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Life Insurance - PPP
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.

— I do not agree with the view that a bachelor without dependents needs no insurance because of the following reasons : -

1. Even though the bachelor does not have any dependents, Insurance is very important as it provides peace of mind. It provides the person with **certainty** and the person can live a better life without the emotional burden of an unfavourable event occurring.
2. It provides **protection** to the life of the individual . If an individual were to get in an accident then insurance helps to bear the financial burden.
3. There are insurance policies like pure endowment which gives the bachelor survival benefits and Endowment policies that will provide **protection as well as help create savings** for the individual.
4. Having a life insurance helps to **improve the credit score** of an individual and a person can even take a loan against certain life insurance policies. Also, the insured gets **tax benefits**.

4] 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.

— Life insurance is concerned with two types of risk

i.e 1) Mortality Risk

2) Survival risk

Life insurance helps to protect ourselves from these risks. But out of these two the mortality risk i.e when the person dies prematurely is more grave.

The reasons for it are as follows:-

1. If a person who is the breadwinner of the family dies suddenly and if he/she does not have insurance then the family has to suffer from emotional but more importantly also from financial problems.
2. If a person survives for too long he/she will be able to make some or the other provisions for their financial stability but once the person has died , there is no way he/she can support their family.
3. Therefore the person should primarily be insured against mortality risk. When the person dies prematurely there is a loss of all the future incomes that the individual might have earned.
4. The sudden death of a loved one also affects their dependents and family members emotionally , whereas the person living too long does not affect that much emotionally the family members and relatives.

6] What is adverse selection & moral hazard with respect to life insurance?

I. Adverse selection

Adverse selection in life insurance means when the insurance company insures a person whose actual risk is higher than the one calculated or quantified by them. This happens when the relevant facts presented to the insurance company are different than the actual facts.

Ex. When underwriting is done improperly, it may be the case that a smoker and non-smoker person are insured under the same policy with same amount of premium. But actually the risk of a smoker is higher than a non-smoker. This is a case of adverse selection.

II. Moral hazard

Moral hazard is when a person consciously acts in a different way as to get the claim amount. It means that a person intentionally does risky things with a bad intention.

Ex. If a man kills his wife so that he can get the insurance money.

12] Bob is a 25-year-old carpenter who is a subcontractor to various builders. He is married and has one 3 year 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.

- Describe briefly the features of insurances Bob could have taken out. These insurance cover may not necessarily exist in India

- Why would anyone buy insurance policy?

1. — As bob saves and invests the remainder of the money he could have taken out a **pure endowment policy**. With this policy he would have been able to get the survival benefit and the **premium amount is less than endowment policy**. In this policy protection is not provided i.e there is no mortality benefit , **only survival benefit**. As the main aim of Bob was savings and investment this is the ideal insurance policy for him

— An **unit linked policy** would also have been a suitable option . An unit linked policy **helps to create wealth** as a part of the premium is invested and the returns made on this policy are received by the insured. Moreover, the person gets **tax benefits** and his/her **life is also insured**. In case anything happens to the insured and he/she dies then the sum assured is paid to the beneficiary.

2. A Person buys an insurance policy **to protect** themselves from **mortality risk** and also **to create savings**. If a person dies prematurely , then there is a loss of the income that he/she could have earned in the future. This way insurance provides with **certainty , peace of mind and protection against a risk.** Some insurance policies such as endowment policies and unit linked policies also help to **save money and create wealth**. Another reason why people buy insurance policy is to get **tax benefits.**

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

The following undesirable consequences may occur if underwriting were not permitted:-

1. If proper underwriting was not permitted then it would have been **impossible to distinguish between an insurable and uninsurable risk**. Every insurance company has a certain risk appetite i.e a certain amount of risk that a company can bear.

2. **Underwriting works as a funnel** for the insurance companies i.e the different insurance applicants can be classified into different groups and premiums can be charged accordingly. Otherwise , a person who is considered a bad risk and a person who is considered a good risk may be charged the same premium even if the risk of one person is higher than the other.

3. It may lead to **adverse selection**. The actual risk maybe higher than the risk which was calculated. And the insurance company may suffer huge losses.

4. It helps to fairly price the policy and premium rates, along with these subsidies can be given to applicants.This also helps the companies to face competition. If underwriting was not done **everyone** would be insured with the **same premiums** and it may be the case that some **uninsurable people may be**

insured and the company would have to pay out them leading to **huge losses** to the company and eventually the company going out of business.

18] Describe various type of life insurance a person can buy. State which reason on level of premiums (highest to lowest) charged in each case.

The different types of policies that can be taken by a person are as follows:-

1. Term Insurance

By taking out this policy , the insured is **protected against mortality risk for the specified term**. If the insured dies within the term of the insurance then mortality benefit i.e sum assured is payed to the beneficiary. There is no survival benefit i.e if the person survives the term or dies after the term of the policy then no amount is paid back. The main aim of this policy is protection.

The premium charged for this policy is one of the **lowest** , because the term of the policy is limited and Sum assured is paid only if the insured dies within this term. There is level premium which is paid annually, six-monthly , quarterly or monthly.

2. Whole Life Insurance

This policy provides protection to the insured for the **whole life**. The benefit of this insurance is never paid to the insured and is not paid until the insured dies. The purpose is

long-time protection. The insured gets tax benefits and also a loan can be taken out against this policy.

The premium is **higher than term insurance** as the person is insured for his entire life.

3. Pure endowment policy

This policy is the **opposite of term insurance** and provides a savings opportunity to the insured. There is no mortality benefit in this policy only survival benefit.

The premium is **less than endowment** policy because it only provides savings but no protection.

4. Joint Life Policy

Under this policy **two people are insured**. The sum assured is paid when one of the two people dies and the surviving partner receives the benefit.

The premium is **comparatively less** than two different term life insurance policies. It helps to save money.

5. Endowment Policy

Endowment policy provides the benefit of savings as well as provides protection. It combines the benefit of term insurance and pure endowment. It gives mortality benefit and also survival benefit. It helps to achieve the long term financial goals of the insured.

The **premium rates are higher** as it pays the sum assured on death as well as survival.

6. Unit linked Policy

This is a policy where a part of the premium is invested and its benefits are given to the insured wither when a claim is made or when the term ends. As the benefits are linked to the investments it is known as unit-linked policy. However, the policyholder bears the risk of the investment.

The **premium** charged is **higher** as they are invested and the insurance company must carefully do the investment which requires high knowledge.

The premiums from highest to lowest as follows: -

1. Endowment Policy - Provide Mortality as well as Survival benefit. Therefore a high premium is charged

2. Unit linked Policy - High premium is charged because a part of premium is invested by the choice of the insured.

3. Whole Life Policy - As the insured is protected for his/her whole life a higher premium is charged

4. Joint Life policy - Two people are insured and hence the premium is lower than the premium for two separate term insurances

5. Pure Endowment - The premium is comparatively low as only Survival benefit is paid.

6. Term Insurance - This policy charges one of the lowest premiums as a person is insured for a specified period only.