UNIT 8 : ESSENTIALS OF LIFE INSURANCE-II

UNIT STRUCTURE

8.1 Learning Objectives

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8.3 Essentials of Life Insurance

8.3.1 Essential Defination of Life Insurance

8.3.2 The Special Treatment of Life Insurance

8.4 Provision of Policies

8.5 Selection and Classification of Risk

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8.7 Let Us Sum Up

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8.1 LEARNING OBJECTIVES

After going through this unit, you will be able to-

- know the essential of life insurance
- describe the various provisions of life policy
- discuss the selection and classification of risk associated with the life policies
- illustrate the basis of premium construction

8.2 INTRODUCTION

Life Insurance can be defined as a contract between the insurance company and the policy holder, where the life insurance company pays a specific sum to the insured individual's family upon his death. The life insurance sum is paid in exchange for a specific amount of premium. Life is uncertain, but it is beautiful and we all want enjoy our life. Whatever we do, however smart and hard we work, we are never sure what life has in store for us.

It is therefore important that we do not leave anything to chance, especially regarding 'life insurance'. So, we should cover our life with insure well in advance as death is the only certain thing in life, apart from taxes.

The dictionary definition of "life insurance" is a financial product that pays you or your dependants a sum of money either after a set period or upon your death as the case may be.

However, if you were to understand the term clearly and also appreciate its importance in your life, consider "life insurance" as always, our back-up plan for life. In simple terms Life insurance means being prepared financially, come what may be in future. It also ensures that your family and you receive financial support in case you are not able to bring in the much-needed income yourself (maybe due to an accident, retirement, or untimely demise).

From legal point of view, life insurance is a contract between an insurance policy holder (insured) and an insurance company (insurer). Under this contract, the insurer promises to pay a pre-calculated sum of money (also known as "Sum Assured" or "Cover Amount") upon the death of the insured person or after a certain period of time.

8.3 ESSENTIALS OF LIFE INSURANCE

Life insurance is a contract between an insurer and insurance policy holder, where the insurer promises to pay a definite sum of money in exchange for a premium, upon or up to death of an insured person. Life policies are always a legal contract.

There are many long-term tax saving investment options available, life insurance is one of the most fundamental instruments that one need to invest in. Here are some reasons why life insurance essential:

(i) To replace loss of income: A life insurance policy pays out death benefits in the event of the policyholder's death. This is generally a lump sum amount that can help the insured's family deal with the loss of their primary source of income.

(ii) To repay pending debts: Debts taken in the name of the insured

continue to remain a financial responsibility even after demise of the policy holder. However, without an alternate source of income, the legal heirs of the deceased may be incapable of repaying any pending debts.

(iii) To meet educational expenses: If you invest in a life insurance policy when you are in your early 20s, its most likely that the policy will mature just around the time your child attains college going age. The benefits received as a part of the maturity benefits can help you meet the steep costs.

(iv) To diversify investments: Life insurance is one of the few investment options that come with very low risks as per market condition.

(v) To save for retirement: It is also a retirement benefit option in case you don't have retirement plan, investing in life insurance can help get started. So, for a nominal monthly, quarterly, or annual payment can help investment plan in place and contributing to retirement fund.

(vi) To receive tax benefit: Life insurance is also among the many tax saving investment options available to investors. The premiums can be deducted from total taxable income as per the provisions of section 80c, up to Rs1.5 lakhs.

(vii) To achieve long term goal: These types of funds can help achieve long term goals one may have planned for life.

(viii) To leave behind an inheritance: A life insurance policy can also ensure that you leave behind a sizeable amount for your inheritance.

8.3.1 Essential Defination of Life Insurance

- **Policy owner:** The person who buys and controls the insurance policy. The policy owner may or may not be the one whose life is insured. For example, a wife could own a policy on her husband. The policy owner is the only one who can change the beneficiary and get policy details from the insurer.
- **Premium:** The amount of money you pay for insurance,

generally quoted per month or per year.

- **Beneficiary:** The person who receives the life insurance payout. You can name more than one beneficiary, and you can designate a specific percentage for each beneficiary. For example: 70% to Ram and 30% to Rahim.
- **Death benefit:** The life insurance money that is paid to the beneficiary.
- **Insured person:** The person whose life is being insured.
- **Term life insurance:** This type of policy lasts for a specific number of years. You select the term, such as 5, 10, 20 or 30 years.
- **Permanent life insurance:** This type of policy lasts for your entire life and also has a cash value component. There are multiple varieties of permanent life, including whole life, universal life, variable life and variable universal life. If you decide to buy permanent life insurance, work with a financial advisor and be sure you understand the difference between term vs. whole life insurance before you buy.
- **Cash value:** If you buy permanent life insurance, part of your payment goes into a "cash value" account that grows in value over time. You can take a loan against the cash value and use the money for anything you like.
- **Accelerated death benefit:** This policy feature allows you to receive some of the life insurance payout early if you are terminally ill. Some insurers now call this a "living benefit." It's usually a free feature, so make sure your policy has it.
- **Rider:** An add-on that provides an additional feature or coverage at extra cost. For example, with a "waiver of premium" rider you don't have to pay for your life insurance if you become totally disabled and can't work.

  "Imagine a life insurance policy is like buying a car, and a rider like all the accessories the dealer offers you. Do you need it? It's up to you to decide," says Chris de Lorimier of

O'Connor Wealth Management in Pasadena, California.

- **Underwriting:** This is the process by which insurance companies evaluate the risk of insuring you and determine your life insurance quote. It often includes accessing your medical records, driving record and prescription drug history.

8.3.2 The Special Treatment of Life Insurance

The most unique part of Life insurance is it provides a sum of money when you die; it receives special treatment by the various tax code and regulatory agencies. This has provided opportunities for insurance companies to provide a variety of options. These diverse options confuse many consumers.

- **Tax Code:** Life insurance has historically been an "insurance" product. Meaning it existed for safety and security. Therefore, the insurance industry has always been successful at maintaining favourable tax status, meaning they could lobby for continued favourable tax treatment.
- Life Insurance's favourable tax status includes a tax-free death benefit, tax-deferred cash value accumulation, and tax-free borrowing of cash value (as long as the policy is not a modified endowment contract that remains in force until death).
- **Regulatory Agencies:** The insurance and securities regulatory agencies provide life insurance companies an advantage over providers of other investments. Insurance companies can provide sales literature with futuristic computer illustrations of cash values.



CHECK YOUR PROGRESS

Q 1: Define legal terms of life insurance. (Answer in about 20 words)

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Q 2: Why life insurance is a must for everyone? (Answer in about

30 words)

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Q 3: What are the Special treatments of Life Insurance? (Answer in about 40 words)

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8.4 PROVISION OF POLICIES

Policy provisions are clauses in an insurance contract that lay out the exact conditions for which coverage is provided and for what amounts, along with exclusions and other restrictions.

Policy provisions in an insurance contract can include such details as coverage periods, exclusions, riders, start dates, and other important information. As it determines whether coverage applies and for what amount, it is important for policyholders to carefully read the details of their policy and understand them. Otherwise, they risk not taking advantage of the protection their policy provides or potential unexpected financial hardships due to losses that are not covered but assumed to have been.

1. **Standard Policy Provisions:** The standard insurance contract provision is a provision of an insurance policy that allows an insurer or any insurance company to cancel a property or a health insurance at a specific time or expiration date. The standard insurance contract provision is a legal clause or condition that requires parties to perform a certain requirement or prevent from doing something in a stipulated period of time.
2. **Key Provisions to Life Insurance Policies:** Some of the important provisions to life insurance policies are stated below, among all provisions some are for the advantage of the insured and beneficiary,

while others protect the insurance company.

(i) **Naming A Beneficiary:** While buying a life insurance in India, you must name a beneficiary who can legally claim the sum assured in your absence. You might think that naming a beneficiary will be an easy process. Though the selection of life insurance beneficiary is simple, you need to take care of various financial, legal and tax obligations to make it work for you. If you don't add a beneficiary properly for your life insurance, it can cost you and your family a lot. Two types of life insurance beneficiaries:

Primary Life Insurance Beneficiary: This is the person whom you can name in your policy as a beneficiary who will be entitled to receive the proceeds of sum assured in case of death of the insured person. But if the primary beneficiary dies before the insured person, then no amount can be claimed in his name.

Secondary or Contingent Life Insurance Beneficiary: This is the person you can add to your life insurance policy who can claim the sum assured in case of death of the primary beneficiary. The catch in this rule is that a contingent beneficiary will only be entitled to receive the sum, if the primary beneficiary dies before the insured person. Then after the death of the insured person, the secondary beneficiary can claim the money.

(ii) **Grace Period:** There are several options exist when paying for a life insurance policy, with the most common being annually, quarterly or monthly. If the premiums aren't paid, the policy will lapse, meaning no coverage will exist. If the insured dies during the lapsed period, the beneficiary will not receive the death benefits. However, depending on the insurance policy, the grace period can be as little as 24 hours or as long as 30 days. The amount of time granted in an insurance grace period is indicated in the insurance policy contract. Paying after the due date may

attract a financial penalty from the insurance company.

(iii) **Policy Reinstatement:** If the policy lapses, the insurance company may also have a policy reinstatement period in which the insured can pay past due premiums and resume the same policy without applying for a new one. The insured should pay close attention to the reinstatement period as it can vary by insurance company. If the insured doesn't pay during the reinstatement period the policy remains terminated and the insured must reapply. Reapplication could result in a higher premium or denial since the process is based on several different factors, such as health, occupation and the age of the insured.

(iv) **Misstatement of Age Provision:** The age is important factor in life insurance so any misstatement of age provision may harm both the parties in future. As age is major factor in calculating life insurance premiums, insurance companies utilize actuarial tables that calculate the probability of death and their is direct correlation between age and premiums. Essentially, the older you are, the greater risk of death and the higher your premium. If you lie about your age, the misstatement of age provision allows insurance companies to adjust the premium based on your true age or to cancel the policy.

(v) **Policy Loan Provision:** There are two main types of life insurance policies: term and whole. A term policy provides coverage for a specific period of time, while a whole policy lasts until the death of the insured. An additional benefit to whole policies is they build cash value (called reserves) when the insurance company invests the premiums.

Mr. A purchased a whole life policy for `100,000, and after 10 years, the invested premiums create a cash value of `10,000. The insured can borrow up to `10,000, hence the policy loan provision. Typically, the insured must pay back the `10,000; if they do not, the beneficiary will simply receive the stated amount



of `100,000 (rather than `110,000) after the insured dies.

CHECK YOUR PROGRESS

Q 4: State about standard policy provisions. (Answer in about 20 words)

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Q 5: Mention key policy provisions of life insurance? (Answer in about 30 words)

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8.5 SELECTION AND CLASSIFICATION OF RISK

Every life insurance company is liable to assess the risk. It wishes to accept and on that basis fix a fair and equitable premium payable by the applicant. This is possible only if company carefully selects and classified risks it assumes. The process through which a life insurer decides whether an application received by it can be accepted at standard rates of premium or on different terms or be rejected is called underwriting.

Underwriting is otherwise called selection and classification of risk. While selection represents the 1st part and the 2nd part viz the terms on which the proposal can be accepted is called classification.

According to - Mehr and Cammack "underwriting is the process of accepting or rejecting risk."

The purpose of selecting of risk or underwriting and the selection of risk is aimed at finding out those lives:

- Who can be offered life assurance;
- Who are uninsurable and are to be declined?

All companies generally gather underwriting information through traditional underwriting sources including; an application, medical exam,

a MIB check, a motor vehicle report, and your prescription drug records.

We should also keep in mind, that many agents give quotations based on the best insurance rate class without asking you enough questions in order to win your business. However, the insurance rate class that you get at the end of the application process is what really matters!

Here are the common names that are associated with the rate classes available in the life insurance industry.

Table 8.1: Classification of Risk in Insurance

Sl No	Preferred plus	Table A= 25% above standard rate
	Preferred	Table B = 50% and above standard rate
	Standard Plus	Table B = 75% and above standard rate
	Standard	Table B = 100% and above standard rate

*Life insurance tables of A, B, C, and D

We have also provided you with some helpful descriptions of each of the underwriting risk classifications.

Hopefully, these general life insurance underwriting risk classifications will help clarify where you might fit into the life insurance health classes.

- **Preferred Plus/Super Preferred Risk Life Insurance Rate**
  - The preferred plus risk classification used by underwriters means that you fit into the best class and have excellent overall health
  - You are free of any type of tobacco for 3-5 years
  - You do not engage in a risky occupation or hobby's like scuba diving or aviation
  - You have no history of drug or alcohol abuse
  - You must also have no history of heart disease (sometimes cancer) among your parents or siblings prior to their age 60
- **Preferred Risk Life Insurance Rate Class**
  - The preferred risk classification used by underwriters generally applies to those who are in excellent overall health and do not participate in dangerous activities

- A few medications are allowed like blood pressure, cholesterol, and family history guidelines are slightly more lenient with the preferred risk category

- **Standard Plus Life Insurance Rate Class**
  - The standard plus insurance risk class is associated with optimum health, but you may have a few minor health issues
  - You may be slightly over the life insurance height and weight chart, but you also have no family history of diseases
- **Standard Risk Insurance Rate Class**
  - The standard risk insurance rate class generally apply to those who are in average overall health
  - You are taking multiple medications
  - You do not fit within the published life insurance height and weight chart
  - You also have a family history of cancer or other diseases
- **Substandard Risk Category**
  - The substandard risk classification is also called impaired risk or table rated life insurance
  - The substandard risk class refers to people who have significant health impairments
  - These individuals may have to pay an extra fee or "table rating" depending on the risks they pose to the issuing life insurance company.

These insurance risk classes are general guidelines and many insurance companies have different rules to qualify for each rate class. If you participate in a hazardous occupation or risky hobby like sky diving or scuba diving, it is important to disclose it to your agent.

Many agent may forget to ask you or do not realize that these endeavors can also bump you into a substandard risk class.

This is why it is important to work with an experienced agent that



is familiar with life insurance underwriting risk classifications of many carriers. This will allow you to be matched with a company specializing in your type of risk at the best possible price.

CHECK YOUR PROGRESS

Q 6: What is the purpose of selection of risk? (Answer in about 20 words)

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Q 7: What is the various classification of Risk in life insurance? (Answer in about 30 words)

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Q 8: Mention some of preferred plus/super preferred risk life insurance rate?

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8.6 BASIS OF PREMIUM CONSTRUCTION

A life insurance policy is a contract between an insurer and a policyholder. To make the contract valid, a premium amount is paid by the policyholder at the time of buying the policy and later at agreed intervals of time, depending on the frequency and mode of payment.

Life insurance is a way to provide your family (the nominees) financial support in case of the insured's untimely demise. Generally, in the case of death the policyholder during the policy term, a pre-agreed amount (sum assured) is paid to the nominee.

Keeping the above view in mind, you must understand the following three important factors that are key determinants in the life insurance premium calculation for every insurer. The premium amount differs among insurers due to these factors when you compare their policies for the same coverage/sum insured. The premium rate for a life insurance policy

is based on two underlying concepts: mortality and interest. A third variable is the expense factor which is the amount the company adds to the cost of the policy to cover operating costs of selling insurance, investing the premiums, and paying claims.

- **Mortality:** Life insurance is based on the sharing of the risk of death by a large group of people. The amount at risk must be known to predict the cost to each member of the group. Mortality tables are used to give the company a basic estimate of how much money it will need to pay for death claims each year. By using a mortality table a life insurer can determine the average life expectancy for each age group.
- **Interest:** The second factor used in calculating the premium is interest earnings. Companies invest your premiums in bonds, stocks, mortgages, real estate, etc., and assume they will earn a certain rate of interest on these invested funds.
- **Expense:** The third consideration is the expenses of operating the company. The company estimates such expenses as salaries, agents' compensation, rent, legal fees, postage, etc. The amount charged to cover each policy's share of expenses of operation is called the expense loading. This is a cost area that can vary from company to company based on its operations and efficiency.

The premium that you have to pay for a life insurance policy depends on various factors like age, total coverage (sum assured), your medical history, gender, lifestyle, and job. However, the premium for the same life insurance coverage amount will vary from insurer to insurer.

- **Types of insurance premium:**
  - **Premium paid:**
    - **Fixed premium:** it is also known as level premium. These premiums remain unchanged till the policy maturity.
    - **Flexible premium:** this premium allows the policy holder to make changes vis-à-vis the policy.
  - **Insurance purchased:**

- **Life Insurance:** life insurance premiums are calculated based on age, occupation, income, health, asset owned and so on.
- **Health Insurance:** these premiums are calculated based on age. Older you are, greater the chances of falling sick. Higher the age, higher is the premium.
- **Car Insurance:** these premiums are calculated based on the type of car insurance plan. 3rd party liability insurance or comprehensive insurance, riders opted, car model, daily commute, the age of the driver, and so on.



CHECK YOUR PROGRESS

Q 9: State three variables which effect life insurance premium construction. (Answer in about 20 words)

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Q 10: State types of life insurance premium and its factors? (Answer in about 60 words)

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8.7 LET US SUM UP

- **Evaluate Life Insurance Needs:** Only purchase additional life insurance if you have a need for it. First examine the amount of life insurance that you need to provide for those financially dependent on you.
- **Purchase Life Insurance for Protection:** The first priority for

purchasing insurance should be for protection. It is most important that people, who need insurance purchase it and start their coverage without delay. At the very least, procure term life insurance with an appropriate death benefit, and term period, at a competitive premium. Term insurance provides the most economical decision for most middle-income people today. Most financial experts and commentators recommend term insurance for most people since it provides the most amount of protection at the lowest cost, enabling you to save and invest.

- **Purchasing Cash Value Life Insurance:** The decision to purchase cash value life insurance should be made in tandem with the outcome of your financial plan. Most people's first priorities are the proper funding of their retirement and other plans. After people have implemented the proper action steps in their financial plan, they may want to consider cash value life insurance for longer term needs. Seek advice from a trusted financial professional to help evaluate the appropriate options. A close examination of a contract should include not only attractive illustrations and sales literature, but a thorough analysis of their prospectuses and fully disclosed information. Insurance agents should provide best, good and worst case illustrations. Remember insurance agents are paid vastly more commission for permanent cash value insurance, so some may feel pressure to sell this.
- **Life Insurance as an Estate Planning Vehicle:** People with large net worth may want to consider life insurance as a viable legacy planning tool to aid in liquidity and estate and tax planning. They should consult their estate planning attorneys and financial planners for direction.



8.8 FURTHER READINGS

1) Mishra, M. N. & Mishra, S. B. (2016). *Insurance: Principles & Practice*, 22/e, New Delhi: S .Chand and Company Ltd.

2) Mishra, Kaninika, (2016), *Fundamentals of Life Insurance Theories and Applications*, PHI Learning Private Limited

8.9 ANSWERS TO CHECK YOUR PROGRESS

Ans to Q No 1: In legal terms, life insurance is a contract between an insurance policy holder (insured) and an insurance company (insurer).

Ans to Q No 2: Life insurance is a must - to replace loss of income, to repay pending debts, to meet educational expenses, to diversify investments, to save for retirement and to receive tax benefit.

Ans to Q No 3: Life insurance is not only unique because it provides a sum of money when you die; it receives special treatment by the tax code and regulatory agencies. This has provided opportunities for insurance companies to provide a wide array of options.

Ans to Q No 4: It is a legal clause or condition that requires parties to perform a certain requirement.

Ans to Q No 5: Key Provisions to Life Insurance Policies - Naming A Beneficiary, Grace Period and Policy Reinstatement, Misstatement of Age Provision and Policy Loan Provision

Ans to Q No 6: Two Purposes - who can be offered life assurance and who are uninsurable and are to be declined.

Ans to Q No 7: Preferred Plus = 25% above standard rates
Preferred = 50% above standard rates
Standard Plus = 75% above standard rates
Standard = 100% above standard rates

Ans to Q No 8: It means that you fit into the best class and have excellent overall health - You are free of any type of tobacco for 3-5 years; You do not engage in a risky occupation or hobby's like scuba diving or aviation; You have no history of drug or alcohol abuse

Ans to Q No 9: Three variables are - Mortality, Interest and Expense.

Ans to Q No 10: Types of insurance premium: 1) Premium paid- a) Fixed

premium: it is also known as level premium. b) Flexible premium. 2) Insurance purchased- a) Life insurance: Life insurance premiums are calculated based on age, occupation, income, health, asset owned and so on. b) Health insurance: these premiums are calculated based on age. c) Car insurance: these premiums are calculated based on the type of car insurance plan.



8.10 MODEL QUESTIONS

Short Questions (Answer each question in about 150 words)

Q 1: What do you mean by the terms a) Life Insurance and b) Life Insurance Product?

Q 2: What are the essentials of life insurance contract?

Q 3: Write short notes on a) Standard Policy Provisions b) Grace Period and c) Policy Reinstatement.

