. If the complainant accepts the recommendation they will send a communication in writing within 15 days of the date of receipt acknowledging their acceptance. If the recommendation is accepted by the complainant, then it will be binding on the insurer and it will have to fulfil its obligation.

Award	• If there is no agreement or settlement and the recommendation is also not acceptable to the complainant, then in this case the Ombudsman will grant an award. This award will be granted within a period of three months from the receipt of the complaint. The award is binding upon the insurance company (if it is acceptable to the complainant). • If the policyholder is not satisfied with the award of the Ombudsman they can approach other venues such as Consumer Forums and Courts of law for redressal of their grievances. • The steady increase in the number of complaints received by various ombudsman offices shows that the policyholders are placing their confidence in the Institution of Insurance Ombudsman.
Non-acceptable/ not maintainable complaints	• Complaints received which the Ombudsman feels are without sufficient cause or where there is no loss or damage or inconvenience suffered by the complainant may be classified as non-acceptable or non-maintainable and dismissed by the Ombudsman. • The Ombudsman's powers are restricted to insurance contracts of value not exceeding Rs. 20 lakhs. • Complaints will be dismissed by the Ombudsman in the following cases: – if the complainant approaches the Ombudsman directly without first approaching the insurer and giving the insurer an opportunity to hear their complaint and attempt to resolve their grievance. – If the same complaint on the subject is pending before any court, consumer forum or arbitrator. – If the complaint is not within the jurisdiction of the Ombudsman.

Be aware

As per the Policyholders' Protection Regulations, when sending the policyholder's documentation each insurer must provide information of how to contact the Insurance Ombudsman pertaining to their region, in the event that they wish to lodge a complaint against their insurer.

F Grievance Redressal Cell of the IRDA

The IRDA has recently introduced the IRDA Grievance Call Centre (IGCC). The IGCC provides an additional channel for policyholders to lodge their grievances and also check the status of their complaint over the phone/email.

Be aware

A complaint can be lodged by calling up the IGCC on the toll-free number 155255 or by sending an email to the IRDA at complaints@irda.gov.in

The call centre environment will interface with IGMS, once it is implemented (see section D2). The IGCC has enabled policyholders to have easy access to the Grievance Redressal Cell of the IRDA both through telephone and email, apart from providing details of the redressal systems of insurance companies whenever policyholders require them. The call centre fills out grievance registration forms on the basis of the call. The IGCC also provides a channel for tracking grievances.

The IGCC also educates policyholders about the role of the Insurance Ombudsman.

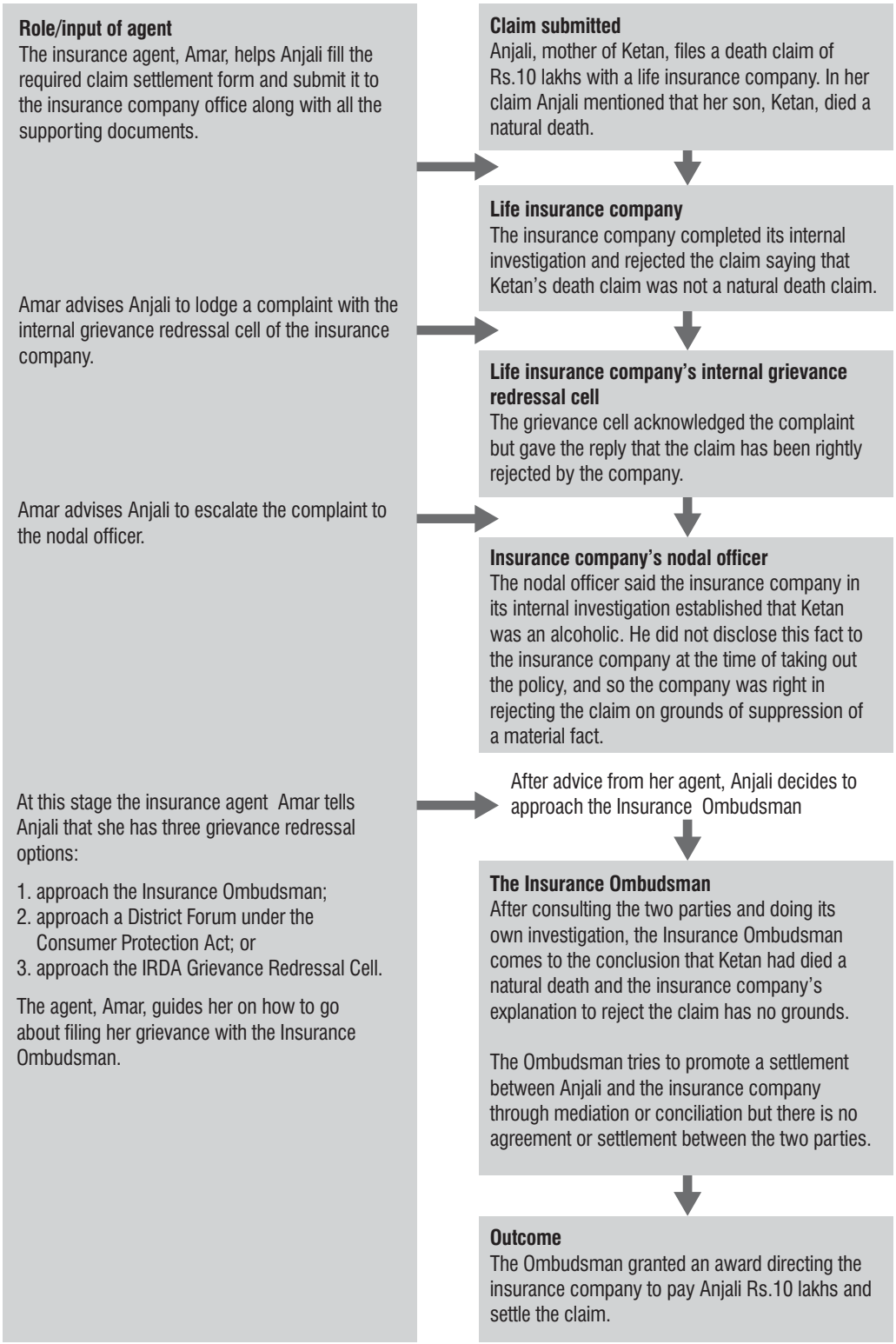
With a view to going beyond the facilitation of complaints resolution, the IRDA has begun to look into details of complaints to identify instances of violation/non-compliance of various provisions of the applicable regulations through enquiries and inspections. Wherever it is required, regulatory action is initiated by the IRDA.

