Life Insurance Assignment

Ch-1,2,3,4,5,6

Q1. A) A bachelor with no dependants should buy a life insurance policy for the following reasons:

Uncertainty of the Future: The bachelor may have dependants in the future due to the uncertainty of life. He may decide to get married and have kids. His parents will also retire after a certain age. Thus he can have many upcoming dependants even though he has none right now. To provide financial protection to the family he should buy a life insurance policy.

Tax Savings: Life insurance policies also act as an effective tax saving tool. The premiums paid for life insurance policies are exempted under section 80(C) and 10(10D) of the income tax act of 1961. This allows the bachelor to save some money on taxes.

Cheaper premiums: The bachelor enjoys the benefit of cheaper premiums as he has no dependants right now. Since he starts paying premiums at a young age he would be paying less than what he would have had to pay if he started at a later time.

Q4.A) In my opinion the risk of dying too young is far greater than living too long. The risk of dying prematurely leaving the dependent family to fend for itself is more serious and difficult to manage. When the sole earner of the family dies suddenly then the family faces both emotional as well as financial loss. In the phase of mourning the family has to make a number of difficult decisions regarding their lives which include the financial decisions as well. It becomes very difficult for the family members to do proper financial planning and management. They have to repay all the debts and dues of the dead person as well. They have to make sure to use their resources wisely and make them last lolonger

.However in the case of living too long, the person can at least plan his next moves and can make certain arrangements like joining old age homes, retirement homes etc. He may also become dependant on his children for financial support. Thus the risk of living too long is not as sudden and surprising as dying young. The person can plan his future suitably and make arrangements so that he can face this adversity of life.

Q6. What is adverse selection & moral hazard with respect to life insurance?

A) **Adverse selection:** Adverse selection occurs when one party in a transaction possesses more accurate information compared to the other party. The other party, with less accurate information, is usually at a disadvantage since the party with more information stands to gain more from that transaction. Suppose that a smoker wants to buy a life insurance policy for himself. Since the smoker is aware that disclosing his condition will attract high premiums, he may conceal the information in order to get similar treatment as the other client with no health condition. Concealing such vital information leads to adverse selection.

Moral Hazard: Moral hazard means the likelihood that a client's behaviour will change as a result of purchasing a life insurance policy and that change will increase the chance of a loss. Life insurance companies look to ensure that the act of purchasing life insurance does not make it more likely for someone to end their own life or the life of another.

Q12. A) A. The features of insurance bob could have taken out are:

1. Income Protection: Bob could have taken out income protection for 75% of his net income of Rs. 300,000 which would provide him with a monthly benefit of Rs. 18750. As he had no sick leave or savings to fall back on ideally Bob should take out the shortest waiting period of 14 days but this is also the most expensive. Other alternatives would be to take out a longer 30 day waiting period but include an accident option which would begin payments from day one if he suffered an accident. Due to his youth Bob should ideally take out an age 65 benefit period as if his injury proved to be permanent and he could not work again in his own occupation he would be paid a benefit for the remaining 40 years of his income earning capacity.

2. Business Expenses cover: As his income protection will not cover his Rs. 200,000 of fixed expenses Bob could have taken out 12 months cover for this so that he did not have to meet these expenses out of the Rs. 18750 he received from his income protection.

3. Total and Permanent Disability (TPD) / Life insurance: Bob could have taken out an amount of Rs. 30,00,000 of TPD cover so that if he was totally and permanently disabled and unable to work again he would receive a lump sum to supplement his income protection payments. This could be used to pay medical expenses, home modifications and even to purchase a house of his own.

4. Trauma Insurance: Bob and his wife could have taken out trauma insurance of say Rs. 12,00,000 to be paid in the event of serious illness.

5. Life insurance: Bob can also purchase a life insurance policy making his wife the beneficiary. He should choose a suitable amount which is able to meet various expenses like :

Funds to cover immediate expenses after death. This includes medical expenses for terminal illness, expenses for the performance of last rites and religious ceremonies connected with death.

Funds for meeting expenses for education and marriage of dependent children.