Long Questions (Answer each question in about 300-500 words)

Q 1: What is Provision of Policies? Discuss about the key provisions of life insurance policy.

Q 2: Critically discuss the various issues related with Selection and Classification of Risk.

Q 3: Discuss in details about basis and types of premium construction.

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UNIT 9 : ESSENTIALS OF HEALTH INSURANCE-I

UNIT STRUCTURE

9.1 Learning Objectives

9.2 Introduction

9.3 Essentials of Health Insurance

9.4 Individual health insurance

9.4.1 Top Insurers Providing Individual Health Insurance

9.4.2 Understanding Individual Health Insurance

9.4.3 Exclusions in Individual Health Insurance

9.5 A Model Health Insurance Format and Explanation of the Items.

9.6 Let Us Sum Up

9.7 Further Readings

9.8 Answers to Check Your Progress

9.9 Model Questions

9.1 LEARNING OBJECTIVES

After going through this unit, you will be able to-

- know the essentials of health insurance product
- idea about various individual health insurance product
- discuss about a model health insurance format
- explain various items included in a health insurance

9.2 INTRODUCTION

Health insurance (sometimes called health coverage) generally pays for some or all of the cost of the health services you receive, like doctors' visits, hospital stays, and visits to the emergency room. It also helps to keep your health care costs predictable and affordable. Several different amounts for health insurance you may likely to pay:

1. Pay a premium, a monthly fixed payment to the insurance company.
2. Pay a deductible as this is the fixed amount that you pay out of pocket before your health insurance begins to pay for your health services.

3. After paying the deductible, you and your insurance company typically share the cost of covered health services. Your insurance pays most of the cost first, and then you pay the remaining cost. The amount that you pay is either a copayment (a fixed amount) or a coinsurance (a percentage of the cost of the service).

Health insurance, is a system for the financing medical expenses by means of contributions or taxes paid into a common fund to pay for all or part of health services specified in an insurance policy or the law. The key elements generally common to all of the health insurance plans are advance payment of premiums or taxes, pooling of funds, and eligibility for benefits on the basis of contributions or employment.

A health insurance system is generally organized and administered by an insurance company or other private agency, with all the provisions specified in a contract and is known as private, or voluntary, health insurance. Private health insurance is usually financed on a group basis, but most health plans also provide for individual policies. Private group plans are usually financed by groups of employees whose payments may be subsidized by their employer, with the money going into a special fund. Insurance of hospital costs is the most prevalent form of private health insurance coverage; another type is major medical expense protection, which provides protection against large medical costs but avoids the financial and administrative burdens involved in insuring small costs.

9.3 ESSENTIALS OF HEALTH INSURANCE

All over the world Health insurance is a necessity today as it gives mental peace to all the individuals. Given the increasing medical costs day by day, this insurance policy and the coverage it offers can provide several benefits to the insured, some of the most important are-

1. **Protect savings:** opting for health insurance policy protects savings from getting washed-out for medical treatment. If you have insurance policy, a majority of cost can be covered.
2. **Provide Coverage:** an insurance policy mainly provides coverage

against hospitalization expenses along with it covers other medical costs that may be incurred before, after and during the course of treatment.

3. **Quality treatment:** generally, most of the insurance policies have a cashless treatment, where the insurance company directly settles bills with the hospitals.
4. **Provides coverage for the family:** buying individual health insurance policies always much expensive. So, most insurance companies provide family floater plans where policies and their benefits are clubbed together and premium also affordable.
5. **Lifestyle changes:** during recent decades there is enormous change in the present lifestyle. With the increase in the number of sitting workers, there is higher chances for lifestyle related diseases such as diabetes, cardiac problems etc. to protect the family from such shocks, it is best to buy a health insurance policy.

There are numerous reasons to buy health insurance, a few of them are listed below:

- To pay the various medical treatment expenses in case of hospitalization due to any disease or accident.
- Health coverage can help the insured to limit their extra costs, protects their assets and safeguard their present and future earnings.
- Insured need not have to worry about arranging money for medical treatment at the last hour, which gives peace of mind.
- Nonattendance of any risk protection measures by the government to bear the cost of expenses related to health.
- The cost of medical expenses is rising and it is expected that in future the cost will rise further due to high rate of inflation and increasing cost of medicines and other expenses.
- With cashless hospitalization treatment, one just need to show the identity card (health card) and rest of the thing is taken care by the hospital staff.
- Insured can get best treatment in the listed hospitals of the insurance company which was otherwise not affordable by the common man.

- Insurance companies offer 24 hours helpline, that always helpful to arrange for ambulances, get information about nearest hospitals, best doctors and so on.
- Human life is very unpredictable, even if someone is healthy and exercise regularly, may suffer unexpected illness or injury.
- Our food habits, lifestyle, stress levels, use of electronic gadgets are changing which increases the chance of getting caught by diseases and health problems.
- In case of critical illness, the cost of treatment generally very high and it is not always possible to meet the expenses from own sources.



CHECK YOUR PROGRESS

Q 1: Mention some key elements of health insurance. (Answer in about 20 words)

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Q 2: What are the benefits of health insurance? (Answer in about 30 words)

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Q 3: Mention some of the reasons to buy health insurance? (Answer in about 40 words)

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9.4 INDIVIDUAL HEALTH INSURANCE

Health insurance mainly an agreement between an insurance provider and an individual, by which the former guarantees to take care of certain medical costs of the latter based on the investment made. There are different plans, some offer health insurance for individuals while

others offer health insurance for family and group.

The Individual Health Insurance plan covers only one individual, the policyholder, who will gain the benefits of the health insurance for his investment.

- **Key Features:**
  - This type of health insurance for individuals mainly covers only for the insured individual
  - The insurance provider covers certain declared medical costs of the insured based on the premium paid by the individual
  - Hospitalization- The policy covers hospitalization charges
  - Lifetime renewal
  - Tax deductions under section 80D of the Income Tax act
  - Covers surgery costs, room rent, physician's fee and laboratory tests but depends on choice of individual policy
  - The insured must pay a predetermined amount for certain health care services. This is called co-payment.
  - Pre and post hospitalization expenses are covered under this plan.
  - Provides coverage for critical illness.
- **Advantages of Individual Health Insurance Plan:**
  - In individual health insurance plan, the insured alone earns all the benefits under the plan.
  - The individual will earn the benefit of individual sum assured rather than floating sum assured.
  - Policy best suited for people with higher health risks.
  - Parents and immediate family members can be added to the plan with additional premium
  - No restrictions on the maximum age for the members for the renewal of the policy.
  - There is no need to worry about making more than one claim in a year since the plan caters only to a single person.
- **Who should buy this plan?**
  - The plan is best suited for individuals with higher health risks.

- Single individuals with family members who are already insured.
- An individual who wants to earn the benefit of the sum assured rather than floating sum assured.
- Individuals who want to renew the policy without having to worry about any age restrictions.
- An individual who wants higher protection than what is offered under a family floater plan.
- Cashless facility for claim settlement can be availed in this plan.

9.4.1 Top Insurers Providing Individual Health Insurance

There are a lot of insurance providers who offer individual health insurance. Listed below are some of the individual health insurance providers.

- **National Mediclaim Policy** (Individual Plan) of National Insurance Company Limited. The key features of the policy are:
  - Sum Insured range– Rs.1,00,000/- to Rs.10, 00,000/- Entry Age– 18 to 65 years
  - Who can be covered – Self, Spouse, Dependent natural or legally adopted children, Parents, Parent-in-laws, Brother up to 25 years, if a bona-fide student and not employed, Sister if not employed, till marriage, new born from 3 months age.
  - Lines of treatment covered – Allopathy, Ayurveda and Homeopathy (Up to 100% of SI)
  - Room Rent/ICU charges, Medical practitioners, surgeon, anaesthetist, consultants, specialist's fees and other charges as per limits mentioned in the policy.
  - Ambulance Charges and Organ Donor's expenses covered up to sublimit mentioned.
  - Pre and Post Hospitalization up to 45 days and 60

days respectively for same disease/illness/injury for which Hospitalization occurred.

- 12 Modern treatments like Robotic surgery, oral chemotherapies, immunotherapies and etc., are now covered in the policy.
- Mental illness, HIV/AIDS, Genetic disorders are now covered.
- Cashless Facility available at Network Hospitals Only through TPA.
- Pre Negotiated Package rates for specific surgeries/ procedure in network hospitals.
- Life Long Renewability.
- Portability (migration) allowed from/to similar products as per IRDAI guidelines.

➢ **ICICI Lombard - Personal Protect Insurance Policy:** The key features of the ICICI Personal Protect Insurance Policy are:

- You can choose the coverage against Death or Permanent Total Disablement (PTD) due to an accident anywhere between Rs. 3 lakhs - Rs. 25 lakhs as a sum assured.
- The ICICI Personal Protect Insurance Policy will even provide insurance cover to individuals who can claim after being in an act of violence from acts of terrorism.
- There will no requirement for the individual to go through a health check in order to take up this policy.
- The policy has an easy claim process with the need of documentation to be minimal, the coverage for this policy will be worldwide.
- For the ICICI Personal Protect Insurance Policy an individual between the ages of 18 - 60 years, is eligible for a policy term of 1-5 years.

➢ **Bajaj Allianz - Individual Health Guard:** The key features

of the Bajaj Allianz Individual Health Guard are:

- With this policy you will receive hospitalization charges and you will also receive 10% discount for family members. You can also get cashless hospitalization in the partner hospitals which are more than 3700 hospitals in the country.
- The policy will cover pre and post hospitalization expenses that are of relevance, which would have occurred 60 days prior to hospitalization or 90 days after hospitalization. This will also costs of the ambulance if there's a case of emergency. The ambulance costs will be covered up to Rs. 1000/- .
- The sum assured will be in a range of Rs. 1.5 lakhs- Rs. 10 lakhs for an individual aged between 3 months- 55 years. And for an individual aged between 56 years- 65 years the sum assured will be from Rs. 1.5 lakhs- Rs. 5 lakhs.
- There are 130 day care procedures that will be covered under this policy.
- For the Bajaj Allianz Individual Health Guard an individual between the ages of 18 - 65 years, is eligible for a policy. For Spouse and parents as well. The proposer can also take up this policy for his/her children they will need to be between the ages of 3 months - 25 years.

➢ **Oriental Health Insurance - Individual Mediclaim:** The key features of the Individual Mediclaim Health Insurance are:

- This policy will offer cashless hospitalization and reimbursement hospitalization in the partner hospitals in the country.
- The policy will cover pre and post hospitalization expenses that are of relevance, which would have occurred 30 days prior to hospitalization or 60 days after hospitalization.
- The hospital charges for nursing expenses, room,

boarding, etc for Rs. 5,000/- or 1% of the sum assured whichever is less.

- For family members covered under this policy, they will receive a 10% discount.
- Any special fees for surgeons, ambulance, consultation etc will be covered under the policy.
- If the individual is in Intensive Care the cost of the Intensive Care Unit will be borne for up to 2% of the sum assured of Rs. 5,000/- whichever is less.
- The sum assured will range from Rs. 50,000- Rs. 50,000.

➢ **Star Health Insurance-Medi Classic Insurance:** The key features of the Medi Classic Insurance are:

- The insured individual will get protection under in patient hospitalization for a minimum of 24 hours.
- Surgeon, Medical Practitioner, Anaesthetist, Specialist, Consultants Fees.
- In case of emergencies, charges for transporting the covered patient to a hospital in an ambulance are covered up to Rs. 750 per hospitalisation (maximum Rs. 1500 per policy period).
- Blood, Anesthesia, Oxygen, charges for Operation theatre, Pacemaker cost etc.
- Room charges, nursing expenses, boarding as provided by the Nursing Home or Hospital at also covered at 2% of the Sum Insured (maximum Rs.5,000 per day).
- Non-Allopathic treatments are also covered by this policy up to 25% of the sum insured (maximum Rs.25,000 per policy period).
- The policy term is one year but special discount of 5% is offered when premium is paid for two years in advance.

9.4.2 Understanding Individual Health Insurance

- **Who does the individual health insurance plan cover?**

  The Individual Health Insurance plan covers only the policyholder.

- **What is the difference between Individual Health Insurance and Family Floater Health Insurance?**

  In individual health insurance plans, each individual of a family is entitled to a health cover of a certain sum; whereas in the family floater health insurance plan, the health cover of the same amount is shared by all the family members included in the plan.

- **What does individual health insurance plan cover?**

  The charges covered by individual health insurance are listed below.

  - Medical examinations
  - Hospitalization
  - Emergency services
  - Laboratory services
  - Maternity and new born care
  - Room, boarding expenses
  - Physician fee

- **Is there an age limit to avail an individual health insurance?**

  No. Anyone can avail an individual health insurance.

- **Does the policy offer tax deductions?**

  Individual health insurance plan offers tax deductions under section 80D of the Income Tax Act.

- **Will there be additional costs other than regular premiums?**

  There are a few additional costs other than regular premiums that one has to pay

  - Medical
  - Deductibles

- Co-payment
- Co-insurance

➢ **Can my family members be included in the plan?**

The main aim of individual health insurance is to provide complete protection just to the insured but the plan can be extended to parents and in-laws in certain cases.

9.4.3 Exclusions In Individual Health Insurance

Though individual health insurance covers most of the medical expenses, there are some exceptions:

- Individual health insurance covers pre-existing diseases subject to a waiting period of 2 to 4 years which can prove to be a disadvantage to some.
- Cost of prescription glasses, lenses and hearing aids aren't covered by this plan.
- Dental treatment.
- Naturopathy treatment.
- Certain ailments like cataract, hernia, sinusitis, etc. won't be covered under first year of policy. For instance, Mr. Deka and Ms. Kalita who were traveling in a car meet with an accident. After the treatment, the hospital bill comes up to Rs.1.8 lakh for each person. Mr. Deka has a family floater health insurance which offers coverage of Rs.3 lakh for his family of three. Ms. Kalita has an individual health insurance plan that offers coverage of Rs.2 lakh. Ms. Kalita manages to use her insurance to pay for the hospital bills. Unfortunately, Mr. Deka's family member had already made a claim of Rs.2.5 lakh the same year for a surgery. Hence, Mr. Deka had to pay up Rs.1.3 lakh from his own pocket for the medical bills. Since he did not have an individual insurance plan he had to pay from his own pocket. This instance shows why exactly individual health insurance is a better option.



CHECK YOUR PROGRESS

Q 4: What do you understand by individual health insurance? (Answer in about 20 words)

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Q 5: What are the advantages of health insurance? (Answer in about 30 words)

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Q 6: Mention some of the key features of Individual Health Insurance Plan? (Answer in about 40 words)

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Q 7: What are the charges covered under individual health insurance plan? (Answer in about 30 words)

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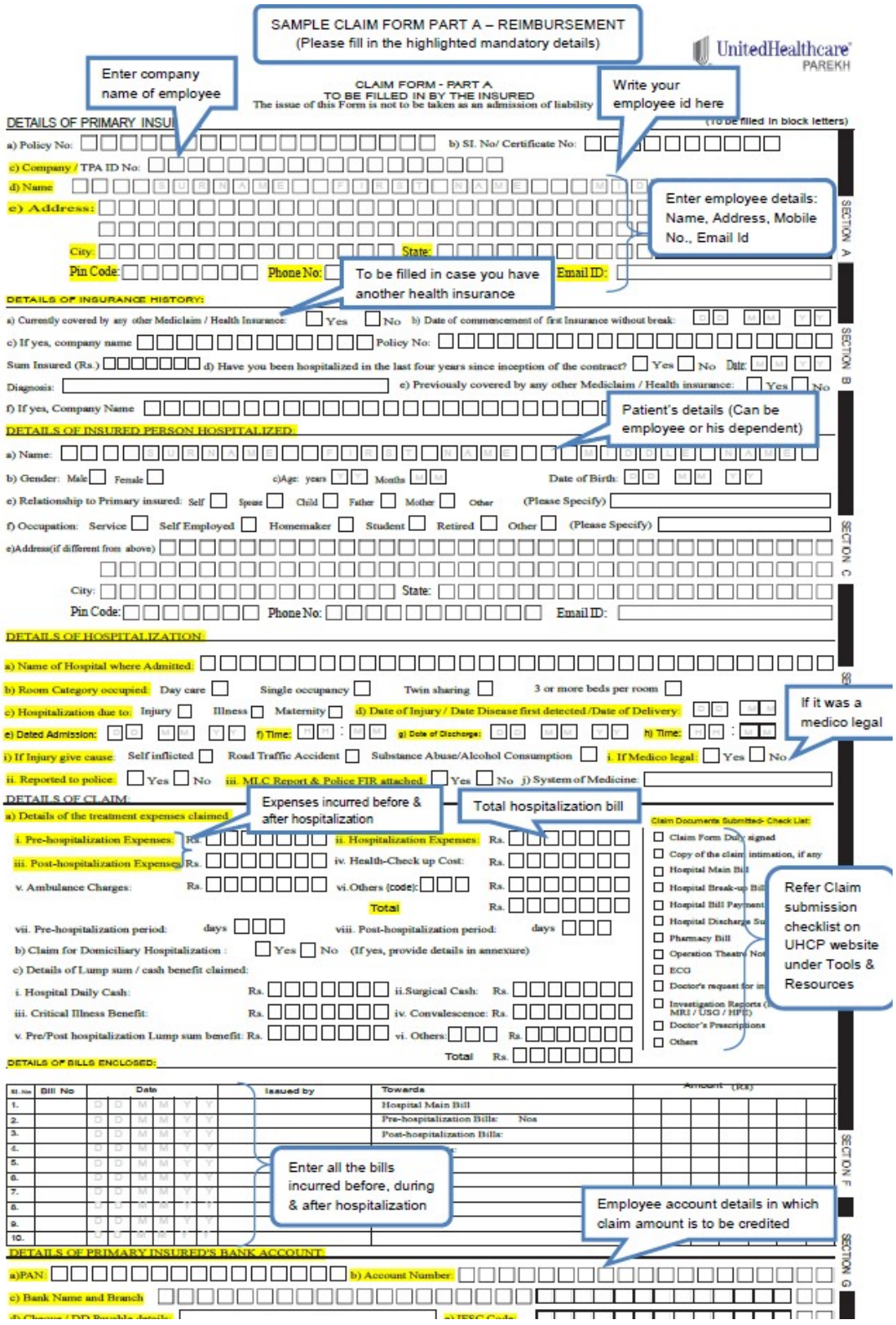
Q 8: Mention those expenses which are not covered by Individual Health Insurance Plan? (Answer in about 30 words)

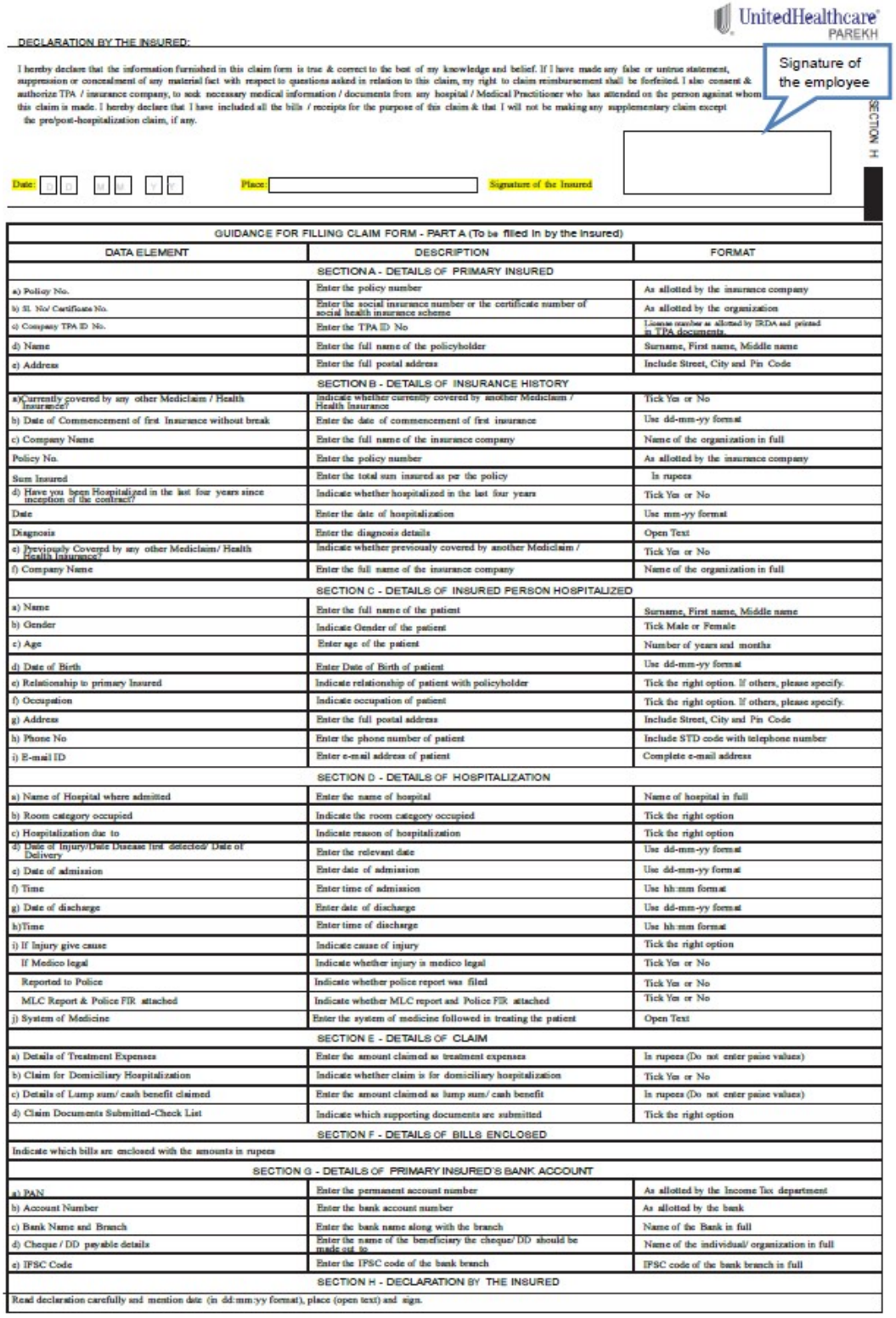
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9.5 A MODEL HEALTH INSURANCE FORMAT AND EXPLANATION OF THE ITEMS





UnitedHealthcare PAREKH

DECLARATION BY THE INSURED:

I hereby declare that the information furnished in this claim form is true & correct to the best of my knowledge and belief. If I have made any false or untrue statement, suppression or concealment of any material fact with respect to questions asked in relation to this claim, my right to claim reimbursement shall be forfeited. I also consent & authorize TPA / insurance company, to seek necessary medical information / documents from any hospital / Medical Practitioner who has attended on the person against whom this claim is made. I hereby declare that I have included all the bills / receipts for the purpose of this claim & that I will not be making any supplementary claim except the pre/post-hospitalization claim, if any.