The Institution of Insurance Ombudsman is also being reviewed for possible changes and expansion of jurisdiction to ensure that grievances that are not resolved by insurers and which are escalated to the Regulator and/or Ombudsman are resolved conclusively, except where they would fall necessarily within the ambit of the courts.

G A typical complaint

While each complaint is individual, the following diagram illustrates the path a typical complaint might follow if a claim is disputed by the insurance company, and highlights the role and input that might be expected of the agent at each stage in supporting their client in the process.

Figure 14.5



Question 14.2

Make a list of the different ways in which the complaints are handled/resolved by the Insurance Ombudsman.

H Renewal of licence

Now that you are nearing the end of this study text, you will have a very good understanding of how you should go about your dealings with your clients to ensure that their interests are at the forefront of your mind, and how that will contribute to your success as an agent in the longer term. If clients are satisfied they will generally renew their policies if they are financially able to do so.

As a final measure to protect customers the IRDA has drawn up guidelines that propose that the licence of an insurance agent will not be renewed if less than a specified percentage of the policies sold by them are renewed annually, as this indicates that an agent has not met the needs of his clients effectively and may be guilty of mis-selling.

In section G of chapter 15 we will return to how the IRDA goes about evaluating, monitoring and disciplining agents and insurance companies where practices have fallen short of requirements and expectations.

?

Question 14.3

How can a customer lodge a complaint against their insurer through the IRDA Grievance Redressal Cell?

Summary

It will now be clear to you from what has been discussed in this and earlier chapters that it is the behaviour and practices of all those engaged in the business of insurance which underpin, shape and define the industry in which you have chosen to work.

In the final chapter of this course we shall conclude by explaining the role that ethics plays in this process.

Key points

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

Importance of customer protection

Customer protection in the insurance industry is very important due to low financial literacy levels and because insurance is still not well understood by the masses in India.

Low customer protection leads to high levels of dissatisfaction which is detrimental to the growth of the entire insurance industry as a whole.

Transparency in transactions during the entire life of the policy ensures fair treatment to the customers.

IRDA (Protection of Policyholders' Interests) Regulations 2002

In October 2002 the IRDA, in consultation with the Insurance Advisory Committee, issued the regulations for protection of policyholders' interests.

The Regulations clearly specify what the prospectus of an insurance product should state.

The Regulations specify that every insurer shall have in place proper procedures and effective mechanisms to address the complaints and grievances of policyholders efficiently.

The Regulations specify exactly what should be clearly stated in the policy.

The Regulations lay down the procedures to be followed pertaining to the settlement of life insurance claims.

The Regulations specify the matters in which the insurer has to respond to the policyholder within 10 days of the receipt of any communication from its policyholders.

Role of the Insurance Ombudsman

The main objective of the Ombudsman's office is to resolve complaints relating to claims, disputes with regard to terms of policy or premium paid, and non-issue of policy documents in a cost-effective, impartial and efficient manner.

The governing body has appointed twelve Ombudsmen across the country, allotting them different geographical areas as their areas of jurisdiction.

The complaints received by the Ombudsman are handled in the following manner: withdrawal/settlement, recommendation, award, and non-acceptable complaints.

Typical complaints

Typical complaints against insurers include complaints relating to claims, policy servicing, premiums and policy lapse claims etc.

Typical complaints against insurance advisers are related to inappropriate plans being allotted, wrong term allotted and charges not being disclosed.

Handling customer complaints effectively

The Consumer Affairs Department of the IRDA oversees the compliance by insurers of the IRDA Regulations for Protection of Policyholders' Interests and aims to empower consumers by educating them about grievance redressal procedures.

To enable the effectiveness of the grievance redressal mechanisms of insurers as well as to create a central repository of industry-wide insurance grievance data, the IRDA is on the verge of implementing the Integrated Grievance Management System (IGMS).

An internal grievance redressal system of an insurer involves the following two-tier system: first registering a complaint with the helpline or the insurer's office and secondly escalating it to the nodal officer/appellate authority.

Grievance Redressal Cell of IRDA

A complaint can be lodged with the IRDA by calling up the IGCC on the toll free number 155255 or by sending an email to the IRDA at complaints@irda.gov.in

Renewal of licence

As a final measure to protect customers, the IRDA has drawn up guidelines to increase the persistency ratio of insurance agents.

The IRDA has proposed that the licence of an insurance agent be cancelled if less than a specified percentage of the policies sold by the agent are renewed annually.

