Life Insurance – Assignment 1

1. Do you agree with the view that a bachelor without dependents needs no insurance? If you feel that he needs insurance, state the reasons in support of your view.

   Ans. All lives are uncertain. The risk of loss of a life does not depend on the status of the person i.e. whether he/she is married or not; having a family that depends on them does not have to be the primary reason for a person to be insured. Even without dependents to take care of, it may so happen that the person himself due to a life-threatening disease or injury at workplace or elsewhere may not be able to work and hence may require financial assistance. Insurance in such cases plays an important role as well.

2. Life insurance in short is concerned with two hazards that stand across the life path of every
   person 'that of dying prematurely leaving the dependent family to fend for itself' and 'that of living too long without visible means of support'. Of the two hazards which is more serious and difficult to manage? Give your views with reasons.

   Ans. Losing a loved one no matter what age leads to a period of grief for the family members as a vital part of the family is no longer with them. Having said that no life is more or less valuable than the other.
   But practically speaking the death of a person dying prematurely especially if he/she is the sole earner in the family, leaving the dependents to fend for themselves would be a cause of greater concern than that of a person living too long.
   Apart from the emotional and mental trauma, the financial implications accompanied with the loss is terrifying for those left behind
   - In the absence of a regular stream of income, the family will not be able to sustain and even the most basic of needs will not be met.
   - Education needs of the children (if any) would also be affected to a great extent.
   - Debts of the deceased will become a burden for the family.

On the contrary a person living a long life may not be in the best shape in terms of health but might have a regular stream of income coming in through pensions that'll sustain him/her for the rest of their lives. Old age homes could also be helpful in such cases wherein constant medical attention is given and a sense of companionship is prevalent.

3. What is adverse selection & moral hazard with respect to life insurance?
   Ans. Adverse selection in life insurance is a situation wherein an insurance company may offer insurance coverage to an applicant at a cost below their true level of risk. In such cases the possibility of a loss occurring is higher that what was initially expected from a random sample of applicants.
   Moral hazard on the other hand is a straight reflection of the intentions of an insured. It refers to the defects in a person's character which may lead to an increase

in the frequency or severity of loss. Such a behaviour on part of the insured acts as a huge loss for the company.

4. Bob is a 25-year-old carpenter who is a subcontractor to various builders. He is married and has one 3year old daughter. He earns Rs. 700,000/- gross but pays Rs 200,000/- in expenses, most which are fixed expenses i.e. a leased car and leased equipment. Bob rents an apartment and spends his earnings of Rs. 300,000/- on living and entertainment expenses. Bob saves and invests all the other money.
   A. Describe briefly the features of insurances Bob could have taken out. These insurance cover may not necessarily exist in India
   B. Why would anyone buy insurance policy?

Ans. A

- Bob can buy a **joint life insurance policy** for him and his wife that you get on a first – death basis. This will be beneficial as it will pay out regardless of which partner dies and it also works out cheaper as opposed to two individual life insurance policies.
- He can also invest in an **endowment policy** which will pay out either upon maturity or to the beneficiary in case of death. This policy provides a dual combination of protection and savings.
- Bob can also invest in a **child term rider** which can be bought along with a basic life insurance policy. 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.

B: Insurance enables a person to be financially secure and provides protection against any risk that he/she may face. It provides certainty of payment against losses. A person can be insured for his health, the assets he may own (house, car, phone), and life in general. One can also invest in annuity policies which pay out a stream of payments used mostly after retirement.

5. What undesirable consequences might follow if underwriting were not permitted in the private, voluntary markets for life and health insurance?

   Ans. The process of underwriting for a company determines its standing in the market against its competitors. Underwriting allows a company to evaluate the risks associated with a customer, correctly price its products and set premium rates thereafter. If underwriting were not permitted in the private, voluntary markets for life and health insurance and a single rate was set for the products it would lead to potential losses for the company as the insurer may not be able to assess the risk linked with a particular person and hence set wrong premium rates that may be below the true level of risk.
6. Describe various type of life insurance a person can buy. State with reason on level of premiums (highest to lowest) charged in each case.

Ans: The different types of life insurance are:

- Whole Insurance: This type of insurance provides a lifetime coverage against death or up to 100 years of age. It also offers loan facilities. In case of early demise the sum assured maybe reduced in case the insured fails to pay back the loan.
- Term Life Insurance: In this type of life insurance a death benefit is given only if the insured dies within a certain period. There is no pay-out in case the insured survives till the end of the policy term.
- Endowment policy: This type of insurance provides a means of both savings and protection to the insured i.e. it is payable in the event of death (to the beneficiary) or if the insured survives till the policy's maturity date. An additional bonus, participating profits or guaranteed additions (if any) are paid out upon death.
- Pure endowment: In this type the insured is paid a stated sum if he/she survives the policy term and nothing is payable in the event of prior death.
- Joint life policy: In this type the coverage is offered to two people i.e. both partners are the owners as well as the beneficiaries. In case of death of one of them, the other partner gets the benefit of the life cover.
- Unit linked contracts: These are whole life or endowment policies that are directly linked to the value of the underlying investment. In this a proportion of the premium is invested in an investment fund chosen by the insured which are priced continuously. At the time of the claim the value of the cumulative number of units purchased along with a minimum guaranteed sum assured (if specified in the contract) is paid out.