Signature of the employee

SECTION H

Date: D D M M Y Y Y Y Place: Signature of the Insured

GUIDANCE FOR FILLING CLAIM FORM - PART A (To be filled in by the Insured)		
DATA ELEMENT	DESCRIPTION	FORMAT
SECTION A - DETAILS OF PRIMARY INSURED		
a) Policy No.	Enter the policy number	As allotted by the insurance company
b) Sl. No/ Certificate No.	Enter the social insurance number or the certificate number of social health insurance scheme	As allotted by the organization
c) Company TPA ID No.	Enter the TPA ID No	License number as allotted by IRDA and printed in TPA documents.
d) Name	Enter the full name of the policyholder	Surname, First name, Middle name
e) Address	Enter the full postal address	Include Street, City and Pin Code
SECTION B - DETAILS OF INSURANCE HISTORY		
a)Currently covered by any other Mediclaim / Health Insurance?	Indicate whether currently covered by another Mediclaim / Health Insurance	Tick Yes or No
b) Date of Commencement of first Insurance without break	Enter the date of commencement of first insurance	Use dd-mm-yy format
c) Company Name	Enter the full name of the insurance company	Name of the organization in full
Policy No.	Enter the policy number	As allotted by the insurance company
Sum Insured	Enter the total sum insured as per the policy	In rupees
d) Have you been Hospitalized in the last four years since inception of the contract?	Indicate whether hospitalized in the last four years	Tick Yes or No
Date	Enter the date of hospitalization	Use mm-yy format
Diagnosis	Enter the diagnosis details	Open Text
e) Previously Covered by any other Mediclaim/ Health Health Insurance?	Indicate whether previously covered by another Mediclaim /	Tick Yes or No
f) Company Name	Enter the full name of the insurance company	Name of the organization in full
SECTION C - DETAILS OF INSURED PERSON HOSPITALIZED		
a) Name	Enter the full name of the patient	Surname, First name, Middle name
b) Gender	Indicate Gender of the patient	Tick Male or Female
c) Age	Enter age of the patient	Number of years and months
d) Date of Birth	Enter Date of Birth of patient	Use dd-mm-yy format
e) Relationship to primary Insured	Indicate relationship of patient with policyholder	Tick the right option. If others, please specify.
f) Occupation	Indicate occupation of patient	Tick the right option. If others, please specify.
g) Address	Enter the full postal address	Include Street, City and Pin Code
h) Phone No	Enter the phone number of patient	Include STD code with telephone number
i) E-mail ID	Enter e-mail address of patient	Complete e-mail address
SECTION D - DETAILS OF HOSPITALIZATION		
a) Name of Hospital where admitted	Enter the name of hospital	Name of hospital in full
b) Room category occupied	Indicate the room category occupied	Tick the right option
c) Hospitalization due to	Indicate reason of hospitalization	Tick the right option
d) Date of Injury/Date Disease first detected/ Date of Delivery	Enter the relevant date	Use dd-mm-yy format
e) Date of admission	Enter date of admission	Use dd-mm-yy format
f) Time	Enter time of admission	Use hh:mm format
g) Date of discharge	Enter date of discharge	Use dd-mm-yy format
h)Time	Enter time of discharge	Use hh:mm format
i) If Injury give cause	Indicate cause of injury	Tick the right option
If Medico legal	Indicate whether injury is medico legal	Tick Yes or No
Reported to Police	Indicate whether police report was filed	Tick Yes or No
MLC Report & Police FIR attached	Indicate whether MLC report and Police FIR attached	Tick Yes or No
j) System of Medicine	Enter the system of medicine followed in treating the patient	Open Text
SECTION E - DETAILS OF CLAIM		
a) Details of Treatment Expenses	Enter the amount claimed as treatment expenses	In rupees (Do not enter paise values)
b) Claim for Domiciliary Hospitalization	Indicate whether claim is for domiciliary hospitalization	Tick Yes or No
c) Details of Lump sum/ cash benefit claimed	Enter the amount claimed as lump sum/ cash benefit	In rupees (Do not enter paise values)
d) Claim Documents Submitted-Check List	Indicate which supporting documents are submitted	Tick the right option
SECTION F - DETAILS OF BILLS ENCLOSED		
Indicate which bills are enclosed with the amounts in rupees		
SECTION G - DETAILS OF PRIMARY INSURED'S BANK ACCOUNT		
a) PAN	Enter the permanent account number	As allotted by the Income Tax department
b) Account Number	Enter the bank account number	As allotted by the bank
c) Bank Name and Branch	Enter the bank name along with the branch	Name of the Bank in full
d) Cheque / DD payable details	Enter the name of the beneficiary the cheque/ DD should be made out to	Name of the individual/ organization in full
e) IFSC Code	Enter the IFSC code of the bank branch	IFSC code of the bank branch in full
SECTION H - DECLARATION BY THE INSURED		
Read declaration carefully and mention date (in dd:mm:yy format), place (open text) and sign.		

- **Explanation of the Items used in Health Insurance Policies:** There are some standard definitions of terminology generally used in Health Insurance Policies. It has become increasingly necessary to ensure

that certain basic terminology being used in Health Insurance policies are given standard definitions so that prospects and insured are able to understand them without doubt. All insurers generally follow the following standard definitions for the terminology listed hereunder, Where a particular terminology is not applicable to one or more types of policies, it is indicated against it in brackets.

- **Accident:** An accident means sudden, unforeseen and involuntary event caused by external, visible and violent means.
- **Any one illness:** (not applicable for Travel and Personal Accident Insurance) Any one illness means continuous period of illness and includes relapse within 45 days from the date of last consultation with the Hospital/Nursing Home where treatment was taken.
- **Cashless facility:** Cashless facility means a facility extended by the insurer to the insured where the payments, of the costs of treatment undergone by the insured in accordance with the policy terms and conditions, are directly made to the network provider by the insurer to the extent of pre-authorization is approved.
- **Condition Precedent:** Condition Precedent means a policy term or condition upon which the Insurer's liability under the policy is conditional upon.
- **Congenital Anomaly:** Congenital Anomaly means a condition which is present since birth, and which is abnormal with reference to form, structure or position.
- **Co-Payment:** Co-payment means a cost sharing requirement under a health insurance policy that provides that the policyholder/ insured will bear a specified percentage of the admissible claims amount. A co-payment does not reduce the Sum Insured.
- **Cumulative Bonus:** Cumulative Bonus means any increase or addition in the Sum Insured granted by the insurer without an associated increase in premium.
- **Day Care Centre:** A day care centre means any institution

established for day care treatment of illness and/or injuries or a medical setup with a hospital and which has been registered with the local authorities, wherever applicable, and is under supervision of a registered and qualified medical practitioner and must comply with all minimum criterion as under – i) has qualified nursing staff under its employment; ii) has qualified medical practitioner/s in charge; iii) has fully equipped operation theatre of its own where surgical procedures are carried out; iv) maintains daily records of patients and will make these accessible to the insurance company's authorized personnel.

- **Deductible:** Deductible means a cost sharing requirement under a health insurance policy that provides that the insurer will not be liable for a specified rupee amount in case of indemnity policies and for a specified number of days/hours in case of hospital cash policies which will apply before any benefits are payable by the insurer. A deductible does not reduce the Sum Insured. (Insurers to define whether the deductible is applicable per year, per life or per event and the manner of applicability of the specific deductible)
- **Disclosure to information norm:** The policy shall be void and all premium paid thereon shall be forfeited to the Company in the event of misrepresentation, mis-description or non-disclosure of any material fact.
- **Domiciliary Hospitalization:** Domiciliary hospitalization means medical treatment for an illness/disease/injury which in the normal course would require care and treatment at a hospital but is actually taken while confined at home under any of the following circumstances: i) the condition of the patient is such that he/she is not in a condition to be removed to a hospital, or ii) the patient takes treatment at home on account of non-availability of room in a hospital.
- **Emergency Care:** Emergency care means management for an illness or injury which results in symptoms which occur

suddenly and unexpectedly, and requires immediate care by a medical practitioner to prevent death or serious long-term impairment of the insured person's health.

- **Grace Period:** Grace period means the specified period of time immediately following the premium due date during which a payment can be made to renew or continue a policy in force without loss of continuity benefits such as waiting periods and coverage of pre-existing diseases. Coverage is not available for the period for which no premium is received.
- **Illness:** Illness means a sickness or a disease or pathological condition leading to the impairment of normal physiological function and requires medical treatment.
  - **Acute condition:** Acute condition is a disease, illness or injury that is likely to respond quickly to treatment which aims to return the person to his or her state of health immediately before suffering the disease/ illness/ injury which leads to full recovery
  - **Chronic condition:** A chronic condition is defined as a disease, illness, or injury that has one or more of the following characteristics: (i) it needs ongoing or long-term monitoring through consultations, examinations, check-ups, and /or tests (ii). it needs ongoing or long-term control or relief of symptoms (iii). it requires rehabilitation for the patient or for the patient to be specially trained to cope with it (iv). it continues indefinitely (v). it recurs or is likely to recur.
- **Injury:** Injury means accidental physical bodily harm excluding illness or disease solely and directly caused by external, violent, visible and evident means which is verified and certified by a Medical Practitioner.
- **Inpatient Care (not applicable for Overseas Travel Insurance):** Inpatient care means treatment for which the insured person has to stay in a hospital for more than 24 hours for a covered event.

- **Intensive Care Unit:** Intensive care unit means an identified section, ward or wing of a hospital which is under the constant supervision of a dedicated medical practitioner(s), and which is specially equipped for the continuous monitoring and treatment of patients who are in a critical condition, or require life support facilities and where the level of care and supervision is considerably more sophisticated and intensive than in the ordinary and other wards.
- **ICU Charges:** ICU (Intensive Care Unit) charges means the amount charged by a Hospital towards ICU expenses which shall include the expenses for ICU bed, general medical support services provided to any ICU patient including monitoring devices, critical care nursing and intensivist charges.
- **Medical Advice:** Medical Advice means any consultation or advice from a Medical Practitioner including the issuance of any prescription or follow-up prescription.
- **Medical Expenses:** Medical Expenses means those expenses that an Insured Person has necessarily and actually incurred for medical treatment on account of Illness or Accident on the advice of a Medical Practitioner, as long as these are no more than would have been payable if the Insured Person had not been insured and no more than other hospitals or doctors in the same locality would have charged for the same medical treatment.
- **Pre-Existing Disease (not applicable for Overseas Travel Insurance):** Pre-Existing Disease means any condition, ailment or injury or related condition(s) for which there were signs or symptoms, and / or were diagnosed, and / or for which medical advice / treatment was received within 48 months prior to the first policy issued by the insurer and renewed continuously thereafter. (Life Insurers may define norms for applicability of PED at reinstatement).
- **Pre-hospitalization Medical Expenses:** Pre-hospitalization

Medical Expenses means medical expenses incurred during predefined number of days preceding the hospitalization of the Insured Person, provided that: i. Such Medical Expenses are incurred for the same condition for which the Insured Person's Hospitalization was required, and ii. The In-patient Hospitalization claim for such Hospitalization is admissible by the Insurance Company.

- **Post-hospitalization Medical Expenses:** Post-hospitalization Medical Expenses means medical expenses incurred during predefined number of days immediately after the insured person is discharged from the hospital provided that: (i) Such Medical Expenses are for the same condition for which the insured person's hospitalization was required, and (ii) The inpatient hospitalization claim for such hospitalization is admissible by the insurance company.
- **Room Rent:** Room Rent means the amount charged by a Hospital towards Room and Boarding expenses and shall include the associated medical expenses.
- **Surgery or Surgical Procedure:** Surgery or Surgical Procedure means manual and / or operative procedure (s) required for treatment of an illness or injury, correction of deformities and defects, diagnosis and cure of diseases, relief from suffering and prolongation of life, performed in a hospital or day care centre by a medical practitioner.



CHECK YOUR PROGRESS

Q 9: Explain about cashless facilities under health insurance plan. (Answer in about 40 words)

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Q 10: What is the meaning of pre and post hospitalisation expenses? (Answer in about 40 words)

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9.6 LET US SUM UP

- The Insurance Regulatory and Development Authority of India (IRDAI), on January 2, 2020 issued a circular mandating health and general insurance companies to offer a standardised product that will take care of the basic requirements of policyholders.
- According to IRDAI, the policy will be named as Arogya Sanjeevani Policy, succeeded by the name of the insurance company. The regulator said, no other name is allowed in any of the documents. Insurers will have to start offering the policy from April 1, 2020.
- According to IRDAI's guidelines, issued on January 2, these are the key features of the Arogya Sanjeevani Policy.
  - Health insurance policy to take care of basic health needs of insuring public
  - To have a standard product with common policy wordings across the industry
  - To facilitate seamless portability among insurers
- Some important things we should know about the health insurance plan, as per IRDAI:
  - **Minimum and maximum sum insured:** The minimum sum insured under the health insurance plan will be Rs 1 lakh and the maximum sum insured limit should be Rs 5 lakh (in multiples of 50,000).
  - **Eligibility:** Minimum entry age is 18 years and the maximum age at entry is 65. However, there is no exit age. The policy is subject to lifelong renewability.The policy can be availed for

self and the following family members:-

- Legally wedded spouse
- Parents and parents-in-laws
- Dependent children (i.e., natural or legally adopted) between the age of 3 months and 25 years.

- **Policy period:** The health insurance plan should be offered with a policy term of one year.
- **Modes of premium payment:** All the premium payment modes are available, that is, you can pay the insurance premium either annually, half-yearly, quarterly or in monthly mode. There will be uniformity in premium pricing. Also, the premium under this health insurance plan will be pan India basis. No geographic location/ zone-based pricing is allowed.
- **Grace period for premium payments:** For yearly premium payment mode, a fixed period of 30 days is to be allowed as Grace Period. However, for all other modes of payment, a fixed period of 15 days grace period will be allowed.



9.7 FURTHER READINGS

1) Gupta, P. K. (2016). *Essentials of Insurance and Risk Management*, Himalaya Publishing House

2) Patukale, Kshitij (2020), *Mediclaim and Health Insurance*, Prabhat Prakashan



9.8 ANSWERS TO CHECK YOUR PROGRESS

Ans to Q No 1: Key elements are - advance payment of premiums or taxes, pooling of funds, and eligibility for benefits on the basis of contributions or employment.

Ans to Q No 2: Benefits are- Protect savings; Coverage against hospitalization; Quality treatment; Provides coverage for the family

and protection against lifestyle related diseases such as diabetes, cardiac problems etc.

Ans to Q No 3: To pay the medical treatment expenses in case of hospitalization due to any disease or accident and to get 24 hours helpline with cashless hospitalization. To enjoy best treatment in the network hospitals and protects their assets and safeguard their future earnings.

Ans to Q No 4: The Individual Health Insurance plan covers only one individual, the policyholder, who will gain the benefits of the health insurance for his investment.

Ans to Q No 5:

- The insured alone earns all the benefits under the plan.
- Best suited for people with higher health risks
- Parents and immediate family members can be added to the plan.

Ans to Q No 6:

- Pre and post hospitalization expenses are covered under this plan.
- Lifetime renewal.
- Tax deductions under section 80D of the Income Tax act.
- Covers surgery costs, room rent, physician's fee and laboratory tests.
- Provides coverage for critical illness.

Ans to Q No 7: The charges covered by individual health insurance are listed below.

- Medical examinations
- Hospitalization
- Emergency services
- Laboratory services
- Maternity and new born care
- Room, boarding expenses
- Physician fee

Ans to Q No 8: Though individual health insurance covers most of the

medical expenses, there are some exceptions:

- Pre-existing diseases subject to a waiting period of 2 to 4 years
- Cost of prescription glasses, lenses and hearing aids aren't covered by this plan.
- Dental treatment.
- Naturopathy treatment.
- Certain ailments like cataract, hernia, sinusitis, etc. won't be covered under first year of policy.

Ans to Q No 9: Cashless facility means a facility extended by the insurer to the insured where the payments, of the costs of treatment undergone by the insured in accordance with the policy terms and conditions, are directly made to the network provider by the insurer to the extent pre-authorization is approved.

Ans to Q No 10:

- Pre-hospitalization Medical Expenses means medical expenses incurred during predefined number of days preceding the hospitalization of the Insured Person provided that:
  - Such Medical Expenses are incurred for the same condition for which the Insured Person's Hospitalization was required, and
  - The In-patient Hospitalization claim for such Hospitalization is admissible by the Insurance Company.
- Post-hospitalization Medical Expenses means medical expenses incurred during predefined number of days immediately after the insured person is discharged from the hospital provided that:
  - Such Medical Expenses are for the same condition for which the insured person's hospitalization was required, and
  - The inpatient hospitalization claim for such hospitalization is admissible by the insurance company.



9.9 MODEL QUESTIONS

Short Questions (Answer each question in about 150 words)

Q 1: Write notes on health insurance system?

Q 2: What are the essentials of health insurance contract?

Q 3: Mention some of the key features of health insurance policy provided by top insurer.

Long Questions (Answer each question in about 300-500 words)

Q 1: What are the advantages and disadvantages of individual health insurance plan?

Q 2: Critically discuss understanding and exclusion under health insurance plan.

Q 3: Discuss about model health insurance format and explain some of the important items included in health insurance policy.

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UNIT 10 : ESSENTIALS OF HEALTH INSURANCE-II

UNIT STRUCTURE

10.1 Learning Objectives

10.2 Concept of Insurance

10.3 Historical Perspective of Insurance

10.4 Reforms in Insurance Sector in India

10.5 Principles of Under-Writing of Life Insurance and Health Insurance

10.6 Classification of Risks

10.7 Group Insurance

10.8 Let Us Sum Up

10.9 Further Readings

10.10 Answer to Check Your Progress

10.11 Model Questions

10.1 LEARNING OBJECTIVES

After going through the unit, you will able to-

- explain the principles of underwriting of insurance
- discuss about life and health Insurance
- discuss about group insurance

10.2 CONCEPT OF INSURANCE

Insurance is a means of protection from financial loss. It is a form of risk management, primarily used to hedge against the risk of a contingent or uncertain loss.

An entity which provides insurance is known as an insurer/ insurance company. A person or entity who buys insurance is known as an insured or as a policyholder. The insurance transaction involves the insured assuming a guaranteed and known, relatively small loss in the form of payment to the insurer in exchange for the insurer's promise to compensate the insured in the event of a covered loss. The loss may or

may not be financial, but it must be reducible to financial terms, and usually involves something in which the insured has an insurable interest established by ownership, possession, or pre-existing relationship.