Question answers

14.1. A prospectus of any insurance product should clearly state:

- the scope of benefits;
- the extent of insurance cover;
- the warranties, exceptions and conditions of the insurance cover;
- information in an explicit manner;
- whether the product is participating (with-profits) or non-participating (without-profits);
- the premium on all the riders relating to health or critical illness, in the case of term or group products, shall not exceed 100% of the premium of the main policy;
- that the allowable rider or riders on the product will be clearly spelt out with regard to their scope of benefits, and under no circumstance will the premium relatable to all the other riders put together exceed 30% of the premium of the main product; and
- the benefits arising under each of the riders shall not exceed the sum insured under the basic product.

14.2. The complaints received by the Ombudsman are dealt with in the following manner:

1. withdrawal/settlement;
2. recommendation;
3. award; and
4. non-acceptable/not maintainable.

14.3. A person can lodge a complaint against the insurer with the IRDA Grievance Redressal Cell by calling up the IGCC on the toll free number 155255, or by sending an email to IRDA at complaints@irda.gov.in.

Self-test questions

1.	As per the IRDA (Protection of Policyholders' Interest) Regulations what should all life insurance policies clearly state?
2.	List the cities in which the offices of the Insurance Ombudsman are located.

You will find the answers on the next page

Self-test question answers

1.	A life insurance policy shall clearly state the following: a. the name of the plan governing the policy, its terms and conditions; b. whether it is participating in profits or not; c. the basis of participation in profits such as cash bonus, deferred bonus, simple or compound reversionary bonus; d. the benefits payable and the contingencies upon which these are payable and the other terms and conditions of the insurance contract; e. the details of the riders attached to the main policy; f. the date of commencement of risk and the date of maturity or date(s) on which the benefits are payable; g. the premiums payable, period of payment, grace period allowed for payment of the premium, the date of the last instalment of premium, the implication of discontinuing the payment of an instalment(s) of premium and also the provisions of a guaranteed surrender value; h. the age at entry and whether it has been disclosed; i. the policy requirements for (i) conversion of the policy into a paid-up policy, (ii) surrender (iii) non-forfeiture and (iv) revival of lapsed policies; j. contingencies excluded from the scope of the cover, both in respect of the main policy and the riders; k. the provisions for nomination, assignment, and loans on security of the policy and a statement that the rate of interest payable on such loan amount shall be as prescribed by the insurer at the time of taking the loan; l. any special clauses or conditions, such as first pregnancy clause, suicide clause etc.; m. the address of the insurer to which all communications in respect of the policy shall be sent; and n. the documents that are normally required to be submitted by a claimant in support of a claim under the policy. Along with the policy document the insurer should also include information on the Insurance Ombudsman.
2.	The offices of the twelve Insurance Ombudsmen are located at: • Ahmedabad; • Bhopa; • Bhubaneswar; • Chandigarh; • Chennai; • Cochin; • Guwahati; • Hyderabad; • Kolkata; • Lucknow; • Mumbai; and • New Delhi.

15
Ethics and code of conduct

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Learning objectives

After studying this chapter, you should be able to:

- discuss the meaning of ethics;
- analyse the dangers of unethical behaviour;
- discuss the importance of ethics for individuals and insurers;
- analyse typical ethical behaviour;
- explain the elements of an ethical framework;
- explain the importance of underpinning professional responsibilities;
- discuss the importance of evaluation, monitoring and discipline for ethical practices followed by insurance companies;
- discuss the Code of Conduct prescribed by the IRDA.

Introduction

As we discussed in chapter 10 it is important that insurance agents behave in a professional and ethical manner towards their clients at all times. But what do we mean by 'ethics'?

The word 'ethics' comes from the Greek word 'ethikos' which relates to a person's character. Ethics in insurance pertain to certain standards or principles that are followed by insurance agents and insurers in the course of their business, while maintaining the profitability of the business.

In simple terms, sales targets aside, the main concern for an insurance company should be the policyholder's needs and requirements and in providing assistance to them and their family at the time of a claims situation, should the need arise. Unethical practices may result in short-term profits, but in the long run, they will tarnish the image of the company. A negative image can result in a loss of business – both existing and new business.

In this chapter we will highlight the importance of following ethical practices in insurance business and we will also highlight the adverse effects of following unethical practices.

Finally, we will discuss the Code of Conduct that has been prescribed by the IRDA to monitor and discipline the conduct of insurance agents.

Key terms

This chapter features explanations of the following terms and concepts:

Ethics	Churning	Discipline	Unethical behaviour
Delay in claims settlement	Ethical codes	Underpinning professional responsibilities	Overselling of insurance policies
Positive image	Evaluation and monitoring	Underselling of insurance policies	Embedding ethics

A What do we mean by ethics?

Considering the many instances of mis-selling that have been reported in the recent past, one of the biggest concerns and issues of debate for the insurance industry in India is the need for a high standard of ethical behaviour when selling insurance.

Ethics can be defined as:

- those values we commonly hold to be 'good' and 'right;
- behaviour that is based upon the moral judgments of an individual; and
- a study of what makes one's own actions right and wrong.

Ethical standards depend upon the actions – whether they are right or wrong – practised by all those involved in the process of advising on, selling and servicing insurance products. This includes the insurance agents themselves and the officers and managers of insurance companies.

The ethical standards of an insurance agent will be demonstrated by the actions he takes to achieve his desired end result, i.e. his sales target. For example, behaving in an ethical manner means not suggesting products to clients that will help the agent earn a high amount of commission, irrespective of the fact that the product might not be suitable for the client.

Be aware

The agent has a responsibility to ensure that he only recommends suitable needs-based products to his clients. If the agent uses unethical conduct to sell an insurance product to his client then he has failed in his duty to provide his client with the best service.