Regular income fund for meeting the day-to-day expenses of dependant spouse and children.

Fund for paying off debts. This includes outstanding house mortgage loan dues, car loan and credit card dues and other miscellaneous dues.

B. One should buy an insurance policy for the following reasons:

Financial Security: No matter how much you are earning or how much you have saved; your financial position can be dented by an unexpected event in a moment. So, the best way to become financially secure is to cover yourself, your family, and your assets with insurance.

Transfer of Risk: The contract of insurance works on the 'principle of transfer of financial risk from the insured to the insurer'. As an insured, you pay premiums to receive compensation from the insurer, in case of occurrence of an unforeseen event. So, having insurance reduces the financial burden on your shoulders.

Complete Protection for You and Your Family: Family is the most important asset that you have and your family also depends on you for financial support. This is why it is important to make sure that you and your family are completely secure to face any emergency.

No More Stress or Tension During Difficult Times: Any unforeseen tragedy can leave you physically, mentally, and financially strained. So, if you have insurance to take care of the outcomes of such tragedies such as illness, injury or permanent disability, even death- you save yourself and your family from tension and stress. With insurance in place, any financial stress will be taken care of, and you can focus on your recovery.

Peace of Mind: Having insurance offers you financial security and also peace of mind. No amount of money can replace your peace of mind. So, when you have insurance you know that you are secured against any unforeseen events in life, and this gives you complete peace of mind.

Q15. A) Underwriting is how an insurance company evaluates and analyses the risks involved in insuring a person or an asset. This may be in regard to insuring a home, car, driver, or a person's health or life. It helps an insurance company decide whether taking a chance on providing coverage to a person or business would be profitable.

If underwriting were not permitted in the private, voluntary markets for life and health insurance then the companies won’t be able to evaluate the risks associated with a person.

The companies won’t be able to charge suitable premiums to balance those risks. Also no allowing underwriting may be a disadvantage for tha customers who are perfectly fit as they would have to pay a higher premium to balance those of bad risks.

Q18. A) There are various types of life insurance policies depending of the criteria for receiving the sum assured:

1. Whole life insurance - Whole life insurance is a type of life insurance that provides you coverage throughout your lifetime provided the policy is in force. You receive the death benefit whenever you die(up to 100 years). You receive tax benefits for whole life.

2. Term life insurance - Term life insurance is a type of life insurance that provides a death benefit to the beneficiary only if the insured dies during a specified period. If the insured survives until the end of the period, the coverage ceases without value and death claim cannot be obtained.

3. Endowment policy - An endowment policy is defined as a type of life insurance that is payable to the insured if he/she is still living on the policy's maturity date, or to a beneficiary if the policyholder dies. An endowment policy provides you with a dual combination of protection and savings.

4. Pure endowment - An insurance contract promises to pay the insured a stated sum if he survives a specified period with nothing payable in case of prior death. It is frequently used when a policyholder intends to save up money towards some specific financial goals.

5. Annuity - An annuity is a financial product that pays out a fixed stream of payments to an individual who has paid a huge lumpsum at the outset. These financial products are primarily used as an income stream for retirees. Upon annuitization, the holding institution will issue a stream of payments at a later point in time.

6. Joint life policy - A Joint Life Policy is the insurance cover that you get on a first – death basis. It is a pay out which an insurer receives in case of death of his other insured partner during the period. Usually, when you apply for a life insurance policy, you mention a nominee or beneficiary. In Joint Life Insurance, both you and your partner will be the owner as well as the beneficiary. So, in case something happens to one of you, the other will receive the benefit of the life cover.

7. Unit Linked Contracts: In these policies the sum assured is dependant on an index like NIFTY, SENSEX etc. Each policyholder receives the value of the units allocated to the policy. As each premium is paid, a specified proportion (the “allocation percentage”) is invested in an investment fund chosen by the policyholder. When each investment allocation is made, the number of units purchased by the policyholder is recorded. The value at the date of death or survival (i.e. at the time of the claim) of the cumulative number of units purchased is the sum assured under the policy.