The insured receives a contract, called the insurance policy, which details the conditions and circumstances under which the insurer will compensate the insured. The amount of money charged by the insurer to the policyholder for the coverage set forth in the insurance policy is called the premium. If the insured experiences a loss which is potentially covered by the insurance policy, the insured submits a claim to the insurer for processing by a claims adjuster. The insurer may hedge its own risk by taking out reinsurance, whereby another insurance company agrees to carry some of the risk, especially if the primary insurer deems the risk too large for it to carry.

The basic principle of insurance is that an entity will choose to spend small periodic amounts of money against a possibility of a huge unexpected loss. Basically, all the policyholder pools their risks together. Any loss that they suffer will be paid out of their premiums which they pay.

10.3 HISTORICAL PERSPECTIVE OF INSURANCE

Insurance is a system of spreading the risk of one onto the shoulders of many. Insurance is a method or process which distributes the burden of the loss on a number of persons within the group formed for this particular purpose.

Although not in the present-day form of insurance, the concept of such a philosophy of grouping together or risk sharing developed in very ancient times. 4th century witnessed the practice of Bottomry Bonds and Respondentia Bonds in maritime trade. If at a time of distress in mid-ocean, the master of a vessel was in urgent need of fund/money for the completion of the journey, and he could not manage the same at an intermediary port either on his own account or on the account of the owner of the vessel, he (master) was authorised to gather such fund by mortgaging the vessel. This system was known as Bottomry Bond as the loan was to be given by signing a bond.

The term of the agreement was that the loan was required to be reimbursed only if the ship reached destination unscathed. In case of total loss or destruction of the ship, nothing was required to be repaid.

Therefore, it was quite obvious, that the creditors used to charge a premium, in addition to interest to protect themselves against the possibility of total losses when they lose the principal amount. Similar loans could also be gathered on the mortgage of a cargo and this was used to be done on RESPONDENTIA BONDS. The terms of repayment were exactly the same. The practice has been abolished since 19th century due to the immense development in a communication system.

Until the 18th century, there is a system of sharing risks with each other amongst the merchant community. They used to form a group where in one of the merchants, in a particular voyage, used to accept the risk against a premium from others whilst the others used to trade. On a different occasion, another from the group used to accept the risk whilst the rest used to trade, and so on.

History of Insurance in India started from the prehistoric period as Insurance in its primitive form has been known to exist from as back as 3000 BC. Various civilizations were known for practicing the basic concept of insurance - pooling and sharing in an unorganized manner.

Modern Insurance in India began around 1800 AD with agencies of foreign insurance starting a marine Insurance business.



CHECK YOUR PROGRESS

Q 1. Name two bonds signed during the 4th Century in relation to evaluation of insurance contract.

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Q 2. What is insurance contract?

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10.4 REFORMS IN INSURANCE SECTOR IN INDIA

The formation of the Malhotra Committee in 1993 initiated reforms in the Indian insurance sector and is considered as one of the milestones in the history of Insurance in India. The aim of the Malhotra Committee was to assess the functionality of the Indian insurance sector. This committee was also in charge of recommending the future path of insurance in India. The Malhotra Committee attempted to improve various aspects of the insurance sector, making them more appropriate and effective for the Indian market.

The Insurance Regulatory and Development Authority Act of 1999 brought about several crucial policy changes in the insurance sector of India. It led to the formation of the Insurance Regulatory and Development Authority (IRDA) in 2000.

A Brief about insurance history

- 1818: Oriental Life Insurance Company, the first life insurance company on Indian soil started functioning.
- 1870: Bombay Mutual Life Assurance Society, the first Indian life insurance company started its business.
- 1912: The Indian Life Assurance Companies Act enacted as the first statute to regulate the life insurance business.
- 1928: The Indian Insurance Companies Act enacted to enable the government to collect statistical information about both life and non-life insurance businesses.
- 1938: Earlier legislation consolidated and amended to by the Insurance Act with the objective of protecting the interests of the insuring public.
- 1956: Nationalization of life insurance: Life insurance business was nationalized on 1st September 1956 and the Life Insurance Corporation of India (LICI) was formed through the LIC Act, 1956. A capital contribution of Rs. 5 crores from the Government of India was also made. There were 170 companies and 75 provident fund societies doing life insurance business in India at that time. From

1956 to 1999, the LIC held exclusive rights to do the life insurance business in India.

- 1972: Nationalization of non-life insurance: With the enactment of General Insurance Business Nationalization Act (GIBNA) in 1972, the non-life insurance business was also nationalized and the General Insurance Corporation of India (GIC) and its four subsidiaries were set up. At that point of time, 106 insurers in India doing non-life insurance business were amalgamated with the formation of four subsidiaries of the GIC of India.

10.5 PRINCIPLES OF UNDER-WRITING OF LIFE INSURANCE AND HEALTH INSURANCE

Life Insurance Underwriting is the process of accepting the proposal of the customer based on the guidelines formulated by the insurance company. The insurance companies codify a set of procedures which must be followed before accepting any new business. When a new proposal comes to the insurance company, its underwriting department scrutinizes the proposal whether or not it fulfils the criteria laid down by the company. If they find any gaps, they ask the agent to get it corrected. It is not that one can get whatever cover one wants. The issue of policy depends on income of the insured and whether he has the capacity to pay the premium over the years. Once the underwriters are satisfied that all the conditions have been fulfilled, they go ahead to accept the premium and issue the policy.

Commonly insurance is known as a social device in which a group of individuals (i.e. insured) transfer risk to another party (i.e. insurers) in order to combine loss experience, which permits statistical prediction of losses and provides for payment of losses from funds contributed (i.e. premiums) by all members who transferred the risk. The insurers resort to underwriting which is the process of classifying the potential insured into the appropriate risk classification in order to charge the appropriate rate. Insurance involves-

- A large group of people or organizations who are exposed to similar risks;
- Each person or the organization that becomes an insured to transfer risk to the whole group (i.e. pooling of risk), as evidenced by an insurance contract issued by an insurer;
- The systematic accumulation of funds through the statistical prediction of losses and calculation of premiums;
- Payment of losses in accordance with the terms of insurance as a legal contract.

Two Procedure of Underwriting of Insurance are

- Group Insurance
- Individual Insurance
- **Group underwriting:** the group characteristics, demographics, and past losses are judged. Because individual insurability is not examined, even very sick people such as CORONA patients can obtain health insurance through a group policy in India and even in international parlance.

  Whereas for individual underwriting, the insured has to provide evidence of insurability in areas of health insurance or specific details about the property and automobiles in for property/casualty lines of business. An individual applicant for the health insurance must be approved by the health insurance company underwriter, a process that is specific to recognize the hazards associated with a person. Even for a person entering in health insurance after attaining the age of 50 years (& above) pre-acceptance Medical check-up (at their own cost) for blood/urine sugar, blood pressure, echo-cardiograph and eye-check including retinoscopy - all has now become mandatory.
- **The underwriting manual:** Every carrier has its own underwriting manual. This defines the guidelines that an individual carrier will use to determine your final premium rates.

  An underwriting manual will state things like what service a carrier's underwriters should use for ordering an attending physician

statement online, when they require a prescription history report, how height and weight correlate to health classifications, and more.

Since each carrier has their own guidelines, the underwriting process may include - conducting physical test etc. Everything that is followed is a standard set of tools and tasks for an underwriter, but the specification of what is used, when, and how may not be the same across insurance companies.

- **Step 1: Application quality check:** Before the process of life insurance underwriting begins, the carrier will go through the application to make sure that all information is correct. It's not uncommon for applications to be accidentally incomplete. The carrier is looking to make sure that all the information is accurate and completely filled out. Unless the missing information is related to medical history, most changes that need to be made to an application will not slow down the underwriting process.

  Depending on the carrier, you may need to do a phone interview as well. You'll usually need to do this if you only gave the most basic information on your application, like your date of birth, address, and coverage needs, and the carrier needs to dig a little deeper into things like your hobbies.

  After that, you'll go into the official underwriting process. Each of the following checks can add some time to your application, but it's important in getting you the premium price you will need to pay over the life of your policy.

- **Step 2: Paramedical exam:** The Paramedical exam is like a checkup with your doctor, except it is free to you. You will have to go to a lab where a medical technician will perform the exam.

  After the paramedical exam, the results will be sent to the underwriter. The information an underwriter uses falls into three main categories:

  - Basic measurements. Height, weight, blood pressure - Your height-to-weight ratio plays a big role in how you'll

be classified and, ultimately, what you'll pay for your life insurance policy. High blood pressure, which becomes a particular concern as you get older, is also required for setting your rates.

- Blood test. You can get a lot of information on potentially risky health concerns with a simple blood test. Heart disease, stroke, diabetes, blood-borne illnesses, and more can all be found out with a few vials of blood.
- Drug test. A urine test for a full drug panel will alert the carrier to the use of drugs like amphetamines, cocaine, barbiturates, and more. Generally speaking, drug use makes you riskier to insure and raises your premiums (unless it's marijuana, which is in a legal, social, and insurance grey area at the moment).

You can reuse the results of your paramedical exam to apply for other types of insurance, like disability insurance, or even for life insurance from another carrier. You are under no obligation to go with a particular life insurance company just because they paid for your medical examination.

- **Step 3: Attending physician statement(APS):** If there are red flags coming out of your paramedical exam, the underwriter will order an attending physician statement to answer some remaining questions.

It provides the status of each condition your doctor is treating and information about the condition such as how long you've been treating it, how long symptoms have been present, and your prognosis.

Say you're showing signs of high blood pressure. An APS can let an underwriter know that the high blood pressure is a temporary side effect of medication you're taking and not necessarily indicative of a larger problem. In that way, it complements the paramedical exam by getting down into the finer details of your health.

This step can skew the timeline for the life insurance underwriting process, adding anywhere from a few days to a few months depending on how long it takes for a doctor's office to comply with the request.

- **Step 4: Medical Information Bureau check:** The Medical Information Bureau (MIB) is a trade group that helps insurers share medical data, which helps a carrier fend off fraud by seeing where and when you've previously applied for life insurance in a general window of six months.

  It's not a bad thing if you've applied for life insurance with different carriers in the past, but the MIB will let carriers see what sort of information you've been disclosing on some applications that you may have accidentally left off others. Tested positive for drug use on a previous test but failed to disclose it on your current application? They'll find out.

- **Step 5: Prescription check:** The underwriter will check all the medication prescribed to you over the past five to seven years. As with the paramedical exam and APS, the prescription check will confirm the information in your application: the prescriptions you say you're on or if you've omitted any medication up to this point.

  Whether your underwriter requires this step depends on what he or she finds in other areas of investigation. Life insurance policies with higher coverage amounts may also require a prescription check.

- **Step 6: Motor vehicle report:** The underwriter will receive a motor vehicle report, or MVR, detailing your driving history. Just like your health history, your driving history plays a role in your life insurance rates because it helps determine how risky you are to insure.

  An MVR notes driving violations like traffic citations (think speeding or reckless driving tickets), vehicular crimes, accident reports, driving record points, and DUI convictions. It can look

as far back as five to seven years.

If you have a tendency to speed, drink and drive, or engage in other dangerous driving habits, you're riskier, and your rates will be higher than someone who's not.

You can request to see your MVR from your state. It's also used when determining your auto insurance rates, so a copy of your MVR can be nice to have.

- **Step 7: Actuarial tables:** Underwriters use a number of different actuarial tables to determine what risk you pose to the insurer and how much the insurer needs to charge to offset that risk.
  - **Mortality table:** This table shows the mortality probability for a given population, usually based on age and gender and assuming all other things being equal. Think of it as a baseline for when, statistically speaking, you're most likely to die.
  - **Build table:** This table takes your body mass index (BMI) based on your height and weight and translates it into information that's relevant to setting your insurance classification. A poor build can automatically set your classification to Standard, meaning you'll pay more for your life insurance policy than someone with a Preferred classification.
- **Step 8: Credit system:** After the underwriter has gone through all of the tests, tool, and checks needed to set your insurance classification, the last thing he or she may do is use a credit system to give you a little bump to help you get better rates.

  If a chronic illness you have results in a Standard (or worse) classification, the underwriter's credit system can make your premium more affordable if you're actively taking steps to improve your health and undergoing preventative care.

  The APS and prescription check will let an underwriter know what you are doing to keep health problems from getting

worse, which can be a boost to both your health and your wallet.

- **Step 9: Your final rating:** Once underwriting is complete, you are now the proud owner of a life insurance policy. The whole process can take anywhere from three to eight weeks, and relying on outside sources - like a doctor's office for an APS - can add time. All that's left is to confirm the premium rate, sign the policy to put it in force, and your family is protected.

If that was a lot to digest, you could consider getting simplified-issue life insurance, which skips the paramedical exam and the attending physician statement. But simplified-issue offers lower coverage amounts and isn't available to people with certain health profiles.

Understanding Risk Selection:

The underwriter does not approve all applications. In some cases, the underwriter determines that the risk associated with the application is too high. It is the underwriter's responsibility to ensure that the insurance company is not taking on too much risk, which could lead to a loss for the company.

In order to determine which applicants, represent a reasonable risk to the company, the underwriter uses the following information in addition to the application:

- Medical history and examinations
- Inspection reports, and
- The information from the Medical Information Bureau (MIB)

Not every applicant will require a detailed medical examination. Insurance companies have criteria regarding the type of information that they must gather for the face amount, or the amount of insurance coverage for which the applicant is applying. The larger the face amount, the more information the applicant will have to submit. For example, if Mr. A applies for a $5 million policy, the insurance company would want her

doctor to conduct a medical examination, and she may be required to complete additional testing.

Sometimes, underwriters request an inspection report, or independent information on the applicant's financial situation and lifestyle. For example, Mr. A may have disclosed that he has only participated in skydiving once, but the insurance company may want to verify this information before making a decision on hisr policy. If he regularly participates in skydiving, he would have a greater risk of dying than someone who does not participate in this activity.

The Medical Insurance Bureau, or MIB, maintains the applicant's medical information that the underwriter uses to make a decision about the application. The underwriter compares information obtained from the MIB to the application to identify any inconsistencies.

The MIB also provides the underwriter with information about the number of times in the past two years that another company had requested this information. The underwriter uses this information to identify whether the applicant is in the habit of cancelling his/her insurance coverage in the first two years of the policy, as this is the time when the insurance company incurs the majority of the policy's costs.

10.6 CLASSIFICATION OF RISKS

Risk can be classified into 3 categories

1. Financial and Non-Financial Risks.
2. Pure and Speculative Risks.
3. Fundamental and Particular Risks

1. Financial and Non-Financial Risks: Financial risks are the risks where the outcome of an event (i.e. event giving birth to a loss) can be measured in monetary terms.

The losses can be assessed and a proper money value can be given to those losses. The common examples are:

- Material damage to property arising out of an event. We may consider the damage to a ship due to a cyclone or even sinking of a ship due to the cyclone. Damage to the motor car due to a road accident which may be of partial or total nature. Damage to stock or machinery etc.
- Theft of a property which may be a motorcycle, motor car, machinery, items of household use or even cash.
- Loss of profit of a business due to fire damage the material property.
- Personal injuries due to the industrial, road or other accidents resulting in medical costs, Court awards, etc.
- Death of a breadwinner in a family leading to corresponding financial hardship.

All such losses, i.e. the outcome of unforeseen untoward events can be measured in monetary terms.

The losses can be replaced, reinstated or repaired or even a corresponding reasonable financial support (in case of death) can be thought about.

We would call all such financial risks as insurable risks and these are indeed the main subjects of insurance.

Non-Financial risks are the risks the outcome of which cannot be measured in monetary terms.

There may be a wrong choice or a wrong decision giving rise to possible discomfort or disliking or embarrassment but not being capable of valuation in money terms.

- **Examples can be:**
  - Choice of a car, its brand, color, etc.
  - Selection of a restaurant menu,
  - Career selection, whether to be a doctor or engineer etc.
  - Choice of bride/bridegroom,
  - Choice of publicity etc.

Since the outcome cannot be valued in terms of money, we shall call these non-financial risks as uninsurable.

2. **Pure and Speculative Risks:** Pure risks are those risks where the outcome shall result in loss only or at best a break-even situation. We cannot think about a gain-gain situation.

   The result is always unfavorable, or maybe the same situation (as existed before the event) has remained without giving birth to a profit (or loss).

   As opposed to this, speculative risks are those risks where there is the possibility of gain or profit. At least the intent is to make a profit and no loss (although loss might ensue).

   Investing in shares may be a good example. Pricing, marketing, forecasting, credit sale, etc. are yet examples falling within the domain of speculation.

   Consider another example where we can have the existence of both pure risks and speculative risks. A garment factory may be in our minds. Here we have:

   - Cyclone damage possibility to the factory building,
   - Fire damage possibility to stock,
   - Machinery breakdown possibility to Machinery,
   - Theft possibility to removable items,
   - Personal accident possibility of factory workers etc.

3. **Fundamental Risk and Particular Risks:** Now coming to the last stage of classification of risk we may consider the subject from the viewpoint of the cause of risk and its effect. We call such classifications as fundamental risks and particular risks.

   Fundamental risks are the risks mostly emanating from nature. These are the risks that arise from causes that are beyond the control of an individual or group of individuals.

   The losses arising out of such causes may be catastrophic in dimension and felt by a huge number of populations, the society or by the state although an individual may be a part of that catastrophe. The common examples are:

   - Flood & Cyclone, Subsidence & landslip,
   - Earthquake & volcanic eruption, Tsunami,

- The convulsion of nature and other natural disasters,
- Famine, Draught

We may also add in the list perils like war, terrorism, riots & other political activities which are neither created by nature nor by an individual but resulting in colossal losses.

But one thing is certain which are this that all such perils are impersonal not being caused or contributed by an individual or even a group of individuals.

Normally fundamental risks were not supposed to be insurable because of the magnitude and these were considered to be the responsibility of State. Now because of demand and insurers' strength, these risks are easily insurable.

Particular risks are; as opposed to what has been narrated hereinbefore, there are risks which usually arise from actions of individuals or even group of individuals.

These may be identified as causes arising from personal (or group) behavior and effects (losses) not being of that magnitude.

These are mostly men created because of their negligence, error in judgment, carelessness, and disregard for law or respect.

We may call these as risks of personal nature. The common examples are:

- Fire, Explosion,
- Burglary, housebreaking, larceny, and theft,
- Stranding, Sinking, Capsizing, Collision in case of a ship, including cargo loss,
- Machinery breakdown and deterioration of stock due to machinery breakdown,
- Motor accidents including death and bodily injuries, industrial accidents,
- The collapse of bridges, derailments.

  Particular risks are insurable risks and most of the insurances relate to these risks.

However, the students should appreciate that risk is a dynamic

concept and may be modified because of the ever-changing situation.



CHECK IN PROGRESS

Q 3. Mention the important steps under insurance underwriting.

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10.7 GROUP INSURANCE

Group insurance is an insurance that covers a group of people, for example the members of a society or professional association, or the employees of a particular employer for the purpose of taking insurance. Group coverage can help reduce the problem of adverse selection by creating a pool of people eligible to purchase insurance who belong to the group for reasons other than the wish to buy insurance, which might be because they are a worse than average risk. Grouping individuals together allows insurance companies to give lower rates to companies, "Providing large volume of business to insurance companies gives us greater bargaining power for clients, resulting in cheaper group rates"

Salient features of a group plan which makes it unique are discussed below-

- **Relevance:** A group health insurance plan is available only for recognised groups. Groups like employer-employees, trade unions, clubs, associations, etc. can buy a group health insurance plan for their members. The plan can be bought by groups who are already in existence and not by those who are formed for the purpose of buying insurance.
- **Nature:** In a group health insurance policy, different policies are not issued for different members. A single policy is issued which is called a master policy. All the members who are covered are named in the policy with their respective coverage levels.
- **Ownership:** The group health insurance plan is issued in the name

of the group. The group, therefore, acts as the policyholder while the covered members are called beneficiaries. So, if a company, say ABC Private Limited, buys a group health insurance plan for its employees, the policyholder would be ABC Private Limited while the insured members would be the employees.

- **Sum insured:** The sum insured for each member is determined by the insurance company. The members or the group cannot decide the sum insured which it wants.
- **Premiums:** Premiums of group health insurance plans are relatively low and hence affordable. They can be paid by the group itself, by its members, or partially by the group and partially by the members. The insurance company, however, collects the lump sum premium from the group which is the policyholder.
- **Pre-entrance medical check-ups:** Group health insurance plans have simplified underwriting guidelines. Irrespective of the age of the insured members, no pre-entrance medical check-ups are required.
- **Waiting period:** Group Mediclaim plans have minimal or no waiting periods. Pre-existing illnesses are covered from the first day of the plan itself.
- **Cashless treatments:** If the insured member takes treatments at a network hospital, group health insurance plans allow cashless settlement of claims.
- **Policy tenure:** A group health insurance plan is offered for one year. After the coverage period is over, the policy can be renewed. Upon renewal, fresh underwriting is done before the coverage is allowed to continue. The sum insured and the premium can change during renewal
- **Coverage for dependents:** Under many group health insurance plans, coverage can be taken not only for the group members but for their dependents too. Dependents could include the member's spouse, dependent children and dependent parents.
- No co-payment clause - In individual health insurance plans, if the insured is aged 60 years and above, a co-payment clause is

applicable. Under that clause, a part of the claim is borne by the policyholder. However, group health insurance plans have no co-payment clause. The policyholder is not required to bear a portion of the claim as the insurer settles the claims in full.