The objectives of ethics in the insurance industry can be described as follows:

- To establish moral standards for insurance agents/insurers in insurance selling.
- To define 'dos' and 'don'ts' in insurance selling.
- To address the ethical and unethical conduct of insurers.
- To give guidance on the correct/appropriate behaviour for an insurance agent to follow in a specific situation.
- To regulate the wrong and inappropriate practices followed by insurers and intermediaries.

Case study

Sushil Mehta is a newly appointed life insurance agent. Being newly recruited, he doesn't have much experience in the business and he will struggle initially to create a name for himself. He has been asked to sell at least three insurance policies each month.

It's the end of the month and Sushil has not been able to sell even one policy. He is under tremendous pressure to perform and achieve his monthly target. He has been preparing a presentation on financial planning for five prospective clients whom he is scheduled to meet in the next three days.

Sushil decides to modify his presentation and suggest a newly launched product by the insurance company to all his prospective clients, irrespective of whether they require that product or not.

In his meetings with the clients he highlights only some of the good benefits about the product and hides certain charges, exclusions, terms and conditions from them. He does this because he fears it will result in refusal from the clients to buy the product. He is able to convince two of his clients to purchase the product even though it is not the most suitable product for them based on their needs.

Is this ethical behaviour on the part of Sushil?

No, it is not – Sushil has resorted to unethical behaviour by focusing on meeting his sales target rather than meeting the needs of his clients.

Insurance agents should never resort to such unfair and unethical practices. They should always put the clients' needs ahead of their own interests.

Consider this…

In your opinion, what should be the role of the insurance company in the above case study? What steps can the insurance company take to avoid such instances from occurring?

B Typical unethical behaviour

In the past a common statement made about the insurance industry was 'Life insurance is seldom bought; rather it is sold to clients'. This statement still holds good today and underlines the importance of insurers and agents avoiding unethical practices in the course of their dealings with customers.

Some of the common forms of unethical behaviour in the Indian insurance market have been as follows:

- Projecting exorbitant benefits under the plan (for example promising that the amount invested would double in three to five years).
- Passing off a regular premium payment policy as a single premium payment policy or limited premium payment policy.
- Not making complete and true disclosures about the product and its features.
- Not obtaining complete information about the prospective client.
- Offering a rebate or inducement in return for purchasing a policy.
- Selling a policy saying that the client does not have to pay premiums for the full term while the actual features of the product do not substantiate this statement.

B1 Dangers of unethical behaviour

Unethical behaviour such as that outlined above has consequences for the whole insurance industry. In this section we will discuss the consequences of the following unethical practices:

- **The overselling of insurance policies**. An overambitious insurance agent can mislead clients and sell them more insurance cover than they actually require or can afford. The overselling of insurance policies can result in lapsed policies if the policyholder is not able to pay the premiums.

Example

The sale of a term insurance policy and an unit-linked insurance plan (ULIP) to an unmarried individual is an example of overselling. An unmarried young individual may not need a term insurance policy if they do not have any dependants. The basic need of an unmarried individual is to invest their surplus money and to increase their overall wealth. For such an individual a ULIP would be sufficient as it would take care of their protection needs and would also increase their investments at the same time.

- **The underselling of insurance policies**. In order to achieve their sales targets, insurance agents may compromise on the insurance cover and suggest a lower sum insured to clients. This is done because an insurance policy with a lower cover and hence a lower premium is more attractive to the client and enables a higher success rate for the agent. Suggesting a high premium amount can sometimes result in a loss of business for the agent due to the client's financial limitations. In such cases the consequences of underinsurance will have to be borne by the family in the event of the premature death of the policyholder, as the insurance cover would not be enough to meet the family's financial liabilities.
- **Churning**. Churning (refer back to chapter 10, section D4A for an explanation) should only be recommended in very rare cases; however, it is often used for the purposes of mis-selling products by insurance agents. Some agents recommend certain policies to clients with the advice that they can surrender the policy after a certain period of time and withdraw their funds. Churning is often recommended to clients by insurance agents with the purpose of withdrawing invested funds and reinvesting them in a new insurance plan launched by the company for which they have to meet a certain sales target.

  In this unethical process of churning, the policyholder is the biggest loser. They may incur a loss on their investments and they may not even recover the original investment amount. The insurance company also suffers a loss in this case as the policy is closed ahead of its normal tenure.

Be aware

One of the biggest concerns in the insurance industry is the unethical practice followed by some insurance agents in the selling of products which provide them with high amounts of commission.

- **Delay/refusal to make a claim payment** during the claim settlement process. If the policy has been sold on unethical grounds (such as suggesting benefits to the client for which they might not be eligible), this can result in a delay/refusal in making a claim settlement payment. Due to mis-selling, an individual may not be able to get the benefits falsely promised by the agent and this can result in both a loss of money to the individual and also a loss of faith in the insurance company. Unnecessary delay in making a claim payment during the claim settlement process can also result in negative publicity for the company and should be avoided. The claim settlement period is a difficult time for families and the insurer should help them in the best possible way during this time.

It is these types of unethical practice which have resulted in creating a poor public image for insurance agents and the companies they represent which in turn results in a loss of trust for the whole insurance industry. As a result of this, a priority of the IRDA has been to encourage the industry to be proactive in adopting ethical standards with the hope that these unethical practices will no longer take place.

C The business benefits of ethics

If an insurance company follows ethical practices in the selling of its insurance products and in the claim settlement process, this will help build a good long-term reputation for the company. But the use of inappropriate practices by a company and its agents to achieve sales targets will tarnish the company's image which in turn harms the business of the insurance company and, in the long run, the whole industry.

