Life Insurance

Agenda

- Meaning of life Insurance & its history
- Premature Death
- Financial Impact of Premature Death on Different Types of Families
- Amount of Life Insurance to Own
- Types of Life Insurance

What is Life Insurance?

- Life Insurance can be termed as an agreement between the policy owner and the insurer, where the insurer for a consideration agrees to pay a sum of money upon the occurrence of the insured individual's or individuals' death or other event, such as terminal illness, critical illness or maturity of the policy.

History of Life Insurance

- Insurance in India can be traced back to the Vedas. For instance, yogakshema, the name of Life Insurance Corporation of India's corporate headquarters, is derived from the Rig Veda.

- Bombay Mutual Assurance Society, the first Indian life assurance society, was formed in 1870.

- Other companies like Oriental, Bharat and Empire of India were also set up in the 1870-90s.

- It was during the swadeshi movement in the early 20th century that insurance witnessed a big boom in India with several more companies being set up.

- By the mid-1950s, there were around 170 insurance companies and 80 provident fund societies in the country's life insurance scene. However, in the absence of regulatory systems, scams and irregularities were prevalent in most of these companies.

- As a result, the government decided to nationalize the life assurance business in India. The Life Insurance Corporation of India was set up in 1956 to take over around 250 life insurance companies.

- For years thereafter, insurance remained a monopoly of the public sector. The sector was finally opened up to private players in 2001.

- The Insurance Regulatory & Development Authority, an autonomous insurance regulator set up in 2000, has extensive powers to oversee the insurance business and regulate in a manner that will safeguard the interests of the insured.

Why to have a Life Insurance?

- Protection
- Liquidity
- Tax Relief
- Money when you need it

Premature Death

- The death of a family head with outstanding unfulfilled financial obligations can cause serious financial problems for the surviving family members
  - The deceased's future earnings are lost forever
  - Additional expenses are incurred, e.g., funeral expenses, uninsured medical bills, and estate settlement costs
  - Some families will experience a reduction in their standard of living
  - Noneconomic costs are incurred, e.g., grief

Premature Death

- Life expectancy has increased significantly over the past century
  - Thus, the economic problem of premature death has declined
  - Millions of Indians still die annually from heart disease, cancer and stroke
- The purchase of life insurance is financially justified if the insured has earned income and others are dependent on those earnings for financial support

Financial Impact of Premature Death on Different Types of Families

- The need for life insurance varies across family types:
  - Single person
  - Single-parent family
  - Two income earners with children
  - Traditional family
  - Blended family
  - Sandwiched family

Amount of Life Insurance to Own

- Three approaches can be used to estimate the amount of life insurance to own:
  - The human life value approach
    - The amount needed depends on the insured's human life value, which is the present value of the family's share of the deceased breadwinner's future earnings
    - To calculate:
      - Estimate the individual's average annual earnings over his or her productive lifetime
      - Deduct taxes, insurance premiums and self-maintenance costs
      - Using a reasonable discount rate, determine the present value of the family's share of earnings for the number of years until retirement

Amount of Life Insurance to Own

- The needs approach
  - The amount needed depends on the financial needs that must be met if the family head should die
  - Important family needs must consider:
    - An estate clearance fund: cash needed for burial expenses, uninsured medical bills, and taxes
    - Income needed for the readjustment period, a 1-2 year period in which the family adjusts to its new living standard
    - The dependency period is the period until the youngest child reaches age 18
    - Life income to the surviving spouse, including income during and after the blackout period. The blackout period refers to the period from the time that Social Security survivor benefits terminate to the time the benefits are resumed
    - Families should also consider special needs, e.g., funds for college education and emergencies

Amount of Life Insurance to Own

- The capital retention approach
  - This approach preserves the capital needed to provide income to the family
    - Income-producing assets are preserved for the heirs
  - To calculate:
    - Prepare a personal balance sheet
    - Determine the amount of income-producing capital
    - Determine the amount of additional capital needed to meet the family needs

Amount of Life Insurance to Own

- Most families own an insufficient amount of life insurance
  - About one in five households have no life insurance
  - Consumers procrastinate, and have difficulty in making correct decisions about the purchase of life insurance
- Many families have only a limited amount of discretionary income
  - The purchase of life insurance reduces the amount of discretionary income available for other needs
  - Many families are in debt and have little savings
  - After payment of high priority expenses, such as a mortgage, food and utilities, many families have only a limited amount of income to purchase life insurance

Types of Life Insurance

Term Life Insurance

- Increasing/Decreasing term policies
- Convertible Term Assurance Policy
- Level Term Life Insurance
- Renewable term life Insurance

Endowment Insurance

- Joint life endowment plan
- Money back endowment plan
- Marriage endowment plan

Permanent (Whole) Life Insurance

- Ordinary whole life plan
- Limited payment whole life plan

Unit Linked Plans

Term Life Insurance

- Sum assured is payable only in the event of death during the term.
- In case of survival, the contract comes to an end at the end of term.
- Term Life Insurance can be for period as long as 40 years and as short as 1 year.
- No refund of premium
- Non-participating policies
- Low premium as only death risk is covered.

