ASSIGNMENT 1

1. Following reasons for why you need Life Insurance:

i. **Life is unpredictable:** You think, you are young and healthy now. So, you do not need any insurance to protect you. However, the matter of the fact is no matter how old or young you are, you need life insurance to protect you at all stages of life. Let us understand this better with an example: One beautiful day, you leave for your office. On the way to the office, you met with a severe road crash. When taken to the hospital, it was diagnosed that you survived many severe injuries and operating them will need much money. Life insurance is right for this moment as it saves you from burning a hole in your pocket. Life insurance covers provide many other benefits like permanent disability benefit; chronic diseases benefit, long term benefits to name a few.

ii. **Family:** You might not be thinking of getting married anytime soon in life. However, what happens when a person crosses your path, and you are head over heels in love with that person. You certainly want to move in together with that person. Life Insurance safeguards the interest of that person in your absence.

iii. **Parents:** Our elderly parents will be our responsibility until their last breath. Due to old age, they are prone to many acute and chronic diseases. Life insurance provides a special cover for family expenses and expenses incurred on parents. It will act as a financial cushion if the unfortunate happens, and you die before them. Life insurance is to safeguard their interest after you are gone.

iv. **You have Business:** You are one of the active partners of your small business. After your unfortunate death, a life insurance policy allows your surviving partners to purchase the portion of your business seamlessly.

v. **Life is a risk:** Life insurance does cover not only the risk of living too short but also the risk of living too long. Yes, living too long is also a risk. The well built-up portfolio will take care of the risk arrives with the chances of living too long. Since there are many options out there for this purpose, you can choose any of the plan best suited to the idea of your living. You can also keep in mind factors like future inflation, tax benefits, the expected rate of return on investment, the standard of living to name a few.

Life insurance provides security not only your near and dear ones but also to you. The regular premium can make you live a comfortable life without depending on others. It also helps you deal with the uncertainties associated with survival.

2.

- Life Insurance or Personal Insurance.
- Property Insurance.
- Marine Insurance.
- Fire Insurance.

- Liability Insurance.
- Guarantee Insurance.
- Social Insurance.

3.

i. Profitability

A company will want to ensure that the premiums charged for non-linked contracts will be sufficient to cover the benefits to be provided and the expenses in most foreseeable circumstances, and provide a profit margin. At a general level, a life insurance product can be broken down into three components: savings, protection and administration. This brings into focus the true nature of a product: it is the provision of certain services to the policyholder by the insurance company. What is important is that the product be profitable in its entirety, but ideally every product should be profitable in each of these dimensions:

1. Savings
2. Protection
3. Administration

ii. Marketability

The benefits offered need to be attractive to the market in which the contract will be sold. Innovative design features may make a contract more attractive as may the addition of options and guarantees. The charging structure under a unit- linked contract needs to be attractive to the potential market and consideration needs to be given to whether the charges should be guaranteed.

iii. Competitiveness

A company will not want the structure and level of the charges under a unit- linked contract to depart too far from those of competitors, but this depends on how it will market the contract.

The prime influence on competitiveness will be the level of the expense charges. However, some distribution channels will be more price sensitive than others.

For instance, in the very price-sensitive distribution channel of brokers, companies have sometimes set charges for certain products that are only slightly greater than those required to cover the marginal costs, thereby making an apparently insufficient contribution to fixed overheads. This is then justified on the grounds that there is still some contribution to expense overheads, as opposed to the zero contribution which would result from not selling an uncompetitive product with a "correct" contribution built in.

4. Gambling also known as wager is betting on chance and is highly speculative. One of the wagering parties loses whatever the other person wins from a wager. Before entering into a wager there is no chance of loss and therefore no risk. As soon as a wager is made a new risk of the prospect of losing the wager is created. On the contrary, in case of say a fire insurance the risk already exists and no new risk is created. When insurance is affected all that happens is payment of the determined premium by the proposer and acceptance of risk by the insurer. In other words no new risk is created but an existing risk is transferred to the insurer through an insurance contract.

It is also relevant to note that insurance serves a socially relevant purpose as both the insured and the insurer have a common purpose namely loss prevention. It is a win-win case when no loss occurs. Even when loss occurs the insured is restored to his original situation financially in accordance with the terms of the contract. On the other hand, in gambling the loser is not indemnified under any circumstances.

Features common to gambling and insurance are:

- Promise of payment on the happening of a certain event.
- Amount receivable not commensurate or proportional to the amount Paid

5. Adverse selection is the phenomenon that bad risks are more likely than good risks to buy insurance. Adverse selection is seen as very important for life insurance and health insurance. Moral hazard is the phenomenon that having insurance may change one's behavior. If one is insured, then one might become reckless.

6.