C1 The importance of ethics for individuals and the insurance company

Ethical standards will help to increase business for the company. Ethical selling of insurance products not only benefits the company itself but also helps to build a good reputation for the individual insurance agent. More importantly, if the insurance company and agent have been ethical in selling an insurance policy to an individual and an appropriate policy has been sold, it will help to save the client from a huge financial burden should an unfortunate event occur and a claim need to be made.

The importance of ethics for individual agents and their insurance companies can be summed up as follows:

Positive image	If an insurance company adopts a high standard of ethical practice this will help to build trust and confidence among the public. A positive image is an indicator of success for the company in the long term. Selling the insurance products of a reputable company makes the process of selling insurance comparatively easy for an insurance agent.
Goodwill	Ethical practices help to develop the goodwill of the company. Once public support is obtained, it will have a direct effect on the sales and the profitability of the company. Positive word of mouth publicity about the company and its insurance agents helps in establishing long-term trust with clients who in turn will refer new customers to the company.
Protection by both sides	High ethical standards are of benefit both to the company and also individuals. Insurance selling on ethical grounds also helps the insurance company to expedite the process of claims settlement. Receiving the claim payment on time can also help family members in dealing with the emotional and financial losses.
Model for others	An insurance company that follows high standards of ethical practices leads by example for other companies to follow, in terms of its business success and the loyal clientele it will build up over a period of time.
Confidentiality	During the fact-finding process a client reveals all personal, professional and family information about themself to the agent. In terms of ethical conduct the agent should make sure all client information is always kept confidential and that there is no misuse of this information in anyway.

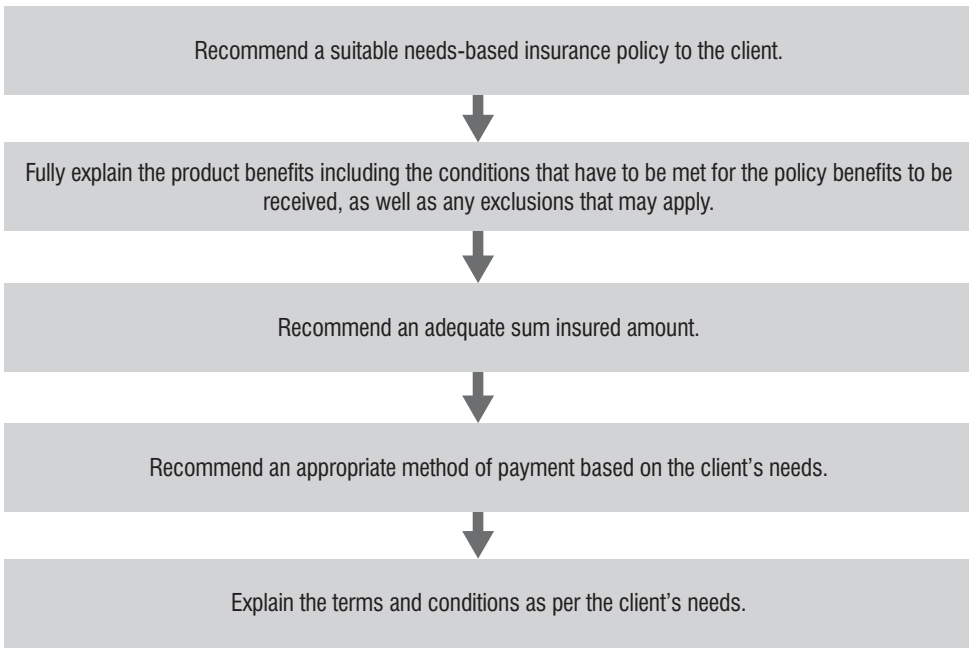
Question 15.1

What can be the impact on the life insured's family members in the case of insurance underselling?

D Typical ethical behaviour

When advising a client, in order to be sure he is behaving ethically, an agent should always work through the following steps:

Figure 15.1



Case study

Madan Mohan is a junior engineer with a telecoms company. He has a three year old son, Rohan. Madan wants to invest for Rohan's education and marriage. He telephones the customer care division of an insurance company and enquires about its child plans. He asks the customer care executive to send an insurance agent to his home so that he can talk to him in more detail about the company's child plans.

Rahul Gupte is a newly appointed insurance agent who visits Madan's home. Rahul starts explaining his company's child plans to Madan. While talking to him, he realises that Madan is very aware of the various insurance plans that are available in the market. He learns that Madan has already invested in a term plan for income protection and has a ULIP to increase his funds. Rahul also realises that Madan has done quite a bit of research about child plans as he has spoken with friends and colleagues and has also read the various published materials that are available.

Madan then asks Rahul about the various terminologies used in a child plan like the 'deferment period', the 'vesting date' and the 'risk commencement date' of the policy. As Rahul is a newly appointed agent he is unsure about the particular information that has been requested by Madan. Rahul looks through the various pamphlets his manager has provided him with but he can't find the relevant information he needs to answer Madan's questions.

In such a scenario what would be the ethically appropriate way of proceeding for Rahul?

1. Should Rahul try to divert the attention of his client to other features of the product such as pricing, which Rahul is well aware of?
2. Should Rahul talk about the maturity amount that will be available to Madan after 15-20 years for his child's education (as Madan is already well informed about child plans)?
3. Should Rahul call upon his sales manager who is more experienced and knowledgeable and will be able to answer Madan's queries?