Types of Term Insurance

Increasing Term Insurance

- Life insurance cover under this plan goes on increasing periodically over the term in a predetermined rate. (Riders)

Decreasing Term Insurance

- The sum assured decreases with the term of the policy. Normally decreasing term assurance plan is taken out for mortgaged protection, under which outstanding loan amount decreases as time passes as also the sum assured.

Convertible term assurance policy

- Under this plan a policyholder is entitled to exchange the term policy for an endowment insurance or a whole life policy.

- Conversion can be done at any time during the term except last 2 years.

Level Term Life Insurance

- The sum assured throughout the term of the policy does not change.

Renewable Term Life Insurance

- With renewable term insurance, the insurance company automatically allows you to renew your coverage after the term of the policy is over (generally 5 to 20 years)

Endowment Insurance

- Endowment insurance plans is an investment oriented plan which not only pays in the event of death but also in the event of survival at the end of the term.

- Is a contract underwritten by a life insurance company to pay a Fixed term plus Accumulated profits that are declared annually.

- Premium includes 2 elements
  –mortality element & investment element

- Minimum age at entry : 12years
- Maximum age at entry: 65years
- Maximum age at maturity : 75years

Types of Endowment Insurance

Joint Life Endowment Plan:

- Under this plan, two lives can be insured under one contract.
- The sum assured is payable at the end of the endowment term or death of either of the two.

Money Back Endowment Plan:

- In this plan, there is an additional advantage of receiving a certain amount of money at periodic intervals during the policy term.

Educational Endowment Plan:

- These plans are specially designed to meet educational expense of children at a future date. If the insured parent dies before the date of maturity the installment is paid in lump sum with immediate effect which helps to meet the educational expenses.

Permanent(Whole) Life Insurance

- Whole life plans are another type of endowment plan, which cover death for an indefinite period.
- When the policy holder dies, the face value of the policy, known as a **death benefit**, is paid to the person or persons named in the life insurance policy (the beneficiary or beneficiaries).
- It can be with or without profits.
- If you cancel the policy after a certain amount of time has passed, the insurance company will surrender the cash value to you.

Types of Whole Life Insurance

1. **Ordinary Whole Life Plan:**

- This is a continuous premium payment plan. The insured pays premium throughout his life. It provides dual facility of protection plus savings.

2. **Limited Payment Whole Life Plan:**

- It provides the same benefit as above but premiums are paid for a limited period. Premiums are sufficiently higher to cover the risk.

Children's Life Insurance

- Since last few years insurance companies have started offering risk cover plans like limited payment whole life, and endowment assurance plan from the age of 12years and money back plan from age of 13 years(completed).

- New plans have been specifically designed for children where the risk of the child starts much earlier say 7 years.

- Policies on the lives of children are taken out by other elders. After some time when the child becomes major and is competent to contract, the child may assume the ownership of the policy. The policy is then said to ‘vest’ in child.

- The date on which this happens is called the ‘testing date’.

- The risk begins when the child attains 18 years of age. This is called the ‘deferred date’ and the period between the deferred date and the date of commencement of policy is called the ‘deferred period’.

Unit Linked Plans

- It has emerged as one of the fastest growing insurance products.
- It is a combination of an investment fund(such as mutual fund) and an insurance policy.
- The premium amount is invested in the stock market and returns better income on the maturity period.

- Better for long-term investment option.
- ULIPs generally provide higher returns as large portion of the funds are invested in equities.
- There is also flexibility and the assured can choose levels and extent of cover needed.
- There is also option of switching over from one fund to another if it does not seem to be profitable.
- ULIPs can be classified as
  - Unit linked – equities, bonds, real estate & money market instruments
  - Equity linked – only in equities
  - Index linked – equity, bonds or money market instruments.

Policy Claim

Life insurance claim can arise either:

- On the maturity of the policy – **Maturity Claim**
- On death of the policy holder – **Death Claim**
- Survival up to specified period during the term – **Survival benefits**

Maturity Claim

- In case of Endowment type of Policies, amount is payable at the end of the policy period.
- Discharge Form & Policy Document
- On receipt of these two documents post dated cheque is sent by post so as to reach the policyholder before the due date
- The gross amount consists of **Basic sum assured** and **bonus** if any.

Survival Claims

- Same as maturity claims, sum assured becomes payable on expiry of full term but on survival of the insured.

- In policies like, money back plan for 15 years term, 1/4th of the sum assured becomes payable on the life assured on surviving 5 year, further 1/4th becomes payable after additional 5 years and rest balance at the end of 15 years.

Death Claim

2 Types:

- Premature death claim – within 3 years
- Other claim – after 3 years

- **Intimation of death** is to be given by a proper person in writing.