CHECK IN PROGRESS

Q 4. What is Group Insurance?

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10.8 LET US SUM UP

- Insurance is a means of protection from financial loss. It is a form of risk management, primarily used to hedge against the risk of a contingent or uncertain loss.
- 4th century stands as witnessed the practice of BOTTOMRY BONDS and RESPONDENTIA BONDS in maritime trade as evolution of insurance
- History of Insurance in India started from the prehistoric period as Insurance in its primitive form has been known to exist from as back as 3000 BC.
- Underwriting is the process of accepting the proposal of the customer based on the guidelines formulated by the insurance company. The insurance companies codify a set of procedures which must be followed before accepting any new business.
- Two Procedure of Underwriting of Insurance are
  - Group Insurance
  - Individual Insurance
- The factors that affect risk on the life of an individual is known as hazard. The hazard may be classified as
  - Physical
  - Occupational
  - Moral

- Group Insurance is a form of Business "Providing large volume of business to insurance companies gives us greater bargaining power for clients, resulting in cheaper group rates"



10.9 FURTHER READINGS

1) GUPTA, L. P. (2014) *India Insurance Guide Paperback- 1*

2) K S N Murthy & K V S Sarma. *Modern Law of Insurance in India*



10.10 ANSWER TO CHECK YOUR PROGRESS

Ans to No 1: Bottomry Bonds and Respondentia Bonds

Ans to Q No 2: Insurance contract is the conditions and circumstances under which the insurer will compensate the insured.

Ans to Q No 3:

Step 1: Application quality check

Step 2: Paramedical Exam

Step 3: Attending Physician Statement (APS)

Step 4: Medical Information Bureau Check

Step 5: Prescription Check

Step 6: Motor Vechicle Report

Step 7: Acturial Tables

Step 8: Credit System

Step 9: Your Final Rating

Ans to Q No 4: Group insurance is an insurance that covers a group of people, for example the members of a society or professional association, or the employees of a particular employer for the purpose of taking insurance. Group coverage can help reduce the problem of adverse selection by creating a pool of people eligible to purchase insurance.



10.11 MODEL QUESTIONS

Q 1: What is insurance?

Q 2: What do you mean by Insurance Underwriting?

Q 3: Discuss the historical perspective of insurance.

Q 4: Discuss about the importance of Group Insurance.

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UNIT 11 : ESSENTIALS OF GENERAL INSURANCE

UNIT STRUCTURE

11.1 Learning Objectives

11.2 Introduction

11.3 Definition of General Insurance

11.3.1 Types of General Insurance

11.4. Importance of general insurance

11.4.1 Importance of general insurance in a country's economic development

11.5. Concept of Short Term Risk

11.6. Fundamental of the following concepts

11.6.1 Common Law

11.6.2 Insurable interest

11.6.3 Proposal accidence

11.6.4 Indemnity

11.6.5 Contribution suborgation

11.6.6 Representation

11.6.7 Utmost good faith

11.6.8 Material fact

11.6.9 Physical Hazard

11.6.10 Moral Hazard

11.7 Let Us Sum UP

11.8 Further Readings

11.9 Answer to Check Your Progress

11.10 Model Questions

11.1 LEARNING OBJECTIVES

After going through this unit, you will be able to-

- Know the definition and types of general insurance
- Describe the importance of general insurance in country's economic development

- Concept of short term risk
- Knows some of basic concept such as common law, proposal accidence, indemnity, insurable interest etc

11.2 INTRODUCTION

Insurance is a legal agreement between two parties i.e, the insurance company (insurer) and the individual (insured). In this, the insurance company promises to return the losses of the insured on happening of the insured contingency. The contingency is the event, which causes a loss. It can be the death of the policyholder or destruction of the property. It is called a contingency because there is an uncertainty regarding happening of the event. The insured pays a premium in return for the promise made by the insurer.

General insurance is insurance, which is not a life insurance. It includes property insurance, liability insurance and other form of insurance. In general insurance, payments made by insurance companies are based on the loss incurred, rather than being a fixed sum as in life insurance.

11.3 DEFINITION OF GENERAL INSURANCE

As already discussed, Insurance may be defined as a consisting one party (the insurer) agrees to pay to the other party (the insured) or his beneficiary, a certain sum upon a given contingency (the risk) against which insurance is sought.

According to British English Dictionary, general insurance means an "insurance (such as house insurance and car insurance) that does not insure someone's life". General insurance is typically defined as any insurance that is not determined to be life insurance



CHECK IN PROGRESS

Q 1: What is an insurance business?

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Q 2: What is general insurance?

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11.3 TYPES OF GENERAL INSURANCE:

Insurance can be widely segregated in three categories–life, health and general. General insurance is insurance for valuables other than our life. General insurance covers the insurer against damage, loss and theft of your valuables. The premium and cover of general insurance depends upon the type and extent of insurance. A general insurance policy typically has a period of a few years. In India, general insurance policies are of the following types:

- **Motor Insurance:** Insurance for the damage or theft of your motor vehicle, two-wheeler, three-wheeler or four-wheeler, is covered under this type of insurance. The damage caused to the vehicle can be caused natural or man-made circumstances, the extent of which would change from policy to policy. Under the Motors Vehicle Act, motor insurance is mandatory in India. New motor vehicles come with third-party insurance right from the showroom itself.
- **Home Insurance:** Home and household insurance protects your home and the items inside it. A home insurance policy would also cover natural and man-made circumstances. The contents that are covered under a home insurance policy would depend on the type of policy you buy.
- **Travel Insurance:** Another popular type of general insurance is travel insurance, which covers your trips abroad. Travel insurance can be taken to cover loss or theft of your valuables as well as documents. Some travel insurance policies also cover flight delays and medical emergencies. Travel insurance can be taken for personal as well as business trips
- **Health Insurance:** Common types of health insurance includes: individual health insurance, family floater health insurance,

comprehensive health insurance and critical illness insurance.

- **Marine Insurance:** Marine cargo insurance covers goods, freight, cargo, and other interests against loss or damage during transit by rail, road, sea and/or air.
- **Commercial Insurance:** Commercial insurance encompasses solutions for all sectors of the industry arising out of business operations.
- **Accident Insurance:** Accidents of different types are possible at any time, at any place and in case of any person or object. Persons and vehicles are more prone to accidents causing injuries and damages.
- **Fire Insurance:** In order to get the asset, stock or machines insured against fire, a proposal form is to be filled in and submitted to the insurance company. The Insurance company examines the proposal with due regards to various factors and the periodical amount of premium is fixed. An insurance policy is then issued in favour of the applicant
- **Education Insurance:** Education Insurance can be used to pay for your child's higher education expenses. Under this insurance, the child is the life assured or the recipient of the funds, while the parent/ legal guardian is the owner of the policy. You can estimate the amount of money that will go into funding your children's higher education using Education Planning calculator.
- **Theft Insurance:** Theft insurance generally covers all acts of stealing against loss or damage caused by the unlawful taking of property. There are three major types of insurance contracts for burglary, robbery, and other theft. Burglary is defined to mean the unlawful taking of property within premises that have been closed and in which visible marks are evidencing forcible entry. Robbery is defined as that type of unlawful taking of property in which another person is threatened by either force or violence. In the robbery peril, therefore, the element of personal contact is necessary.
- **Property Insurance:** The property insurance is the insurance that protects the physical goods and the equipment of the business or

home against any loss from theft, fire, and any other perils. Generally, the property insurance covers the risks of all the damages caused by fire, theft, wind, smoke, snow, lightning, etc.

- **Aviation Insurance:** Aviation insurance normally covers physical damage to the aircraft and legal liability arising out of its ownership and operation. Specific policies are also available to cover the legal liability of airport owners arising out of the operation of hangars or from the sale of various aviation products.
- **Livestock insurance:** The ***Livestock Insurance*** Scheme has been formulated with the twin objective of providing protection mechanism to the farmers and cattle. Farmers can protect themselves against the loss of valuable animals by purchasing livestock insurance. This insurance is typically used to cover domesticated animals such as cattle, sheep, pigs, and horses. There are several types of livestock insurance.
- **Crop Insurance:** Crop insurance is purchased by agricultural producers, and subsidized by the federal government, to protect against either the loss of their crops due to natural disasters, such as hail, drought, and floods, or the loss of revenue due to declines in the prices of agricultural commodities.
- **Rural insurance:** Rural insurance is insurance that has been created for the rural public to insure their businesses such as poultry, cattle, farming, etc. An area with a low population density and in which at least 75% of the male population is involved in agriculture comes under the rural sector.



CHECK IN PROGRESS

Q 3: What are the different types of general insurance?

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11.4 IMPORTANCE OF GENERAL INSURANCE

While life insurance remains a priority for most people, general insurance policies are not far behind. Owing to the risks posed by natural calamities, diseases, medical emergencies, and accidents, general insurance covers is something that can provide a blanket of financial protection from them. Accidents and misfortunes cannot be predicted, but it is in our hands to make sure that we are prepared. That is why investing in the right general insurance covers is something that should be on the top of your to-do list.

General insurance helps us protect ourselves and the things we value, such as our homes, our cars and our valuables, from the financial impact of risks, big and small–from fire, flood, storm and earthquake, theft, car accidents, and travel mishaps – and even from the costs of legal action against us. And we can choose the types of risks we wish to cover by choosing the right kind of policy with the features we need.

In addition, it also covers a special type of insurance such as professional indemnity. Getting any of the general insurance will leave your mind at peace. Obviously, the reasons has increased why getting general insurance is considered to be important because it almost covers everything. It covers even your car, home, and health. Below are numerous reasons why we should have a general insurance.

- **It Pays to stay insured:** Whether we want to open a garage or a restaurant, own a home or buy an automobile, having the right general insurance policy at hand saves a lot of hassle in times of exigencies where finances may get affected.

  General insurance policies are basically contracts on those assets which are vulnerable to damages and whose economic value needs to be taken care of. On the individual front, these include vehicle, house, health, and travel insurance, while for entities, it entails the likes of trade of micro and rural insurance, to name a few.

- **Not having to worry about healthcare expenses:** A medical emergency can affect us at any point in time, and happen to any of

your loved ones. Therefore, getting yourself and your family insured under a health insurance plan can save you a lot of hassle when it comes to bearing healthcare expenses. Be it a medical check-up or an emergency surgery; your bills are taken care of when you have the right health insurance policy at hand.

- **Drive with Peace of Mind:** Most of us own a motor vehicle that enables our everyday commute to the workplace, social gatherings, and even road trips. But no matter how safe you drive, there is always the risk of being involved in an accident, even if it no fault of your own. That is why vehicle insurance is essential. There's a reason it is mandatory and now come with 3 years (four-wheelers) and 5 years (two-wheelers) of third party insurance at the time of purchasing a new vehicle.
- **Never Suffer a Property Loss:** When our property faces a calamity, be it natural or human-made, your home insurance comes to your aid, providing you the financial backup to repair the damages suffered by the property. It is a safeguard you must have to secure one of your most valuable assets i.e. your home.
- **It is Beneficial for Business:** If we have a business of our own, we have to keep in mind that risks associated with our business can sprout up at any moment. It, therefore, becomes important that we get business insurance. If we happen to be plying a trade or have a business based in the rural region, we can opt for trade insurance and micro & rural insurance, respectively.

  With the operational costs, payment obligations and other liabilities that we have in our business, we can ill afford to not be insured.

  Each and every insurance type which comes under the spectrum of general insurance has a singular objective – provide coverage for an aspect it has been designed for. Research about the different insurance types, identify the ones you need and invest in them as soon as you can. The best way to be prepared for exigencies is by being properly insured.

- **It will Give You Peace of Mind:** The principal reason why an individual should get insurance is to have a peace of mind. it is the only weapon that you could have opposed to any risk or misfortune.
- **Loss of property will not give you a burden:** In case of loss of personal property due to natural calamities or man- made, you will not be worrying too much since general insurance almost covers everything. As long as you had insured your properties, you will receive enough amount of money depending on the agreement and policy that you had agreed upon.
- **You will be ready for any type of mishap:** If you are insured, it seems that you are just saving or depositing money through the premium that you are paying. Each amount will be useful in times misfortunes or accidents. The insurance company will give it back to you with additional interest depending on the insurance policy that you buy.
- **Greater Profits for Businessman:** Because insurance almost covers everything, your insurer will handle any future risk. Goods as well as services transportation are all covered by general insurance that is why any type of loss or misfortune will not anymore be a problem.
- **Emergencies can be handled**

  You cannot foretell what might happen next, and getting yourself insured is the most practical alternative you can have. If you had encountered an accident such as road accident, your insurer will shoulder the hospital bill. Moreover, if you are diagnosed having a serious type of disease, you will not hesitate to undergo any type of urgent operation as long as you had yourself a health or medical insurance.
- **Expenses your car repair can be covered also:** If you had your car insured, all expenses will be partially shouldered by the insurance company in case of road accidents and you need a car repair.
- **You can use it during any unexpected liability:** Liability is taken care and the same amount will be paid by the parties for an insurance policy between two or three.

General insurance is the best option you can have if you want to have risk- free life. The premium that you will pay will be all worth it especially in times of mishap. Being secured and guaranty with your life is probably the perfect way to enjoy life.

11.4.1 Importance Of General Insurance in a Country's Economic Development

The world we live in is full of uncertainties and risks. Individuals, families, businesses, properties and assets are exposed to different types and levels of risks. These include risk of losses of life, health, assets, property, etc. While it is not always possible to prevent unwanted events from occurring, financial world has developed products that protect individuals and businesses against such losses by compensating them with financial resources. Insurance is a financial product that reduces or eliminates the cost of loss or effect of loss caused by different types of risks.

Apart from protecting individuals and businesses from many kinds of potential risks, the Insurance sector contributes significantly to the general economic growth of the nation by providing stability to the functioning of businesses and generating long-term financial resources for the industrial projects. Among other things, Insurance sector also encourages the virtue of savings among individuals and generates employments for millions, especially in a country like India, where savings and employment are important.

Let's understand in detail how and why insurance as a sector is key to development of any economy:

- **Provides Safety and Security to Individuals and Businesses :** Insurance provides financial support and reduces uncertainties that individuals and businesses face at every step of their lifecycles. It provides an ideal risk mitigation mechanism against events that can potentially cause financial distress to individuals and businesses. For instance, with medical inflation growing at approximately 15%

per annum, even simple medical procedures cost enough to disturb a family's well-calculated budget, but a Health Insurance would ensure financial security for the family. In case of business insurance, financial compensation is provided against financial loss due to fire, theft, mishaps related to marine activities, other accidents etc.

- **Generates Long-term Financial Resources:** The Insurance sector generates funds by way of premiums from millions of policyholders. Due to the long-term nature of these funds, these are invested in building long-term infrastructure assets (such as roads, ports, power plants, dams, etc.) that are significant to nation-building. Employment opportunities are increased by big investments leading to capital formation in the economy.
- **Promotes Economic Growth:** The Insurance sector makes a significant impact on the overall economy by mobilizing domestic savings. Insurance turn accumulated capital into productive investments. Insurance also enables mitigation of losses, financial stability and promotes trade and commerce activities those results into sustainable economic growth and development. Thus, insurance plays a crucial role in the sustainable growth of an economy.
- **Provides Support to Families during Medical Emergencies:** Well-being of family is important for all and health of family members is the biggest concern for most. From elderly parents to newborn children, medication and hospitalization play important role while ensuring well-being of families. Rising medical treatment costs and soaring medicine prices are enough to drain your savings if not well prepared. Anyone can fall victim to critical illnesses (such as heart attack, stroke, cancer etc.) unexpectedly. And rising medical expense is of great concern. Medical Insurance is a policy that protects individuals financially against different type of health risks. With a Health Insurance policy, an insured gets financial support in

case of medical emergency.

- **Spreads Risk:** Insurance facilitates moving of risk of loss from the insured to the insurer. The basic principle of insurance is to spread risk among a large number of people. A large population gets insurance policies and pay premium to the insurer. Whenever a loss occurs, it is compensated out of corpus of funds collected from the millions of policyholders.



CHECK IN PROGRESS

Q 4: Discuss the importance of general insurance.

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Q 5: Discuss the importance of general insurance in a country's economic development.

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11.5 CONCEPT OF SHORT TERM RISKS

Risk is the potential for uncontrolled loss of something of value. Risk can also be defined as the intentional interaction with uncertainty. Uncertainty is a potential, unpredictable, and uncontrollable outcome; risk is an aspect of action taken in spite of uncertainty. Specifically, in the short-term insurance industry, when we talk about risk we mean the potential to make a financial loss from an unexpected event (such as a burglary or accident). The financial loss can be for anything; indeed, there is insurance available for almost any loss you may suffer that you can imagine.

Short term risk in insurance is a financial contract that you take with an insurer to protect your movable assets in the case of damage or loss. The contract stipulates that the company will pay you a set amount of money, or will replace or repair your movable asset in the event of the damage or loss. Basically, the short-term option provides consumers with

the opportunity to cover any financial risks to their material possessions. These are things such as your vehicle, your property, the things you own inside your house or even yourself



CHECK IN PROGRESS

Q 6. What do you mean by short term risks?

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11.6 FUNDAMENTALS OF THE FOLLOWING CONCEPTS

11.6.1 Common Law

Common law is the body of law derived from judicial decisions of courts and similar tribunals. The defining characteristic of "common law" is that it arises as precedent. In cases where the parties disagree on what the law is, a common law court looks to past precedential decisions of relevant courts and synthesizes the principles of those past cases as applicable to the current facts. If a similar dispute has been resolved in the past, the court is usually bound to follow the reasoning used in the prior decision. If, however, the court finds that the current dispute is fundamentally distinct from all previous cases and legislative statutes are either silent or ambiguous on the question, judges have the authority and duty to resolve the issue (one party or the other has to win, and on disagreements of law, judges make that decision). The court states an opinion that gives reasons for the decision, and those reasons agglomerate with past decisions as precedent to bind future judges and litigants. Common law, as the body of law made by judges, stands in contrast to and on equal footing with statutes which are adopted through the legislative process,

11.6.2 Insurable Interest

A person or entity has an insurable interest in an item, event or action when the damage or loss of the object would cause a financial loss or other hardships. To have an insurable interest a person or entity would take out an insurance policy protecting the person, item or event in question. The insurance policy mitigates the risk of loss should something beset the asset. Insurable interest is an essential requirement for issuing an insurance policy that makes the entity or event legal, valid and protected against intentionally harmful acts. People not subject to financial loss do not have an insurable interest. Therefore a person or entity cannot purchase an insurance policy to cover themselves in the event of a loss.Insurable interest is a type of investment that protects anything subject to a financial loss. It specifically applies to people or entities where there is a reasonable assumption of longevity or sustainability, barring any unforeseen adverse events. Insurable interest insures against the prospect of a loss to this person or entity

11.6.3 Proposal Accidence

It is an offer for consideration and accidence or acceptance means to give consent, approval, or adherence; agree; assent; to accede to a request; to accede to the terms of a contract. An offer or proposal is intimation to another of one's intention to do or to abstain from doing anything with a view to obtaining the assent of that other person to such an act or abstinence. When the person to whom the proposal is made signifies his assent to it, the offer is said to be acceptance. The proposal for general insurance must be in writing. The proposer gives the necessary description of the property or other valuables to the insured. In practice the printed proposal form is used for the purpose. Introduction, type of properties, construction, occupation, etc., are the various information which are required by the insurer. The answers to these questions

must be completely correct. The assured must disclosed all the material facts and should observe utmost good faith. The description of the subject matter of insurance is the basis of the contract for assessing the risk and fixing the premium.

On receipt of the proposal form, the insurer will assess the risk. Sometimes, when the contents and subject-matters are not of very high amount, the insurer may accept on the basis of proposal form only. When the subject-matter is of larger magnitude and when the hazard involved is of a variable or unknown nature, the insurer may send his surveyor to survey the property. The surveyors being expert in the field of insurance evaluation will consider the proposal in the light of this report. The unknown proposers are required to submit an evidence of responsibility. The insured will required to submit a certificate from some known and responsible person about honesty and integrity. As soon as the proposal is accepted, the assured is informing about the decision.

11.6.4 Indemnity

Indemnity means making compensation payments to one party by the other for the loss. Indemnity is considered a contractual agreement between two parties whereby one party agrees to pay for potential losses or damages caused by another party. With indemnity, the insurer indemnifies the policyholder—that is, promises to make whole the individual or business for any covered loss.