The answer is number 3. Ethically, it would be more appropriate for Rahul to call upon his sales manager who is more experienced and knowledgeable to answer Madan's questions so that Madan is provided with all the correct information regarding the policy conditions as to when the risk will commence, the deferment period and the importance of vesting.

You can see then that it is very important that the insurance agent and the insurance company provide complete information to the client to help them understand a policy's features and the various conditions associated with it. Nothing should be hidden. The fact that a client may be more aware about child plans than the insurance agent does not change that.

E Ethical frameworks including ethical codes

It is very important to embed an ethical culture within an organisation. This can be done by developing a coherent framework with the following elements:

- Ethical codes.
- Structures and processes to embed ethics.

E1 Ethical codes

Ethical codes are critical to an insurance company. They are developed to establish accountability among employees and board members with regards to their conduct. Everyone within an insurance company, from the CEO to directors to employees, is expected to comply with these ethical codes. The board members and employees have a duty to avoid situations that could lead to violations of these codes.

Insurance companies can define their own standard ethical code which is unique to their company, or they can adopt industry-specific codes.

It is important to note that behaving ethically will depend on an individual's judgment of right and wrong in a given set of circumstances, but an insurance agent cannot follow a defined checklist for each and every situation. However, general checklists and codes can be an important means for providing guidance to the insurer as well as the insurance agent for monitoring and evaluating ethical conduct.

Be aware

In India the insurance regulator, the IRDA, has prescribed the Code of Conduct for insurance agents in the IRDA (Licensing of Insurance Agents) Regulations 2000. (See section H for the IRDA Code of Conduct.)

E2 Embedding ethics

Embedding means ensuring that ethics are practised at all levels of a business, coherently and consistently in all situations. All employees should be aware of the ethical codes followed by their company and should apply good judgments to ensure that these codes are adhered to. In order to do this, companies need to be able to demonstrate the values that underpin an ethical code. This may involve staff practising ethical decision-making in roleplay situations.

Be aware

Insurance companies have a responsibility towards their customers to:

- avoid the use of misleading promotions and ensure appropriate products are sold;
- provide complete information about the terms and conditions of the policy;
- recommend and provide an adequate amount of insurance cover to clients; and
- make the specified amount of claim payments to clients and avoid unnecessary delays in making the payment of a claim.

If an insurance company fails to provide the above services to its clients, then the ethical conduct of that insurance company can be questioned.

F Underpinning professional responsibilities

The IRDA and the Life Insurance Council have a responsibility to outline the underpinning professional responsibilities of insurers and insurance agents. In this section we will outline the objectives of the IRDA and the Life Insurance Council.

F1 Objectives of the IRDA

The main objectives of the IRDA are as follows:

Figure 15.2

To protect the interests of policyholders. The Regulator issued the IRDA (Protection of Policyholders' Interests) Regulations 2002 for the protection of policyholders' interest (as discussed in chapter 14).

↓

To regulate, promote and ensure the orderly growth of the insurance industry (as discussed in chapter 13).

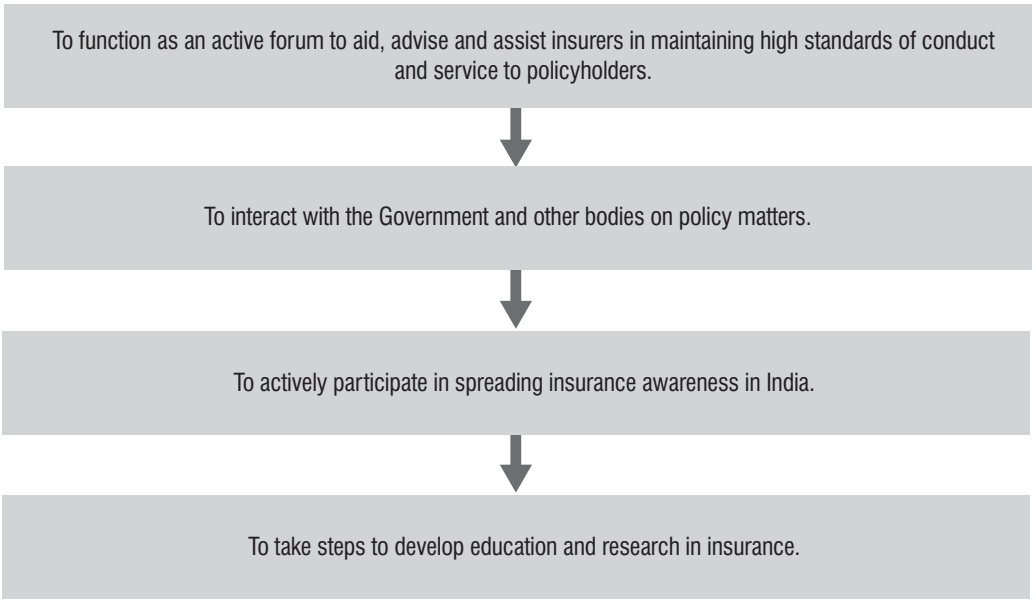
↓

To ensure that insurance business is conducted by all stakeholders in the most ethical manner. To ensure this objective is met, the IRDA has issued a Code of Conduct that must be followed by all insurance agents (we willl discuss the Code of Conduct in section H of this chapter).

F2 Objectives of the Life Insurance Council

The main objective of the Life Insurance Council is to play a significant and complementary role in transforming India's life insurance industry into a vibrant, trustworthy and profitable service, helping people in their journey to prosperity. The other objectives of the Life Insurance Council include the following:

Figure 15.3



The Life Insurance Council also has a responsibility to establish, enforce and monitor the highest standards of ethical responsibility among insurers and their agents.