1. Original Policy Bond
2. Death Certificate
3. Proof of relationship with the deceased person

In case of Accidental Death

Postmortern Report, FIR Copy , Final Police Report is also required

Exclusions in Accident Benefits

- Suicide or attempted suicide or intentional self-inflicted injury
- Under influence of drugs or alcohol, narcotics or psychotropic substance not prescribed by a Medical Professional.
- War, Invasion, Civil War, Riots, Revolution or any war like operation.
- Criminal or unlawful act
- Service in the military or police
- Flying activity other than as a paying passenger.
- Racing vehicle.

Permanent disability benefits

- An additional sum equal to the sum assured will be paid in monthly installments spread over10 years.
- Future premiums are waived
- Max. limit of additional benefit is 5,00,000 or 10,00,000 depending upon the insurer.

- **Pre-condition for granting such benefit are:**
  - Disability should be solely and directly as a result of accidental injury.
  - Disability must be permanent
  - Injury and disability must occur before the insured attains 60 years of age.

"I want to save maximum tax."

❑ Premiums paid for Health Related Riders:

• Some of the critical illness, hospitalization cash and other health related riders attached to a Life Insurance policy may also be eligible for rebate under section 80D of the Insurance Act.

• This deduction is available to both Individuals & HUF.

• Rs.15,000 is the maximum amount deductible during the year for an individual as well as a senior citizen.

• Condition for applicability of deduction is that the premium must be paid by cheque in the previous year out of the income chargeable to tax.

❑Death Claims and Maturity Benefits:

•Life Insurance Policies are under an EEE (Exempt-Exempt-Exempt) regime i.e. that the Premiums Paid, Income earned by the Investments, and payment of Maturity proceeds or claim are all exempt "E" from tax under section 10(10)(D) of the Income Tax Act.

•The only policies that are not eligible for exemption on payment on maturity or claim are Single Premium Policies or Policies where the sum assured was less than 5 times the Premium paid.

Ratings Of Insurance Companies In India - Top 5

Companies	Market Share (2009)	Market Share (2008)
LIC	64%	74%
ICICI Prudential Life Insurance Co Ltd	11.8%	8.93%
SBI Life Insurance Co Ltd	15%	6.99%
Bajaj Allianz Life Insurance Co Ltd	13.1%	7.36%
Reliance Life Insurance Co Ltd	9.8%	2.96%

(Source: Insurance review)

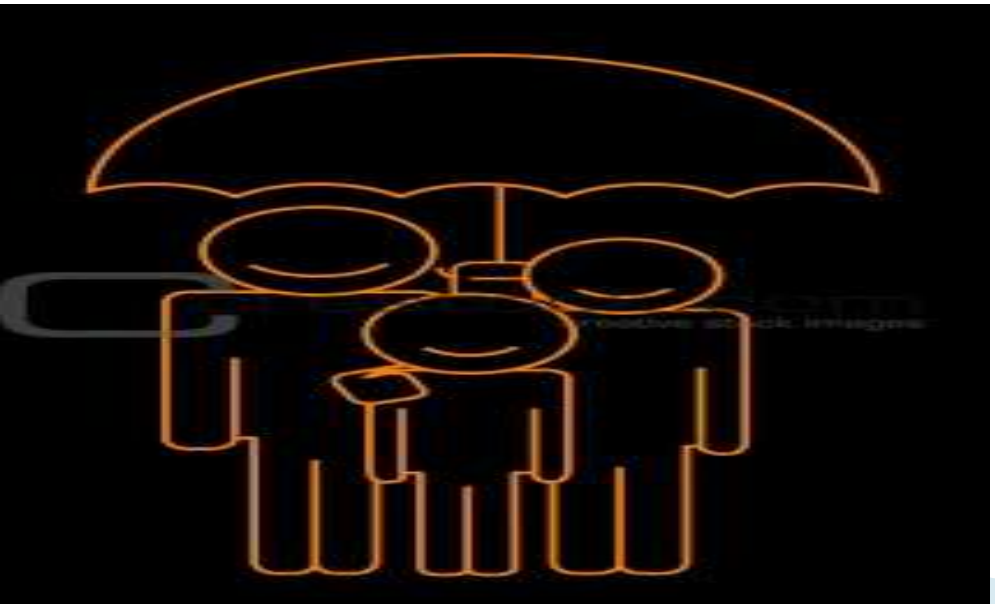
How Much Life Insurance Coverage Should Be Purchased?

- The Rule of Thumb is-

  Coverage should equal to 6 to 10 times annual income.

- The other Rule is-

  Coverage to cover his family consumption need.



Functions of an Actuary in Life Insurance Business

- Main function of an actuary in life insurance is to do assessment and valuation of mortality risk.

- Due to medical advancement now the life span of an individual can be determined which reduce the uncertainty of death.

- Due to which medical selection by the insurer is necessary and desirable both on the grounds of "actuarial fairness" i.e. charging premiums to different lives on the basis of their different levels of risk and for financial viability of the insurance company.

Current News in Life Insurance Sector

- Life insurance premium collection down by 22%

  -LIC premium collection down by 20.5% and 22 private life insurance premium down by 25%.

- AUM of life insurer cross Rs. 15 lakh crore, due to rise in renewal premium which means that increasing number of policy holder are renewing their policies.