It is based on a mutual contract between two parties (one insured and the other insurer) where one promises the other to compensate for the loss against payment of premiums.

The principle of indemnity asserts that on the happening of a loss the insured shall be put back into the same financial position as he used to occupy immediately before the loss. In other words, the insured shall get neither more nor less than the actual amount of loss sustained.

This, of course, is always subject to the limit of the sum insured and also subject to certain terms and conditions of the policy.

Therefore, to put it in a much better way, on the happening of a loss, the insurers will try to put back the insured into the same financial position as the insured used to occupy immediately before the happening of the loss, only if the insurance is properly arranged on full value insurance.

11.6.5 Contribution Subrogation

Contribution is a term used in both marine and non-marine insurance to describe the right of an insurer, when he has discharged their liability to the assured, to call on another insurer to bear his share of the loss and pay his proportion of the amount already paid under the first policy. Insurer's 'rights of contribution' are completely different – this is the insurer's own legal right, under the Insurance Contracts Act. It doesn't depend on the insured's rights. It exists where two (or more) insurance policies cover the same loss. The insurer who pays the claim can require the other insurer(s) to contribute. That's why insurers will not usually waive their right of contribution or treat their policy as "primary" to another policy.

Subrogation means an organization that is controlled by and subordinate to another organization. It is seldom possible to reform a suborganization for the benefit of the parent organization without encountering resistance.

The aim of subrogation is that the insured should not get more than the actual loss or damage. After payment of the loss, the insurer gets the right to receive compensation or any sum from the third party from whom the assured is legally liable to get the amount of compensation. The main characteristics of subrogation are as follows*;* - The insurer subrogates all the remedies, rights and liabilities of the insured after payment of the compensation. The insurer has right to pay the amount of loss after reducing the sum received by

the insured from the third party. But in marine insurance the right of subrogation arises only after payment has been made, and it is not customary as in fire and accident insurance, to after this by, means of a condition to provide for the exercise of subrogation rights before payment of a claim. At the same time the right of subrogation must be distinguished from abandonment. If property is abandonment to a marine insurer, he is entitled to whatever remains to the property irrespective of value of subrogation.

After indemnification, the insurer gets all the rights of the insured on the third parties, but insurer cannot file suit in his own name. Therefore, the insured must assist the insurer for receiving money can receive the amount of compensation from the insured.

11.6.6 Representation

A representation is a statement made by the proposer to the insurer relating to a proposed risk. Such a representation may pertain to both material and immaterial facts. It refers to the act of disclosing important information either in written form or orally that will help the one being disclosed to form the proper course of action. In insurance, this information is crucial to the crafting of the policy by the insurer. Failure to disclose important information might nullify the insurance contract. When a person applies for insurance, he or she tells the representative of the insurance company facts about himself or herself or the property that he or she wants insured that will affect the price and the coverage of the policy.

For examples, a person with diabetes must inform the insurer so that the latter is informed of this health risk and can properly determine the proper policy for the potential insured. Another examples, a person who is insuring their car must tell pertinent facts like whether or not they've ever been arrested for drunken driving or that the car is sometimes used for racing.

In those cases, the insurance company can later deny coverage if those important information were undisclosed. Failure

to represent the facts properly can nullify or void a policy.

11.6.7 Utmost Good Faith

The parties to an insurance contract must be honest with each other and must not hide any information relevant to the contract from each other. This is known as the principle of Utmost Good Faith. It is important to the insurer that they have a full and accurate picture of the risk that is proposed to them.

The principle of Utmost Good Faith is also known as Uberrimae Fides. It means that both the policyholder and the insurer need to disclose all material and relevant information to each other before commencement of the contract.

Under Section 45 of Insurance Act 1938 states that if within 2 years of commencement or revival of the insurance policy, the insurer get to know that there has been a non-disclosure or misrepresentation of material facts, then the insurer can call the policy null and void.

It simply means that if within 2 years the Insurance Company finds out that the policy holder has not stated the complete truth or has lied while filling up the proposal form, then it can cancel the policy and decline the claim. It is not necessary that they will definitely repudiate the claim, but it is also a possibility. The insurer may ask for the difference in premium or change the terms and conditions after the fact has been disclosed.

Thus, if an alcoholic person had mentioned that he is non-alcoholic and he dies in a heart attack within 2 years of the policy commencement, then also the Insurance Company may repudiate or decline the claim on grounds of “non-disclosure” or “misrepresentation” of “material facts”, i.e. for not stating the complete truth or misstating information which is relevant for underwriting and risk assessment. His policy could have been over-rated or loaded with additional premium if the underwriters were

aware of the fact.

Thus, it is the duty of the proposer to make full disclosure. In the event of failure to disclose material facts, the contract can be held null and void. The duty of disclosure in life insurance operates till the risk commences.

11.6.8 Material Fact

Material fact is information that is vital to interpreting a subject matter and is relevant to a legal document. In insurance, it is information that can determine the coverage and the cost of the premium. Withholding it might cause the policy to be null and void.

An insurance transaction works under the principle of utmost good faith. When someone wants to get a health insurance policy, for instance, they must reveal their health history so that the insurer can properly determine the coverage and the premium. If the person smokes tobacco, they must reveal that habit to the insurer or the representative of the insurance company to aid in the proper crafting of the policy. The smoking habit is a material fact because it exposes the insured to a number of health risks that the insurer will likely cover in the future.

11.6.9 Physical Hazard

Physical hazard is a physical condition that increases the possibility of a loss. Thus, smoking is a physical hazard that increases the likelihood of a house fire and illness. Moral hazards are losses that results from dishonesty. Thus, insurance companies suffer losses because of fraudulent or inflated claims.

Physical hazards in insurance, indicates those dangers of the subject matter of insurance which can be ascertained or identified by mere inspection of the risk. The hazards are apparent in the subject- matter itself.

Some of the examples of physical hazard are

(a) **Marine Insurance:** The nature of the cargo, whether these

are more susceptible to damage, e.g., fragile nature of the cargo like fish, egg etc. or glass items which are more prone to breakage. Quality of packing of the goods. Bad quality packing creates more losses.

The voyage itself may be hazardous particularly during the monsoon period in our country.

Nature, construction, age, classification, and condition of a vessel. For example, an over-aged vessel or a vessel in a bad shape or a vessel in an unseaworthy condition presents higher risks and is more affiliated with accidents.

(b) **Fire Insurance:** Nature and construction of the building. Materials used in the construction and whether such materials are of combustible or non-combustible nature.

The system of lighting and heating of the premises. Whether the electrical wirings are in good shape or worn-out.

Whether the premises are kept clear. Rubbishes scattered here and there help the fire to spread.

Indiscriminate smoking throughout the premises, particularly if it is a factory where inflammable materials are required to be kept, is in itself an example of physical hazard.

Whether the risk is situated near the fire brigade, and whether internal firefighting facilities are there on the premises.

Nature of occupation of the premises, e.g., if it is a petroleum or kerosene or chemical trade the hazard will be more.

Nature, construction, the occupation of the adjoining premises because fire may travel from the adjoining premises to the insured premises.

11.6.10 Moral Hazard

Moral hazard indicates those dangers which relate to character, integrity and mental attitude of the insured. These are not visible and cannot be identified or ascertained by mere inspection of the risk or the subject-matter of insurance. These, in fact, refer to

the behavior and attitude of the insured or their employees towards the subject-matter of insurance from the viewpoint of encouraging or discouraging the causation of the insured event. In every risk, an element of moral hazard may be in varying degree, is always present.

There may be an example of first-class moral hazard where the insured gives maximum cooperation to the insurers by materializing their suggestions aimed at risk improvement, or where the insured himself is very strict and particular in maintaining the property or premises with such care that the possibility of the happening of the insured event is reduced.

Examples of bad moral hazards are also there where the insured fraudulently and intentionally brings about an insured event with the sole motive of making money out of insurance at the cost of insurers.

(a) **Carelessness:** It is an implied condition of all insurance contracts that the insured must take all reasonable precaution in averting or minimizing a loss. Carelessness is the cause of most of the accidents and when the insured behaves carelessly, an unsatisfactory moral hazard is created.

(b) Difficult Insured: An insured may be always uncompromising and litigation-minded. He may refuse to accept the amount offered by insurers and press for an unreasonable amount.

(c) Fraud: A very unsatisfactory moral hazard exists when a person wants to take out a policy with the intent to make a profit.

(d) Over insurance: Excessive over insurance is apparently an instance of bad moral hazard.

(e) Maintenance: Bad administration and resultant shabby maintenance of the property premises is an example of bad moral hazard.

It is also an example of a physical hazard since bad maintenance reflects in the untidy atmosphere around which can be physically seen.



CHECK IN PROGRESS

Q 7. Define Common law.

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11.7 LET US SUM UP

- According to British English Dictionary, general insurance means an "insurance (such as house insurance and car insurance) that does not insure someone's life.
- General insurance is an insurance which is not a life insurance. It includes property insurance, liability insurance and other form of insurance. In general insurance, payments made by insurance companies are based on the loss incurred, rather than being a fixed sum as in life insurance.
- Insurance can be widely segregated in three categories–life, health and general**.** General insurance is insurance for valuables other than our life. General insurance covers the insurer against damage, loss and theft of your valuables. The premium and cover of general insurance depends upon the type and extent of insurance. A general insurance policy typically has a period of a few years.
- Short term risk in insurance is a financial contract that you take with an insurer to protect your movable assets in the case of damage or loss.
- Insurance for the damage or theft of your motor vehicle, two-wheeler, three-wheeler or four-wheeler, is covered under the motor insurance.
- Subrogation is referred as the process of seeking re-imbursement from the responsible party for a claim that they had already paid.
- Insurance generates significant impact on the economic development of a country by mobilizing domestic savings. Insurance sectors provide capital into productive investments. Insurance enables to mitigate loss, financial stability and promotes trade and commerce

activities those result into economic growth and development.

- Physical hazards in insurance mean any physical condition that increases the possibility of a loss. It includes any material, structural, or operational features of the business.



11.8 FURTHER READINGS

1) Mishra, M N (January-1, 2016). *Insurance Principle and Practice*. S Chand Publishing, India.

2) Gupta, L.P (January-!, 2016). *Handbook of General Insurance policies and Claim*. Dr. L. Gupta, India

3) Dayal Hargovind, (January-1, 2017). *Fundamentals Of Insurance*. Notion Press, 1st Edition, India

4) Gupta, L. P. (1 January, 2014). *India Insurance Guide Paperback*. Dr. L. P. GUPTA (Author, Contributor) , India.

5) Murthy, K S N & Sarma, K V S. *Modern Law of Insurance in India.*



11.9 ANSWER TO CHECK YOUR PROGRESS

Ans to Q 1 No: A financial institution that provides a range of insurance policies to protect individuals and business against in the risk of financial losses return of regular premiums

Ans to Q 2 No: General insurance that do not come under the scope of life insurance are called general insurance.

Ans to Q 3 No: Home insurance, motor insurance, travel Insurance, health insurance Marine insurance is the General insurance.

Ans to Q 4 No: A general insurance policy is essentially a policy that protects your financial well-being. it is a special type of policy that helps secure your many properties-whether it is your priced vehicles or the most important thing of all.

Ans to Q 5 No: Insurance generates significant impact on the economic

development of a country by mobilizing domestic savings. Insurance sectors provide capital into productive investments. Insurance enables to mitigate loss, financial stability and promotes trade and commerce activities those result into economic growth and development.

Ans to Q 6: Short-term risk in finance involves providing loans with a term of a few months or less, but no longer than a year. car insurance, home insurance, cell phone insurance are examples of short-term risk insurance.

Answer to Q.7:

Common law is the body of law derived from judicial decisions of courts and similar tribunals. It is unwritten law derived from court case decisions based on custom and precedent.



11.10 MODEL QUESTIONS

Short Questions (Answer each question in about 150 words)

Q 1: Write a note on General Insurance.

Q 2: What does travel insurance cover?

Q 3: What are the eligibility criteria for purchasing General Insurance?

Q 4: What do you mean by term 'Insurer' and 'Insured'?

Q 5: Write notes on subrogation.

Q 6: What do you mean by education insurance?

Long Questions: (Answer each question in about 300 to 500 words)

Q 1: What is General Insurance and what are the different kinds of General Insurance?

Q 2: Why we should have a general insurance?

Q 3: Discuss the role of general insurance in the economic development of a country.

Q 4: Explain the meaning of the following terms-
Utmost good faith, insurable interest, indemnity, material facts and physical hazard.

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UNIT 12 : ESSENTIALS OF GENERAL INSURANCE-II

UNIT STRUCTURE

12.1 Learning Objectives

12.2 Policy Endorsements

12.3 Selection and Inspection of Risks

12.4 Rating and Calculation of Premiums

12.5 Marketing of General Insurance

12.6 Let Us Sum Up

12.7 Further Readings

12.8 Answers to Check Your Progress

12.9 Model Questions

12.1 LEARNING OBJECTIVES

After going through this unit, you will be able to-

- explain the meaning of policy endorsement
- understand the concept of risk selection and inspection
- describe the different methods of rating or pricing of general insurance products
- discuss the major distribution systems for marketing of general insurance products

12.2 POLICY ENDORSEMENTS

General Insurance is a type of non-life insurance contract entered into by two parties, namely, the insurer or the insurance company and the insured or the client. It covers insurance of assets, including financial assets. In this type of contract, the insurer agrees to compensate the insured, against any loss suffered by the property insured on the happing of a particular financial event, in exchange of a payment of a specific sum of money called premium. In other words, the premium is paid by the insured, who has a financial interest in the asset covered, and in return, the insurer protects the insured from the financial liability in case of loss. One of the

notable features of an insurance contract is that the policyholder has the provision to make further amendments or modifications to the original terms and condition of the insurance policy. This modification in the original policy contract is usually performed by the insurance company on the behest of the policyholder by setting out the desired alterations in a memorandum called as endorsement. In simple words, any form of change introduced in a pre-existing insurance policy is known as endorsement. An endorsement is generally issued subsequent to the issue of an insurance policy, whenever the policyholder feels the requirement of the same. It may be issued when the insurance the company initially hands over the insurance policy to the insured at the time of purchase, or issued anytime during the term of the policy, or issued when the policy is due for renewal. Endorsement allows the policyholder to change the terms and scope of an existing insurance contract by adding, removing, excluding, restricting and extending the insurance coverage. A policyholder can, by submitting a letter in writing, request the insurer to permit transfers of interest in property, to transfer coverage from one place to another, or to increase or decrease limits of coverage, to list additional conditions, to provide for assignment of policies or changes in beneficiary designations, to provide for changes in settlement options elected, or to permit any amendments to the original contract in a legal manner. The insurance company on receiving the client's request shall make the required changes and record them in the policy after they are satisfied with the validity and accuracy of the alterations as requested. When an endorsement is attached to an original policy, it is imperative that the policy must be read and understood in line with the add-on provisions. The reason being, too many endorsements might result in an alteration of the essential features of the insured risk itself, thus resulting in determination of a new premium amount different than the premium amount initially fixed, as warranted in many cases. An endorsement attached to a policy generally takes precedence over any conflicting provision mentioned in the policy. Also, many policies have endorsements that amend the policy to conform to a given State's law. There are basically 3 types of endorsements: Extra,

Nil & Refund.

- **Extra endorsement:** Involves charging of an additional premium,
- **Nil endorsement:** Involves no change in the amount of premium but correction of some original data such as address etc.
- **Refund endorsement:** Involve estimation of policy contract or refund of premium amount in part or in full

Generally endorsements are issued in respect of the following amendments:

- Change in insurable interest
- Cancellation of insurance
- Change in the value at risk
- Change in the location or situation of risk
- Reduction or addition to the risk
- Change of the insured as and when a transfer of interest or assignment of interest is made. Sometimes an endorsement is also issued to correct a typographical error in the policy already issued.

12.3 SELECTION AND INSPECTION OF RISKS

The process of selection and classification of risks is called underwriting. It is the process of evaluating information crucial to the acceptance or rejection of exposures. In other words, it is a function of assessing and classifying the degree of risk an applicant or a group of applicants represents and then determining the coverage of that risk. The first part of the underwriting process i.e. selection of risks includes the decision regarding acceptance of a proposal. The second part of the process i.e. classification of risks refer to the terms of agreement on the basis of which the proposal is to be accepted by the underwriter. The underwriter is the person responsible for evaluation of risks and computation of premium.

Risk selection is a technique of screening incoming insurance applicants with the aim of grouping them into different risks classes or categories so as to determine the appropriate amount of premium to be charged to a proposed insured. Risk selection in case of general insurance is a complex activity because this line of insurance deals with a vast range

of properties with varying degree of risks. Before accepting or declining a risk proposal, the underwriter is burdened with the task of inspecting the hazards risk associated with it. In general insurance, the commercial properties involved are of high value, because of which the details of the risk and exposures cannot be compiled in a single proposal form alone. The insurance companies for evaluating and inspecting the associated risks take the help of various parties as mentioned below:

- **Application form:** The application form, which varies for each line of insurance, containing the details of the properties as mentioned by the proposed client is the primary source of information required by the underwriter to assess and make selection of risks.
- **Information from the Broker or Agent:** Sometimes, the broker prepares the case for the underwriter. The broker inspects the site or the location of the property and lays down the plans and reports on the relevant aspects of the risk. These documentations are then forwarded to the underwriter to facilitate negotiation on the terms of the contract. In some line of general insurance, the agent may also exercise his right to act as an underwriter. He agrees to exercise his authority to gain incentives out of an insurance contract by making profit for the company.
- **Inspection:** Inspection reports prepared by experts or specialists or company professionals after conducting field surveys to verify the information as provided in the proposal form are also helpful in selection of applications by the underwriter



CHECK IN PROGRESS

Q 1: Mention the three types of policy endorsements

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Q 2: Name the major amendment areas in respect of which endorsements can be issued

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Q 3: What is meant by the term "risk selection"?

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Q 4: Who is responsible for evaluation of risk proposals and calculation of premiums?

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12.4 RATING AND CALCULATION OF PREMIUMS

Insurance is a business of buying risks which is why careful pricing of insurance products becomes an essential element in building business for the insurance company. Rating also known as Pricing of Insurance Products is quite inexplicable to most of the people. The reason being insurance as an intangible service follows a different approach to pricing. Unlike tangible products, one is unable to determine the cost of direct inputs in services. When goods are sold, the company generally knows in advance the costs of producing the same and hence, prices can be fixed in a way that it covers all costs and yields profit simultaneously. Also, in case of other services, the cost of total offer can be estimated with some degree of judgment. But, since insurance offers protection against risks, people consider price in terms of the amount they pay for buying a risk. When an insurer sells a policy, it has no way of knowing what will be the realized cost of the policy because it is contingent upon a future event i.e. whether or not the policy buyer face losses and, if he or she does, how many and how large the amount of losses would turns out to be. The actual cost of providing insurance remains unknown until the policy period has lapsed. Therefore, insurance rates are mainly based on predictions rather than actual costs. Most rates are determined by statistical analysis of past loss data based on specific variables of the insured. Variables that produce the best forecast results serve as criteria for fixing premium amounts. The insurance company cannot tell with precision what its actual costs are going to be. The total

premiums charged for a given line of insurance services may be inadequate for covering all claims and expenses during the policy period. Of course, the insurer hopes that the premium calculated and the investment income will be adequate to pay all claims and expenses and yield a return. But, the actual amount of losses and expenses can only be determined after the expiry of the protection period. This is the primary reason why different prices are charged to different people, by the insurance companies, for policies providing the same kinds and amounts of insurance coverage.

The process of pricing of insurance and the calculation of insurance premiums is known as **rate making**. Rate making plays an important role in determining the overall profitability of the insurance business as it ensures that the premium is charged in a manner that covers all the expected losses and at the same time remains competitive with the premiums charged by other policymakers. The premium amount liable for payment by the insured party, on purchase of an insurance cover, is arrived at by fixing a rate determined by the actuaries. This rate is then multiplied by the number of exposure units and is further adjusted by various rating plans (a process called rating). In other words, insurance prices are called as **premiums**. Premiums are based on rates and rates are based on per unit of exposure. The term rate is synonymous with premium in the insurance business. It is the price per unit of insurance for each exposure unit. An exposure unit is the quantitative unit of measurement used in insurance pricing, which varies by line of insurance. It is a unit of liability or property with similar characteristics. The person who undertakes the responsibility to determine the rates and premiums is known as an **actuary**. An actuary is an individual possessing high mathematical and statistical skills that he applies in all stages of insurance company operations, including research, planning, and pricing of insurance products.