Suggested activity

Select any three advertisements from leading insurers. Analyse the information being communicated in each promotion. Do you find any of the information being provided misleading in any way? If the information is misleading, how would you amend it?

G Evaluation, monitoring and discipline

It is not an easy task to monitor and evaluate the ethical practices followed by insurers and insurance agents. Data can be collected regarding the number of complaints registered against the company's products and services such as premium collection, claims settlement etc. which can provide an insight into a company's practices.

G1 Evaluation and monitoring

G1A Lapses/cancellations/free look-in period

Lapsed and cancelled policies can be either the result of a client's inability to pay premiums or a sign of dissatisfaction with the company's services. Both of these situations can be as a result of unethical practices followed by agents in selling policies to meet sales targets. If a policy has lapsed or been cancelled due to the client's inability to pay the premium, then this can be an indicator that the financial assets and liabilities of the client were not assessed properly. This is a failure on the part of the agent which can result in financial losses to the client as well as to the insurance company itself.

To protect the policyholder against unethical agents, the IRDA allows policyholders a free look-in period of 15 days after receiving the policy. During this period the policyholder can review their decision with respect to the policy purchased.

If the policyholder feels that:

- the policy does not meet their requirement; or
- the terms and conditions of the policy are not in accordance with what the agent has told them at the time of selling the policy; or
- they are dissatisfied with the service of the insurance company; then

they can return the insurance policy within 15 days and ask for a refund of the premium they have paid.

If the policy has lapsed or has been surrendered due to dissatisfaction with the service provided by the insurance company (for example, lack of effective and timely after-sale service provided by the agent), this raises doubts about the efficiency of the company in discharging its responsibilities in a timely and efficient manner.

Therefore, the higher the number of policy lapses, surrenders and returns of policies during the free look-in period, the higher will be the doubts raised about the ethical practices followed by an insurance company and its agents.

G1B Complaint volumes

Repeated complaints regarding a certain product or service provided by an insurer are a good indicator that persistent problems exist. An analysis of the issues raised in the complaints will in turn lead to the insurance company being able to decide on appropriate action to address the issue(s). If a company is receiving a high level of complaints across many of its products and services, then this is likely to suggest that there are serious underlying issues which may well include problems with the ethical standards and the behaviour of its staff during the sales, premium collection and claims settlement processes.

G1C Analysis of products being offered

Insurance companies and their agents must sell products suitable to their clients' needs. Therefore products should be analysed in the context of whether the benefits being offered to clients are actually being delivered, and if not, then the reasons for why this might be. Based on these reasons, products may need to be redesigned to meet clients' needs.

G2 Discipline

Insurance companies may have internal guidelines in place for agents with regards to ethical conduct and the disciplinary procedures to be followed, in addition to the IRDA Code of Conduct which all agents are expected to adhere to. They may have an internal process in place where corrective action is taken against any erring insurance agent. An insurance agent who breaches internal company guidelines or is held for any misconduct in a manner that can be detrimental for the insurance company can be penalised. Once the insurance company has analysed the complaint or issue of misconduct by an insurance agent then, if appropriate, disciplinary action should be taken.

In certain cases further enquiries on the matter and remedial action may be required. In these situations an insurance company may take following the steps:

Revamping internal systems and procedures	Insurers need to create a framework which promotes ethics within their organisation and generally have a checklist of 'do's and don'ts' for the ethical conduct of insurance agents. To improve future standards of ethical behaviour, remedial action should include reviewing and rewriting ethical behaviour guidelines and checklists and amending internal systems and procedures.
Disciplinary action against the offenders	Withholding incentives either permanently or for a specific period, demotion, suspension or permanent dismissal are some of the disciplinary actions that can be taken by a company against an unethical or erring insurance agent.

Question 15.2

List some typical examples of good ethical behaviour.

H Code of Conduct prescribed by the IRDA

The IRDA (Licensing of Insurance Agents) Regulations, 2000 prescribes a Code of Conduct for insurance agents. Every person holding a licence shall adhere to the Code of Conduct as mentioned in the regulations.

The Code of Conduct is specified below:

(i) Every insurance agent shall:
- (a) identify himself and the insurance company of whom he is an insurance agent;
- (b) disclose his licence to the prospect on demand;
- (c) disseminate the requisite information in respect of insurance products offered for sale by his insurer and take into account the needs of the prospect while recommending a specific insurance plan;
- (d) disclose the scales of commission in respect of the insurance product offered for sale, if asked by the prospect;
- (e) indicate the premium to be charged by the insurer for the insurance product offered for sale;
- (f) explain to the prospect the nature of information required in the proposal form by the insurer, and also the importance of disclosure of material information in the purchase of an insurance contract;
- (g) bring to the notice of the insurer any adverse habits or income inconsistency of the prospect, in the form of a report (called 'Insurance Agent's Confidential Report') along with every proposal submitted to the insurer, and any material fact that may adversely affect the underwriting decision of the insurer as regards acceptance of the proposal, by making all reasonable enquiries about the prospect;
- (h) inform promptly the prospect about the acceptance or rejection of the proposal by the insurer;
- (i) obtain the requisite documents at the time of filing the proposal form with the insurer; and other documents subsequently asked for by the insurer for completion of the proposal;
- (j) render necessary assistance to the policyholders or claimants or beneficiaries in complying with the requirements for settlement of claims by the insurer;
- (k) advise every individual policyholder to effect nomination or assignment or change of address or exercise of options, as the case may be, and offer necessary assistance in this behalf, wherever necessary;