Advantages of group insurance

Some of the advantages of group insurance are as follows:

- With group insurance, persons with less or no life insurance are also able to get some measure of insurance protection.
- Coverage is also available to those employees who are otherwise uninsurable.
- Life insurance companies can reach a vast number of clients at less cost within a short span of time.
- It is a tax effective tool. The employer gets tax relief for the premium paid by him on behalf of the employees. Employers are also entitled to tax relief for

premiums paid by them if the scheme is partly contributory.

Limitations of group insurance

There are also some limitations to the group insurance schemes, which are discussed below:

- The nature of group insurance is temporary. It means once the member is out of the group, the coverage ceases. The employee also loses insurance coverage in the event of termination of the group plan.
- The master policy issued by the insurer is not very flexible. It does not meet the individual needs for insurance. The insurer under group insurance cannot focus on the financial needs of the individual, which is possible in individual insurance.
- A few members who could have been charged fewer premiums if individual insurance had been taken, have to pay higher premiums because the premium is fixed for the group as a whole.

7. All insurance contracts of fire or marine insurance are contracts of indemnity. According to it, the insurer undertakes to put the insured, in the event of loss, in the same position that he occupied immediately before the happening of the event insured against. In other words, the insurer undertakes to compensate the insured for the loss caused to him/her due to damage or destruction of property insured. The compensation payable and the loss suffered are to be measured in terms of money. The principle of indemnity is not applicable to life insurance.

Ex – if an individual suffers a loss of 3 lakhs in a car accident, then the inured company will accept a claim up to Rs. 3 lakhs and not more.

8. Benefits:

(i) Reduces worry and fear

(ii) Makes available large funds for investment at low cost

(iii) Provides employment to a large number of people

(iv) Insurance enhances credit worthiness and reduces credit risk

(v) Social benefits

Costs:

- Increased running cost of insurance companies
- Fraudulent claims

- Inflated claims (to cover deductibles)
- Moral Hazard (link with principle of mitigation)
- Adverse Selection

9. Whole life insurance is a type of life insurance that provides you coverage throughout your lifetime provided the policy is in force. Whole life insurance policies also contain a cash value component that increases over time. You can withdraw your cash value or take out a loan against it as per your convenience. In addition, in case of your unfortunate demise before you pay back the loan, the death benefit paid to your beneficiaries will be reduced.

1. One of the major benefits of whole life insurance plan is that it provides **coverage against death for the entire life** of the insured i.e. up to 100 years of age.
2. Whole life insurance plans **offer loan facility** to the policyholder.
3. The whole life insurance plans can be bought online in a **simple and hassle-free way.**
4. For consumers, it is useful as a means of providing for funeral expenses or for meeting any liability to tax, for example inheritance tax or death duties, arising on the death of the life insured. It is a general-purpose contract for providing long-term protection for dependants.
5. In the last respect a whole life assurance is particularly useful as a means of protecting some of the expected transfer of wealth that a parent would be aiming to make to his or her children when he or she died. Without the contract, the wealth transfer would be likely to be very small if the parent died young. Such contracts can also be a tax efficient way of transferring wealth, at any age, depending on legislation (often reducing the liability to death duties or inheritance tax).

10. Here are the most common life insurance riders:

1. **Guaranteed Insurability Rider**

This rider allows you to purchase additional insurance coverage in the stated period without the need for further medical examination. This rider is most beneficial when there has been a significant change in your life circumstances, such as the birth of your child, marriage or an increase in your income. If your health declines with age, you will be able to apply for extra coverage without giving any evidence of insurability. This type of rider may also provide a renewal of your base policy at the end of its term without medical check-ups. This rider may end at a certain age.

2. **Accidental Death Rider**

This rider pays out an additional amount of death benefit if the insured dies as the result of an accident. Normally, the additional benefit paid out upon death due to an accident is equivalent to the face amount of the original policy, which doubles the benefit. Therefore, upon death due to accidental bodily injury, the insured's family gets twice the amount of the policy. That's why this rider is called a double indemnity rider. Just make sure you understand the restrictions on this rider, as many insurance companies limit the meaning of the term "accident." If you are the sole income provider for your family, this rider is ideal for you because the double benefit will take good care of your surviving family's expenses in your absence.

3. **Waiver of Premium Rider**

Under this rider, future premiums are waived if the insured becomes permanently disabled or loses his or her income as a result of injury or illness prior to a specified age. Disability of the main breadwinner can have a crippling effect on a family. In these circumstances, this rider exempts the insured from paying the premium due on the base policy until he or she is ready to work again. This rider can be valuable, particularly when the premium on the policy is quite high. The definition of the term "totally disabled" may vary from one insurer to another, so be aware of the terms and conditions of your specific rider.

4. **Family Income Benefit Rider**

In case the insured dies, this rider will provide a steady flow of income to family members. When buying this rider, you need to determine the number of years your family is going to receive this benefit. The merit of having this rider is obvious: In case of death, the surviving family will face fewer financial difficulties thanks to the regular monthly income from the rider.