In General Insurance, actuaries determine the rates for different lines of insurance. Rates are usually calculated by taking into consideration the company's past data or loss experiences along with industry statistics. Statistical Data on natural calamities and events like earthquake, hurricanes, floods, cyclone, fires, marine-related perils, crime rates, traffic accidents,

and the cost of living are carefully analyzed. Many insurance companies valuates and perform analysis on their own records of past loss data in the process of establishing their policy rates; whereas some companies obtain loss data from authorized advisory organizations. These organizations render services like calculation of costs based on historical or prospective losses that individual companies can further make use of in calculating their own policy rates. Actuaries then conduct analysis of the data in order to estimate the expected loss levels and expected deviations from such levels. However, determining or fixing rates by taking historical analysis as the base may not always provide adequate statistical justification for the same, such as in case of earthquake insurance where one cannot predict the magnitude and likely damage of an earthquake based on past data. In such cases, catastrophe modeling is helpful in calculation of rates, but with less success. Actuaries decide on the insurance rate through extensive study on specific variables, and finally underwriters makes decision as to which variables shall be relevant for an insurance applicant.

Since, the survival of the insurance industry is based on the game of probability and statistics, only the insurer who can make correct estimations and predictions will be able to attract clients. The Insurance actuaries have to constantly deal with a tradeoff while deciding on the premium amount to be charged for insurance coverage. The premium must be high enough to sufficiently cover expected losses and expenses, but not too high to dissuade potential clients. On the other hand, the rate should be low enough to compete with premiums charged by other insurance firms and at the same time equitable for similar exposures. Rating or Pricing of insurance products is a challenging task for the actuaries as the sales price (i.e. the insurance premium)of such insurance offers is collected from the policyholders before the stipulated services, i.e. claim payments, are duly made available to them. Hence, the insurance companies in order to reduce the adverse effects of insurance risks opt for pooling method. They make a pool of applicants from a huge group of customers and then by applying the law of large numbers attempt to mitigate the risks of future losses.

A significant part of ratemaking relies on the process of identification

of characteristics and variables that can make reliable predictions on future losses so as to ensure that low risk customer groups are charged with lower amount of premiums and high risk customer groups are charged with higher amount of premiums. In this way, an insurance company achieves a competitive advantage over the other competing firms. By pricing the premiums lower in case of low risk customer groups, the insurance company is able to meet their needs through the insurance services they are offering, thus, lowering their own chances of making probable losses and expenses out of the contract. This move on their part increases the odds against the remaining insurance companies in the market to suffer from higher losses and expenses since they will be left to cater to the needs of the comparatively high risks profile of customers. Hence, insurance companies are always willing to invest on actuary studies in an effort to identify every characteristic that can forecast future losses with high precision.

The **pure premium,** which is an important component of insurance premium**,** is determined with the help of actuarial calculations. It represents that part of the premium which is necessary to cover for the losses and loss adjustment expenses. **Loading** is another component of the premium necessary to pay for other expenses, particularly sales expenses, and to allow for a profit margin. In other words, it refers to the amount that is added to the pure premium to cover expenses. The **gross rate** is the pure premium amount and the loading per exposure unit and the **gross premium amount** is the gross rate multiplied by the number of exposure units to be insured. The ratio of the loading charge over the gross rate is called the **expense ratio**.

Pure Premium = Losses / Exposure Units

Example: An average loss of Rs. 100,00,000 per year per 1000 automobiles yields the following pure premium:

Pure Premium = Rs. 100,00,000 / 1000 = Rs.10,000 per Automobile per Year

The loading charge consists of the following ancillary insurance costs:

- commissions and other acquisition expenses
- premium taxes

- general administrative expenses
- contingency allowances
- profit margin

Gross Rate = Pure Premium + Load

Loading charges are directly proportionate to the premiums as these charges increase proportionately with the increase in premium amount, especially commissions and premium taxes. Hence, the loading charge is also called an **expense ratio**. Therefore, the gross rate is expressed as a percentage increase over the pure premium:

$$\text{Gross Rate} = \frac{\text{Pure Premium}}{1 - \text{Expense Ratio}}$$

Example: If the pure premium is Rs.6000 and the expense ratio is 40%, then:

Gross Rate = Rs. 6000/(1 – 0.4) = Rs. 6000/0.6 = Rs. 10,000

Gross Premium = Gross Rate × Number of Exposure Units

Expense Ratio = Load / Gross Rate

It is essential that pricing of premiums should be done in the light of the insurance company's objectives as well as requirements mandated by regulations in the insurance sector. Responsiveness of the premium rates to changing business situations is one of the primary business objectives to meet.In addition to that, secondary objectives like simplicity, flexibility and consistency in the rating structure facilitate easy understanding for policyholders. On the other hand, regulations in the insurance sector regarding premium pricing are primarily made to protect customer's interests. Such regulations demand fairness and non-discrimination in rating which means that same rates should be applicable to all the members of an underwriting class drawing a similar risk profile. It also mandates that the premium rates be reasonable and adequate in its amount in order to maintain insurer's solvency.

- **Types of Rating:** Insurance rating evaluates the cost of the insurance product. Rates for most of the insurance offers usually are determined either by individual rating or class rating. Individual rates depend on

the individual whereas class rates depend on the underwriting class of the insured. It is highly probable that all insurance rates fixed could be class rates, where the insurance company simply makes adjustments in the premium amount to accommodate the losses of the entire class. However, some insurance companies initially identify lower risk customer groups within the class, and then offer them lower premiums to capture market share. Hence, depending upon the rating approach followed by an insurance company,the price to the buyer may be-*(a)*entirely different from the one charged to another buyer, *(b)* same as the payment made by other buyers or *(c)* similar to that paid by others, but may not be equal to the exact amount for one reason or another. These rate-making methods applied in general insurance business are as follows:

- **Class Rating:** Class rates are the most common rate used both in life as well as general insurance business. Under class rating, insured risks are classified into different classes on the basis of one or several important factors. For instance, some of the major factors in health insurance are age, health, gender etc. The policyholders belonging to a particular class are subject to same rate per unit of exposure. The class is defined through statistical studies as a group with specific characteristics that reliably predict the insured losses of that group. These rates are most commonly used when the factors causing losses can be easily quantified. This type of rating is also termed as manual rating because the various classifications and the respective rates are printed and published in the form of manuals.

  There are two methods to determine a class rated premium or to adjust it.

  In the **pure premium method**, the pure premium is arrived at by adding the losses and loss-adjusted expenses over a given period, and then dividing it by the number of exposure units. The final step includes the loading charge being added to the pure

premium to determine the gross premium, which is ultimately charged to the customer.

$$\text{Pure Premium} = \frac{\text{Actual Losses + Loss-Adjusted Expenses}}{\text{Number of Exposure Units}}$$

Gross Premium = Pure Premium + Load

In the **loss ratio method**–a comparison is made between the ratio of incurred losses along with loss-adjustment expenses to the earned premiums and the loss ratio that was expected. If the actual loss ratio differs from the expected loss ratio, then the premium is adjusted accordingly. The loss ratio that is expected is the percentage of the premiums that are expected to be used to pay for the losses. The actual **loss ratio** is the sum of losses and loss-adjusted expenses over the premiums charged.

If the actual loss ratio differs from the expected loss ratio, then the premium is adjusted according to the following formula:

$$\text{Rate Change} = \frac{\text{Actual Loss Ratio – Expected Loss Ratio}}{\text{Expected Loss Ratio}}$$

- **Individual Ratings:** Contrary to class rating, Individual ratings use several factors to forecast future losses and these factors vary considerably from one individual to another. Additionally, individuals can also exercise their right to loss control measures that will reduce the amount of losses and allow them to pay a lower premium. Individual ratings are of two types – (a) judgment rating and (b) merit rating. Merit rating can be further classified as schedule rating, experience rating, and retrospective rating.
- **Judgment Rating:** As the name suggests, judgment rating is based on the judgment of the actuary or underwriter calculating the rate. This type of rate is applied when the risk proposed to

be bought is so unusual that little or no statistical information about similar risk is available. In situations when the factors that predict potential future losses are so diverse and difficult to be quantified, the underwriter is left with no option but to evaluate each exposure individually, and use a combination of his judgment and his intuition based on past experience. Because of the complexity of these factors, class rating is rendered useless, as there are no statistics that can reliably assess the probability and quantity of future losses. When judgment rating is used, each premium is unique and is based on the opinion of the person making it. It is widely used in ocean marine insurance and in some lines of inland marine insurance.

- **Merit Rating:** Merit rating is a modified version of class rating. Since this rating plan is based on the concept of class rating, the premium amount charged is adjusted according to individual customers, contingent upon the actual losses of a customer. In other words, it modifies or makes adjustments in the class rate either upward or downward depending on individual loss experience. The underlying principle of this rating method is that the loss experience varies substantially from one insured party to another. Hence, it reflects the extent to which a specific risk differs from the others within the same class. The three types of merit-rating plans are: schedule rating, experience rating and retrospective rating.
- **Schedule rating:** Under this rating method, each exposure is individually rated. In calculation of schedule rates, examining the risk (the person or object insured) is of significance in order to identify the features that are likely to cause losses or to prevent them. The risk is then compared with the average or standard risk of its type, usually class rates are used as the standard base rate. Finally, deductions and additions are made from the standard rate corresponding to the risk's desirable features and its undesirable features. After making modifications in the rate

by debits and credits, the resultant rate is tailored to reflect the characteristics of risk for which it is used. The various additions to and deductions from the basic rate are based upon judgments. For example, schedule rating is used to determine premiums for commercial property insurance, where factors such as the physical features of the building, its size and location, protective devices installed in the building, its occupancy in the building, usage of the building, maintenance and protection of the building are taken into consideration while analyzing the associated risks.

- **Experience rating:** In this rating method, the class rate is modified depending on the claim experience of a particular exposure. In other words, the class rate is adjusted upward or downward on the basis of loss experience in previous years, which is taken as a base to estimate the premium for the next policy period. Usually, the actual amount of losses suffered by the insured during previous policy periods, typically of the prior two or three years is compared to the average risks in the same class. The premium rate is reduced if the risk and losses have a better record than the average. On the other hand, the premium rate is increased if the record losses are higher than the average. Experience rating is used specially for large risks viz. large enough to have many losses each year thus, reflecting a trend. Hence, this type of rating is found to be adopted by larger firms that generate a sufficiently high volume of premiums and have more credible experience.

  The premium under experience rating is calculated by following the loss ratio method. But the actual adjustment to the rate is determined by multiplying it by a credibility factor. The **credibility factor** is a measure of reliability that the actual loss experience is predictive of future losses. In statistics, reliability is directly proportional to the increase in sample size. The larger the sample size, the more reliable is the statistics. Hence, the

size of the business is a determinant of the credibility factor—the larger the business, the higher is the credibility factor. Since the credibility factor for small businesses is low, their eligibility criteria to use experience rating is not met.

Loss Ratio Method for Adjusting Premiums for an Experience Rating

$$\text{Rate Change} = \frac{\text{Actual Loss Ratio} - \text{Expected Loss Ratio}}{\text{Expected Loss Ratio}} \times \text{Credibility Factor}$$

- **Retrospective ratingP:** Contrary to experience rating, retrospective rating makes use of the insured's loss experience in the current policy period in order to determine the actual premium to be paid. In other words, this rating plan considers actual loss experience for a period to calculate the premium for the same time period. A provision is allowed for, in the contract, which determines a range of maximum and minimum amount that can be charged. When losses are small, a minimum premium is charged to the insured otherwise when losses are huge, maximum premium is payable by the insured. Part of the premium is paid at the beginning, and the final part which is determined after the expiration of the policy is usually paid at the end of the period. In most cases, the premium lies between maximum and minimum premium.

Retrospective Premium= [BP+(RL×LCF)]×PTM

BP = Basic Premium

RL = Ratable Losses

LCF = Loss Conversion Factor

PTM = Premium Tax Multiplier

The **loss conversion factor** is expressed as a percentage of the ratable losses. This percentage is added to 1, and then multiplied by the amount of losses incurred during the retrospective period. Likewise, the **premium tax multiplier** is a percentage of the premiums charged, so the premium tax percentage is added to 1 before multiplying it by the total premium.

So if loss adjustment expenses equals 20% of the total losses, then the loss conversion factor = 1 + 20% = 1.2. If the premium tax is 8% of the premiums charged, then the premium tax multiplier = 1 + 8% = 1.08.



CHECK IN PROGRESS

Q 5: Who is an actuary?

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Q 6: What do you mean by an exposure unit?

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Q 7: What do you mean by pure premium?

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Q 8: What is loading charge?

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Q 9: Mention the formula for calculating retrospective premium.

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12.5 MARKETING OF GENERAL INSURANCE

Organizations offering general insurance protection for its customers are basically commercial establishments with risk sharing and profit earning as their primary motives. Being a part of the business community, general insurance companies like any other company attempts to yield a reasonable amount of profit for its long term survival and sustainable growth. The premium amount that the company collects from its policyholders is utilized primarily to cover up the costs and expenses incurred in performing a variety of operations, viz, underwriting, resolving claims, advertising and marketing of their products, rate making and information processing. Out of all the

functions, marketing and distribution is considered to be the most essential of all. The reason being proper marketing of insurance products to potential customers will eventually lead to expansion of customer base and turn in more funds and profits for the company.Hence, integrated marketing and distribution system is one of the keys to success for an insurance company.

After the advent of LPG policy in India, Insurance sector has undergone a sea change with the entry of private players. New and advanced form of distribution and marketing channels were set up by private entities mainly to enhance penetration and expansion of insurance services in the market. They believed that developing integrated marketing channels will expand insurance knowledge, improve its accessibility, and widen the reach of the insurance business, thus, attracting potential customers for the service.

Insurance Marketing System refers to the various marketing strategies adopted for identifying potential customers, and making the insurance products available to them as and when needed. These different methods of selling insurance products through various insurance intermediaries like agencies, institutions and organizations comprise the distribution system. Market Intermediaries play a very crucial role of 'matchmaking' or 'market making'. Their major responsibility is to match the requirements of the clients with the suitable insurance services available in the market which turns out to be a complex multidimensional process. The primary function of the intermediaries is to observe and monitor the market to look for prospective buyers. Once they identify the buyers, they analyze their risk requirements. subsequently, they search for insurers having the necessary risk appetite and financial strength to underwrite the required risk. Next, they help their client select from the list of competing offers. Insurers engage actuaries, claims adjusters, underwriters, and other home office personnel to distribute their products, but unless insurance policies are sold at a margin, the insurer's financial survival will be at stake. Thus, a well-designed and an efficient marketing system are necessary for insurer's survival. The major marketing intermediaries at play for distribution of general insurance products are as follows:

- **Insurance Agents:** An insurance agent is a person who has been granted license by approved authority to procure and carry on insurance business activities including continuance, renewal or revival of insurance contracts. An agent could be an individual agent or a corporate agent. In other words, an insurance agent is a person who works for an insurance company and sells its insurance products on behalf of the company as its sole representative through authorized license. An individual agent, as the name suggests, is an individual who represents an insurance company, whereas a corporate agent is an intermediary other than an individual, representing an insurance company. As per business ethics, an agent can only deal with the insurance products of **one company only**, and thus is typically not allowed to promote and compare prices and features of other products on the market. Since agents are representatives of insurance companies, they usually operate under the terms of an agency agreement with the insurer. In India, agents can have license with only one non-life insurance company as per Insurance Regulatory and Development Authority of India (IRDAI) regulations.
- **Insurance brokers:** Insurance brokers are registered professionals under IRDAI who represent and cater to the interests of insurance buyers. They enter into insurance contracts with insurance companies on behalf of their clients. Insurance brokers usually work for policyholders and act independently in relation to insurers. Brokers act as a connecting link between insurers and potential clients seeking for insurance coverage against specified risks. They mainly assist clients in the selection of suitable insurance policies by presenting them with alternatives in terms of insurers and products. Acting as an 'agent' for the buyer, brokers unlike agents has the freedom to work for and represent multiple companies at the same time to place coverage for their clients' risks. Brokers provide their guidance to their clients with regard to the selection of an adequate policy that matches their risk appetite after obtaining quotes from various insurance companies. As a result, brokers end up working with multiple insurers,

a variety of clients and, in many cases, in a wide geographical area.

- **Bancassurance:** Bancassurance refers to sale of insurance products and services through groups such as business houses, professional associations or banks. Under this form of marketing, banks or professional associations enter into a partnership agreement with an insurance company that permits the insurance company to sell its products to the former's client base. This arrangement creates an additional source of revenue for the organizations through sale of insurance products and at the same time enables the insurance companies to expand their customer base without having to expand their sales force or having to pay additional commissions to insurance agents and brokers. Hence, the bargain turns out to be profitable for both the parties. These affinity groups and banks along with Non-Banking Financial Companies act as a corporate agent i.e. sole representative of the insurance company. Bancassurance is said to be in its infant stage in India but has a huge potential to become one of the leading marketing intermediaries in the insurance business.
- **Worksite marketing:** Worksite marketing is a form of marketing where insurance companies deploy a team to a target group in order to demonstrate them, the features of various general insurance products. The team visits a target group, who can either be an individual or a crowd, at their workplace. The target group may be employees of a particular company, of an educational institution or any kind of organization. The advantage of worksite marketing is that the entire catchment area is available on site in a particular location of a prospective client, which also gives the opportunity to up-sell and cross-sell related insurance products. Premium is generally charged either in the form of payroll deduction or other regular means. This is an emerging medium of marketing with high potential to attract clients initially and then securing them via other marketing channels such as telephone, internet, direct marketing or even through company sales force.
- **Telemarketing:** Telemarketing is another popular method of marketing

general insurance products. It also supplements other aids of distribution channels. Insurance companies approach their potential buyers by giving them a call and explaining to them their offers. The insurance companies, after obtaining data of prospective customers, contact them over the telephone, and when a deal is finalized through the call, the papers and payment instruments are collected physically with the assistance of a runner boy or a courier agency. Companies are extensively using the telephone medium to advertise their products and expand their business.

- **Internet and digital marketing:** Internet marketing or online marketing is one of the most sought after digital marketing channel by the insurance companies because of its worldwide reach and access. Insurance companies take the advantage of internet and place their insurance products in it. In other words, they promote and advertise their insurance services on the World Wide Web or via email to drive direct sales or sales over an electronic site. Various avenues like email, websites, social media, social networking sites, mobile apps are adopted by the insurers to get to customers quickly. The internet gives quick and personal access to customers for review and final selection of various general insurance policies.
- **Web-aggregators:** Web-aggregators utilize the online space to reach out to their potential clients. They offer customers ease of access and comparison of various insurance companies advertising and dealing with the same or similar product offers. This action allows the customer to analyze and evaluate the best option out of the multiple choices available infront of them before making the final purchase. IRDAI has issued guidelines for web-aggregators in 2011, 2013 and 2015 for regulating their operations. Factors like website security, website design, customer services, reliability and product portfolio are important considerations that influence the choice of product and the choice of web-aggregator by the customers of general insurance products.
- **Post offices:** Post offices are also authorized to distribute insurance

products, with IRDAI allowing each circle of the Department of Post to act as a corporate agent of insurance companies. Each circle of India post is identified as a separate unit and is issued an independent corporate agent license to help increase insurance penetration in rural India.

- **Referrals:** Referral refers to an agreement between a referral company and an insurance company. This agreement grants the insurance company the access to the database of the customers of the referral company but does not permit sale, either directly or indirectly through an agent, corporate agent or an insurance intermediary including a micro-insurance agent of an insurance product.
- **Shop-assurance:** Shop-assurance is the technique of promoting and selling insurance services through retail and departmental stores such as Big Bazaar. The retailer may make an attempt of selling burglary and fire policy on purchase of a product from the store. Also referred to as mall-assurance, this method of marketing is more common outside India, where one can get the consumer durable, which one has purchased, insured by applying for the insurance coverage along with it right at the store. These are known as point of purchase policies.



12.6 LET US SUM UP

- General insurance is a type of non-life insurance. It also covers the insurance of assets, including financial assets. It is a contract between the policyholder and insured, which is considered only after the realization of the premium from the insured.
- Policy endorsements refer to the amendments or modifications that are introduced to the original terms and condition of the insurance policy. This modification is usually performed by the insurance company on the behest of the policyholder by setting out the desired alterations in a memorandum called as endorsement. An endorsement is generally issued subsequent to the issue of an insurance policy,

whenever the policyholder feels the requirement of the same.