(ii) No insurance agent shall:
- (a) solicit or procure insurance business without holding a valid licence;
- (b) induce the prospect to omit any material information in the proposal form;
- (c) induce the prospect to submit wrong information in the proposal form or documents submitted to the insurer for acceptance of the proposal;
- (d) behave in a discourteous manner with the prospect;
- (e) interfere with any proposal introduced by any other insurance agent;
- (f) offer different rates, advantages, terms and conditions other than those offered by his insurer;
- (g) demand or receive a share of proceeds from the beneficiary under an insurance contract;
- (h) force a policyholder to terminate the existing policy and to effect a new proposal from him within three years from the date of such termination;
- (i) have, in case of a corporate agent, a portfolio of insurance business under which the premium is in excess of fifty percent of total premium procured, in any year, from one person (who is not an individual) or one organisation or one group of organisations;
- (j) apply for fresh licence to act as an insurance agent, if his licence was earlier cancelled by the designated person, and a period of five years has not elapsed from the date of such cancellation;
- (k) become or remain a director of any insurance company;

(iii) Every insurance agent shall, with a view to conserve the insurance business already procured through him, make every attempt to ensure remittance of the premiums by the policyholders within the stipulated time, by giving notice to the policyholder orally and in writing.

H1 Non-adherence to the Code of Conduct

Every person holding an insurance agent licence shall adhere to the Code of Conduct as mentioned in the Regulations. Section 42 (4) (g) of the Insurance Act 1938 states that any violation of the Code of Conduct as may be specified by the Regulations made by the Authority, may lead to the disqualification of the agent.

Section 42 (4) (c) states that if an agent has been found guilty of criminal misappropriation, criminal breach of trust, cheating, forgery or an abetment of or attempt to commit any such offence by a court of competent jurisdiction, then it may lead to disqualification.

Apart from the above causes that may lead to disqualification of the agent by the Authority, if an insurance company finds any agent guilty of any wrongdoing or misconduct which is detrimental to the interests of the insurance company or its policyholders, then the company may initiate internal proceedings against the insurance agent (as discussed earlier in section G2 of this chapter).

Key points

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

What do we mean by ethics?

Ethics can be defined as:

- those values we commonly hold to be 'good' and 'right;
- behaviour that is based upon the moral judgements of an individual; and
- a study of what makes one's actions right or wrong.

The dangers of unethical behaviour

- Unethical practices result in creating a negative image for an insurance agent and also the company which he represents.

The business benefits of ethics

- Good ethical practices followed by a company help to create goodwill and a positive image for the company.
- An insurance company that follows a high standard of ethical practices can lead by example for other companies to follow.

Typical ethical behaviours

Typical ethical behaviours include the following:

- Recommending a suitable needs-based insurance policy to the client.
- Fully explaining the product benefits, including the conditions that have to be met for the policy benefits to be received, as well as any exclusions that may apply.
- Recommending an adequate sum insured amount.
- Recommending an appropriate method of payment based on the client's needs.
- Explaining the terms and conditions as per the client's needs.

Ethical frameworks including ethical codes

- Ethical codes are defined to establish standards of conduct and accountability among employees and board members with regards to their conduct.
- Insurance companies can define their own standard ethical code which is unique to their company, or they can borrow industry-specific codes.
- Ethics need to be embedded within the company, which means that ethics are practised at all levels of a business coherently and consistently between situations.

The underpinning professional responsibilities

The IRDA and LIC objectives are to:

- protect the interest of policyholders;
- promote the growth of the insurance industry;
- establish, enforce and monitor the highest standards of ethical responsibility among insurers and their agents; and
- regulate the insurance industry and ensure that all the transactions in the insurance sector are fair towards policyholders.

Evaluation, monitoring and discipline

- The process of evaluation and monitoring of ethical practices of insurers can be done by analysing data regarding the number of complaints registered against a company's products and services such as premium collection and claims settlement.
- To improve adherence to ethical standards and the Code of Conduct an insurance company may revamp internal systems and procedures and also take penal action against offenders.

IRDA Code of conduct

- The IRDA prescribes a Code of Conduct for insurance agents which every person holding a life insurance licence must adhere to. Failure to do so can lead to disqualification.

Question answers

15.1 Insurance underselling is where insurance cover for a lower sum insured is suggested to the client even though the client requires a policy with a higher sum insured. In cases where an individual dies prematurely, the consequences of underinsurance will have to be borne by family members, as the insurance claim will not be enough to meet their financial liabilities and needs.

15.2 Ethical behaviour includes:

- Recommending a suitable needs-based insurance policy to the client.
- Fully explaining the product benefits, including explaining the conditions for the policy benefits to be received, as well as any exclusions that may apply.
- Recommending an adequate sum insured amount.
- Recommending an appropriate method of payment based on the client's needs.
- Explaining the terms and conditions as per the client's needs.

Self-test questions

1.	What is insurance overselling?
2.	Briefly describe what is meant by ethical codes.
3.	How can ethical practices help a company to create a positive image for itself?

You will find the answers on the next page

Self-test question answers

1.	An overambitious insurance agent can mislead clients into purchasing insurance cover for more than they require. This is known as insurance overselling. The overselling of insurance policies can result in lapsed policies where the customer is not able to pay the premiums.
2.	Ethical codes are critical to an insurance company. They are defined to establish accountability among the employees and board members towards their conduct. Everyone within the company is expected to comply with these ethical codes. The board members and employees have a duty to avoid such situations that could lead to violations of these codes.
3.	High standards of ethical practice followed by an insurance company can help to build public trust and confidence in the company. This trust and confidence results in clients speaking positively about the company which helps to create a positive image for the company.

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