5. **Accelerated Death Benefit Rider**

Under an accelerated death benefit rider, an insured person can use the death benefits if he or she is diagnosed with a terminal illness that will considerably shorten the insured's lifespan. On average, insurers advance 25-40% of the death benefit of the base policy to the insured. Insurance companies may subtract the amount you receive, plus interest, from what your beneficiaries receive on your death. Most often a small premium or, in some cases, no premium, is charged for this rider. Insurers have different definitions of "terminal illness," so check what the rider covers before purchasing it.

6. **Child Term Rider**

This rider provides a death benefit in case a child dies before a specified age. After the child attains maturity, the term plan can be converted into permanent insurance with coverage up to five times the original amount without the need for medical exams.

7. **Long-Term Care Rider**

In the event the insured has to stay at a nursing home or receive home care, this rider offers monthly payments. Although long-term care insurance can be bought individually, insurance companies also offer riders that take care of your long-term care costs.

8. **Return of Premium Rider**

Under this rider, you pay a marginal premium and at the end of the term, your premiums are returned to you in full. In the event of death, your beneficiaries will receive the paid premium amount. Insurers sell this rider with many variations so verify, the phrasing of the rider before you buy.

11. Group life insurance is a simple and economic way of providing life insurance to employees. Under this policy, generally a fixed sum is paid to the dependants of a covered employee on his death. It is also possible to offer what is known as graded cover that offers different covers to different categories of employees within the same group.

The group gratuity scheme is an insurance scheme covering the employer's liability to pay gratuity under the Payment of Gratuity Act, 1972. The amount of gratuity to be paid is at the rate of 15 days'

wages based on the wages last drawn, for each completed year of service. However, this is subject to a maximum limit. The Act requires that the gratuity be paid to those employees who have served the employer continuously for at least five years.

After retirement, employees need financial security. The provident fund and the gratuity provided by the employer may not be sufficient in an inflationary economy. Secondly such lump sum payments are often utilised by the employees to meet their current contingent liabilities. The employers observed that the employees actually also need a periodical payment over and above the normal terminal benefits.

Such payment is made in the form of pensions by creating a superannuation fund. Superannuation scheme aims at providing old age pensions to employees after retirement.

12.

Adverse selection

This term is used for a situation where the insurance applicant presents a possibility of loss that is higher than the average expected from a random sample of all applicants. It arises when the information presented to the insurer and the actual material facts relating to the risk are different.

Moral hazards

These hazards refer to the defects that exist in a person's character that may increase the frequency or the severity of loss. Such a character may tend to increase the loss for the company. Ex: killing wife to get death proceeds of insurance.

Morale hazards

The fundamental postulate of insurance is that the insured should always conduct him as if he is uninsured and that his having taken insurance should not offer him any licence to be any less careless than he otherwise would be. However, if there is a situation of a wilful carelessness on the part of the policyholder because of the existence of insurance, then it is a case of Morale Hazard. By such negligence and indifference, the possibility of loss is increased. For example, careless acts like keeping the door of one's house open and going out, thereby increasing the possibility of a burglary, or leaving the car keys in the car and increasing the risk of theft are instances of morale hazard.

Fair pricing and subsidizing

Underwriting helps in determining the expected loss potential of the proposed insured and selecting a price in line with this expected loss. Insureds with an approximately equal loss potential are put into one group and charged the same rate. When the premium paid by some insureds in the group does not correspond to the risk attached to them, the other insureds will have to pay the de cit. That is, those likely to suffer fewer losses will be subsidizing those likely to suffer more losses. This inequity will affect the whole group by increasing the premium rates. Here, the underwriter should be guided by previous records in order to safeguard the company against potential high-risk cases.

Competition

An underwriter can also help an insurance company stay one step ahead of its competitors. Some of the ways this is done is through lower premium rates, innovative marketing strategies etc. The underwriter provides all necessary information and thus helps the insurer make the best possible decisions. For example, in life insurance, suppose the underwriter does a thorough job and studies the research done on mortality and morbidity, the insurer will have a much better idea about the factors that influence mortality and will consequently be able to x a better price.

This can be better understood with an example. Insurers, despite knowing that chewing gutkha adversely affects health, pay no attention to this fact and do not take it into account while fixing the premium rate. Then one insurance company decides to charge two separate rates for chewers and non-chewers of gutkha, with lower rates for the latter. As a result, the people who chew gutkha will continue to buy insurance from companies with the previous rate, whereas more and more non-chewers will start buying coverage from the company charging lesser rates. If this continues, the other companies will end up providing coverage only to users of gutka. In the long run, this will prove detrimental to the company, since all gutkha users belong to the high-risk group. This shows how well researched underwriting- which prompted the insurer to charge lower rates, can influence competition and provide bene t to the industry as a whole.

Other risks

There is also another category, the 'Declined Risks'. These are extra hazardous risks that have been rejected. Yet in certain cases, a premium is fixed after imposing restrictive conditions, clauses and warranties. This is done in order to reduce liability, and the acceptance of such risks is called **'Accommodation'.**