- Underwriting is the process of evaluating information crucial to the acceptance or rejection of exposures. It is a task of assessing and classifying the degree of risk an applicant or a group of applicants represents and then determining the coverage of that risk. The first part of the underwriting process is called selection of risks and the second part of the process is called classification of risk.
- The process of pricing of insurance and the calculation of insurance premiums is known as ratemaking. Ratemaking plays an important role in determining the overall profitability of the insurance business as it ensures that the premium is charged in a manner that covers all the expected losses and at the same time remains competitive with the premiums charged by other policymakers.
- Pricing of premiums should be done in the light of the objectives set by the insurance company as well as regulations in the insurance sector. Responsiveness, simplicity, flexibility and consistency are some of the primary objectives to be fulfilled.
- There are mainly two types of rating plans – class rating and individual rating. Class rating is based on the risks levels of the class to which the insured belongs and Individual rating is based on the risk levels of the individual insured. Individual rating plan is further divided into two kinds – judgment rating and merit rating. Again, merit rating is classified into three types – schedule rating, experience rating and retrospective rating.
- Insurance Marketing System refers to the various marketing strategies adopted for identifying potential customers, and making the insurance products available to them as per their risk appetite. Market Intermediaries play a very crucial role of 'matchmaking' or 'market making'. The major marketing intermediaries are – insurance agents, insurance brokers, bancassurance, web aggregators, referrals, shop-assurance, postal office, digital marketing, worksite marketing, telemarketing, direct marketing etc.



12.7 FURTHER READINGS

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2) Parodi, P. (2014). *Pricing in General Insurance* (1st ed.). Chapman and Hall/CRC.

3) Rejda, G. E., & McNamara, M. J. (2014). *Principles of Risk Management and Insurance*. Pearson.

4) The Institute of Chartered Accountants of India. (2008). *Principles and Practice of General Insurance* (4th ed.). The Publication Department on behalf of Dr. T. Paramasivan, Secretary of the Committee on Insurance and Pension of the Institute of Chartered Accountants of India, 'ICAI Bhawan', Indraprastha Marg, New Delhi - 110 002.



12.8 ANSWERS TO CHECK YOUR PROGRESS

Ans to Q No 1: The 3 types of endorsements are - Extra, Nil & Refund.

Extra endorsement – Involves charging of an additional premium,

Nil endorsement – Involves no change in the amount of premium but correction of some original data such as address etc.

Refund endorsement – Involves termination of policy contract or refund of premium amount in part or in full

Ans to Q No. 2: The major amendment areas in respect of which endorsements can be issued are

- Change in insurable interest
- Cancellation of insurance
- Change in the value at risk
- Change in the location or situation of risk
- Reduction or addition to the risk
- Change of the insured as and when a transfer of interest or

assignment of interest is made.

- Rectification of a typographical error.

Ans to Q No 3: Risk selection refers to the process of screening incoming insurance applicants with the aim of grouping them into different risks classes or categories so as to determine the appropriate amount of premium to be charged to a proposed insured individual or a group.

Ans to Q No 4: The underwriter is responsible for evaluation of risk proposals and calculation of premiums

Ans to Q No 5: An actuary is a person who undertakes the responsibility of determining the rates and premiumsof different non-life insurance products. An actuary is an individual possessing high mathematical and statistical skills that he applies in all stages of insurance company operations, including research, planning, and pricing of insurance products.

Ans to Q No 6: An exposure unit is the quantitative unit of measurement used in insurance pricing, which varies by line of insurance. It is a unit of liability or property with similar characteristics

Ans to Q No 7: The pure premium represents that part of the premium which is necessary to cover for the losses and loss adjustment expenses.

Ans to Q No 8: Loading is a component of the premium which is necessary to pay for other expenses, particularly sales expenses, and to allow for a profit margin. In other words, it refers to the amount that is added to the pure premium to cover additional expenses. The loading charge consists of the following ancillary insurance costs: commissions and other acquisition expenses, premium taxes, general administrative expenses, contingency allowances and profit margin.

Ans to Q No. 9: The formula for retrospective premium is

Retrospective Premium = [BP + (RL x LCF)] x PTM

Where, BP = Basic Premium; RL = Ratable Losses; LCF = Loss Conversion Factor; PTM = Premium Tax Multiplier



12.9 MODEL QUESTIONS

Short Questions (Answer each question in about 150 words)

Q 1: Write short notes on (a) Policy endorsements (b) Ratemaking (c) Premium (d) Judgment rating (e) Class rating

Q 2: What do you mean by underwriting? Discuss the main sources of information relevant to the process of underwriting.

Q 3: Discuss the different types of merit rating plan of premium pricing.

Q 4: Explain the two methods of determining class rates for general insurance products.

Q 5: Why is marketing of general insurance products important?

Q 6: Why is rating considered to be a complex activity in the field of general insurance business?

Long Questions (Answer each question in about 300-500 words)

Q 1: Discuss the different types of rate-making methods applicable in general insurance industry.

Q 2: Discuss the role of major distribution channels in marketing of non-life insurance products in India.

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UNIT 13 : PLANNING FOR WEALTH ACCUMULATION AND RETIREMENT NEEDS

UNIT STRUCTURE

13.1 Learning Objectives

13.2 Introduction

13.3 Wealth Accumulation Planning

13.4 Life Cycle Planning

13.5 Planning for accumulation

13.6 Purchase of insurance and accumulation planning

13.7 Investment- Tax advantaged and non-advantaged

13.8 Essentials of individual retirement planning: Analysis of retirement/ Income needs

13.8.1 Decide When to Retire

13.9 Retirement Planning Strategies

13.10 Investment for retirement

13.11 Pension Plans

13.11.1.1 Basic principles of pension plans

13.12 Let Us Sum Up

13.13 Further Readings

13.14 Answers to Check Your Progress

13.15 Model Questions

13.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- discuss the meaning of wealth accumulation planning and life cycle planning.
- discuss the objectives of wealth accumulation planning.
- explain the purchase of insurance and accumulation planning.
- discuss the different types of investments.
- explain the essentials of individual retirement planning.

- analyse the retirement and income need.
- discuss about retirement planning strategies.
- discuss the meaning of pension plans and its principles.

13.2 INTRODUCTION

A wealth accumulation strategy is a broad financial approach to increasing the value of a portfolio. By doing so, the investor builds up a greater and larger stake in the mutual fund as the fund's portfolio grows in value. Wealth accumulation planning refers to the act of preparing with patience and making sound financial decisions. Based on investment scenarios and maintenance methods, lifecycle planning predicts the future performance of an asset, or a collection of assets. From construction to disposal, lifecycle planning refers to the approach to asset main tenance. The objectives of wealth accumulation, insurance buying, accumulation planning, and investment are all included in the accumulation plan.

13.3 WEALTH ACCUMULATION PLANNING

Wealth accumulation is a process of planning with patience and make right decision about one's own money. It is a plan of investment with short term and long term set goals. Building wealth doesn't require large amount of money but one need to be disciplined enough to invest on a consistent basis while making sure that the investment will give adequate gains. Diversification is important to keep risk relatively low and minimum but on the other hand it also gives more gain and alternative platform to make more profits and build more wealth.

As an individual accumulates wealth, he/ she must keep in mind the retirement timing and approach the wealth accumulation process systematically by keeping an eye at the retirement timing. When working with and advising clients with a goal of retirement and financial independence, financial planning focuses on:

- **Creating Confidence in Plan** – As wealth accumulation increases and long-term goal of retirement nears, this is the perfect time to analyze and evaluate key financial inputs under various scenarios. This includes projecting how retirement may proceed under different investment rates of return, higher or lower spending levels, and other variables such as the purchase of a second home. This exercise instills a higher level of confidence that retirement is not only achievable, but also allows to proactively evaluate critical financial decisions such as retirement age, spending levels after retirement, and other inputs associated with upcoming retirement.
- **Retirement Cash Flow** – During working years, people typically focus on income levels but as theretirement time approaches, the focus is on how and from where to fund retirement cash flow. How much and at what age should distribute cash flow from a taxable account versus an individual retirement account? What is the plan for claiming social security benefits? Do people have access to other sources of retirement cash flow such as pension income, deferred compensation plan, real estate income, etc.? What is the most tax efficient way to fund the retirement cash flow needs?
- **Healthcare Insurance Planning** –According to industry analysis of different insurance company in India and according to IRDA data, Health insurance also plays one of a major role for wealth creation in India. Health Insurance is one of the investment plans for wealth creation. Investment plans with life insurance are sure shot way to accumulate wealth over a period. As an investor one can choose suits the best depending on the risk, returns and disposal amount to buy a plan. In future, when investors would required funds for child's education, child's marriage, retirement, pension, etc. So, health insurance plan will financially aid investors wealth,
- Wealth accumulation planning

  An accumulation plan is a general financial strategy in which an investor attempts to build the value of his or her portfolio. In the context of mutual funds, an accumulation plan is a formal arrangement in which

an investor contributes a specified amount of money to the fund on a periodic basis. By doing so, the investor accumulates a larger and larger investment in the fund through his or her contributions and the increase in value of the fund's portfolio. A prudent accumulation plan is key to building a financial nest egg for retirement. Many investors accumulate investment funds with regular contributions and the reinvestment of dividends and capital gains. Generally, the goals are to keep funds invested, reinvest income and capital gains, and have these compounds for as long as possible. An accumulation plan can also be useful for investors who wish to build their positions in a mutual fund over time. It also provides the benefits of dollar-cost averaging. A voluntary accumulation plan is an investment method in which a retail investor periodically invests relatively small amounts of money into a mutual fund, building a large position over an extended period. By spreading the contributions over a period of time, investors reap the benefits of dollar-cost averaging because the fixed contributions will buy more shares of a mutual fund when its price is low than when it is high. This can be an excellent solution for anyone who wishes to build an investment portfolio but is not in a position to invest a large sum of money at one time. Along with the advantage of being able to build up an investment over an extended period, the voluntary accumulation plan has the benefit of being an investment option with mutual funds that are considered to be relatively low risky.

13.4 LIFE CYCLE PLANNING

The strategy to sustaining an asset from construction to disposal is known as lifecycle planning. It entails predicting the future performance of a single asset or a group of assets using investment scenarios and maintenance methods. Lifecycle plans can be used to show how financing and/or performance criteria are met through suitable maintenance techniques, with the goal of reducing costs while maintaining the needed level of performance over a given time period. All road infrastructure assets may benefit from lifecycle planning, which can take a variety of

ways based on the maturity of the individual, the financial organisation, and the talents and risk-taking capacity of its employees. Its implementation, on the other hand, may be more advantageous to assets with the greatest value, which require significant finance, are high risk, and/or are considered vital assets. Complex methodologies may be used in some instances, necessitating the use of higher-quality data and predictive modeling tools. When just limited information is available, a more basic or risk-based strategy may be used.

An asset's life span includes the following stages:

- **Construction of a new road:** This might be a single asset, such as a new bridge, light column, or sign post, or a succession of new assets.
- **Routine maintenance:** This is a reactive and cyclic activity that is done on a regular basis to keep the asset in good working order. Pothole repairs, safety fence tensioning, and drainage and sign cleaning are all examples. It should be highlighted that normal maintenance techniques might have an impact on the asset's long-term performance. Routine maintenance should be considered during the lifecycle planning phase. Routine maintenance can help extend the life of an item.
- **Renewal or replacement:** This is the process of restoring an asset's performance after it has degraded. Unless it's a minor component in the road inventory, in which case it may be replaced as part of normal maintenance, this usually necessitates a capital investment.
- **Decommissioning:** The vast majority of road infrastructure assets are never decommissioned. However, certain assets may be withdrawn from service. Bridges may be closed, and street lighting, signs, and barricades may be removed.

13.5 PLANNING FOR ACCUMULATION

The plan for accumulation involves the objectives of wealth accumulation, purchase of insurance and accumulation planning and investment. These are discussed below.

Objectives

Wealth accumulation helps to build wealth and financial knowledge. Successful design of wealth accumulation results into reach specific goals of financial solutions. Successful financial plan helps to design, whether a person saving for a down payment on a home, considering cost of children's education or working to reduce credit card debt etc. A successful wealth accumulation helps to reach financial goals without impacting on lifestyle.

13.6 PURCHASE OF INSURANCE AND ACCUMULATION PLANNING

The easiest method to accumulate money over time is via an investment strategy. A variety of investing plans are available from life insurance providers. These are the goods that will generate money in the future when it is needed. It requires forethought and knowledge of the many alternatives accessible.

Benefits in wealth Investment Plans:

- **Money Creation:** Investing in life insurance policies is a sure-fire method to build wealth over time. As an investor, you may choose the plan that best fits your needs based on risk, returns, and the amount of money you have available to invest. Life insurance investment plans will financially assist you in the future when you need money for your child's education, marriage, retirement, pension, and other expenses.
- **Financial Security:** A life insurance policy offers life coverage as well as investment possibilities, ensuring that the family is financially secure. At the end of the policy's term, the policyholder gets the proceeds with a profit. This manner, the family's financial stability may be ensured in the long run. The insurance company will pay the nominee the amount guaranteed if the policyholder dies before the maturity term. As a result, the policyholder's family is financially protected.
- **Death Risk Insurance**-Not all investing channels provide death risk insurance.Life insurance policies, on the other hand, have investment strategies. Death risk coverage is included in these policies. Even if you are not present, your family's financial requirements will be met.

In the case of the policyholder's death, the amount guaranteed is paid to his or her nominee.

- **Retirement Savings:** These investment plans may be purchased at any point in a person's life. As a result, you'll be able to start building your retirement fund. One can buy and save money for later use.As a result, the investor will be financially self-sufficient even after he or she retires.
- **Flexibility**: It refers to the amount of money that can be invested as well as the length of time that it can be invested for. Depending on the requirements and plans, a viable option may be selected.
- **Investment Plan:** Investment plans aren't only for risk management or building wealth; they may also help you save money on your taxes. Sections 80C and 10(10D) of the Indian Income Tax Act exempt premiums and payouts from taxation.Savings, wealth development, financial security, and tax advantages all in one package.
- **Loan Facilitator:** Life insurance investment plans may also be used to facilitate loans. However, it is contingent on the kind of insurance purchased, premiums paid, and loan amount qualifying.

  The following are some examples of different investing plans:

  - **Unit Linked Insurance Plan (ULIP):** A Unit Linked Insurance Plan (ULIP) is a kind of insurance that also serves as an investment vehicle. In a ULIP, a portion of the premium is deducted for insurance and the remainder is invested in the stock market. Depending on the investor, money may be invested in bonds, stocks, debt, market funds, or hybrids. It provides transparency in terms of fund investments, which can be evaluated and tracked using Net Asset Value (NAV). Both coverage and investment possibilities are available via ULIPs. One receives the Maturity amount as a Survival Benefit, which is based on the current unit pricing. The nominee will be paid the amount guaranteed as a Death Benefit.
  - **Endowment Plan:** An endowment plan is a conventional insurance policy that also offers the option of investing. It's a

mix of coverage and financial investment. The market is not tied to the funds. There are two components to the premium paid throughout the course of the period:

A portion of the premium is put into a savings account.

A portion of the premiums is retained as a risk cover on maturity, with profit assured, although small. The nominee gets the amount guaranteed if the investor dies before the maturity date.

- **Money Back Plan:** A Money Back Plan is a kind of investment plan offered by life insurance companies that incorporates both investing and insurance. It covers mortality risks and pays out at regular intervals as a proportion of the amount guaranteed. Pay premiums for a certain number of years and get payments each year after the premium payment term has ended. Money is paid out to the policyholder on a regular basis. The remainder of the amount guaranteed is repaid at the end of the term. Terminal bonuses are included in the survival benefit. The coverage is paid to the nominee if the investor dies during the period of the contract.
- **Fixed Deposit (FD):** A fixed deposit, also known as a term deposit, is an investment in which the interest rate is fixed for the duration of the term. As a result, the investor knows exactly how much money he or she will make when the FD matures. For risk-averse investors, this is a good investing strategy to use. Banks and financial organisations that provide FD plans have different interest rates.
- **Public Provident Fund (PPF):** This is one of the most widely used savings and investment vehicles, particularly for tax savings and long-term investment. It needs a minimum yearly investment of Rs. 500 and a maximum investment of Rs. 1,50,000, and offers a 7.6% annual interest rate that is compounded annually. Public Provident Funds allow you to pay for your investment in a single sum or over the course of a financial year in up to 12 simple payments. Depending on the investor's financial goals, the maturity term may vary from a

minimum of 15 years to a maximum of 5 years. From the third financial year forward, the invested money may be transferred from one bank to another in India, and it can be used as security and collateral when applying for a loan. Section 80C of the Income Tax Act of 1961 allows investors to deduct their expenses. The interest that has accrued is likewise tax-free.

- **National Saving Certificate:**A National Savings Certificate is a tax-saving investment guaranteed by the government. Any Indian citizen may buy it from a local post office. They come in 100, 500, 1,000, 5,000, and 10,000 rupee denominations. It's a good option for individuals who don't want to take on too much risk or who want to diversify their portfolio by investing in a fixed-income product. NSC is now available for 5-year subscriptions with a minimum investment of Rs. 100. This investing strategy has no maximum restriction. Interest is compounded yearly and varies according to Ministry of Finance rules. It is, however, only paid out once the maturity period has ended, and no TDS is deducted. According to Section 80C of the Income Tax Act of 1961, the concept is entitled to tax advantages up to Rs. 1.5 lakh per year.
- **The National Pension Scheme (NPS):** The National Pension Scheme (NPS) is a government-sponsored pension plan intended specifically for government workers. From 2009 forward, non-government workers are now eligible to participate in this investment programme. It may be used to achieve a variety of financial goals. An investor may opt to contribute to this pension plan at his or her leisure, or withdraw a portion of the corpus in a lump payment and invest the remainder in annuities to create a strong corpus for post-retirement years.
- **Mutual Funds:** A mutual fund is an investment plan managed by a professional Asset Management Company (AMC) that pools the money from all of its clients and invests it in stocks, bonds, and other assets. These investments are made in accordance with each investor's individual investing goals and risk tolerance.

To build a strong portfolio of bonds, securities, and equities, the units are bought and sold according to the current NAV (Net Asset Value).

- **Tax-Advantaged Mutual Funds**: The sole mutual fund option that provides tax advantages is the Equity-Linked Savings Scheme (ELSS). It's a long-term equity mutual fund with a three-year lock-in period and a Rs. 500 minimum investment amount. Despite market volatility, an ELSS mutual fund can provide long-term financial gain to investors.
- **Bonds:** Bonds are debt investment plans that allow investors to lend money to a borrower, such as a company or the government, for a certain length of time and at a set interest rate.

13.7 INVESTMENTS: TAX ADVANTAGED AND TAX NONADVANTAGED

The word "tax-advantaged" refers to any form of investment, bank account, or savings plan that is either tax-free, tax-deferred, or gives additional tax advantages. Municipal bonds, partnerships, UITs, and annuities are examples of tax-advantaged investments. IRAs (Individual Retirement Accounts) and eligible retirement plans are examples of tax-advantaged programmes. A wide range of investors and workers in varied financial conditions use tax-advantaged investments and accounts. Employees save for retirement through IRAs and employer-sponsored retirement plans, while high-income taxpayers pursue tax-free municipal-bond income. Tax-deferred and tax-exempt status are the two most frequent ways for people to reduce their tax obligations. Tax-deferred accounts provide for immediate tax deductions on the whole amount contributed, but withdrawals from the account will be taxed at ordinary income rates in the future. Traditional IRAs and 401(k) plans are the most prevalent tax-deferred retirement funds in the United States. The most prevalent in Canada is a Registered Retirement Savings Plan (RRSP) (RRSP). Tax-exempt accounts, on the other hand, give future tax benefits

since retirement withdrawals are not taxed. There is no immediate tax benefit because contributions to the account are made using after-tax money.

Tax-advantaged investments protect a portion or all of an investor's income from taxes, allowing him or her to reduce their tax liability. Investors in municipal bonds, for example, get interest on their bonds over the life of the bond. Municipal governments utilise the profits from the sale of these bonds to support capital projects in their communities. The interest income earned by investors is not taxed at the federal level, which encourages additional investors to acquire these bonds. If the bondholder lives in the same state where the bonds were issued, his or her interest income is often tax-free.

13.8 ESSENTIALS OF INDIVIDUAL RETIREMENT PLANNING

Individuals and corporations who invest in real estate can also benefit from depreciation. Depreciation is a tax deduction that allows a taxpayer to reclaim the cost basis of certain assets. The cost of acquiring land or a structure in the United States is amortised over a certain number of usable years by yearly depreciation deductions.

Thinking about retirement objectives and how long it will take to achieve them is the first step in retirement planning. Then one must consider the many sorts of retirement accounts that might assist in raising funds for the future. As one saves money, he or she must invest it in order for it to expand. Before investing any money, it's also important to think about the tax implications of each investment option. The following points should be considered while making retirement plans:

1. Determining time horizons, predicting costs, calculating necessary after-tax returns, measuring risk tolerance, and completing estate planning are all important aspects of retirement planning.
2. Start saving for retirement as soon as possible to take advantage of compounding interest.
3. Younger investors can afford to take greater risks with their assets, but those nearing retirement should be more cautious.

4. As retirement plans change over time, portfolios should be rebalanced and estate plans should be revised as appropriate.
5. **Analysis for retirement**: Retirement analysis is crucial because, according to experts, a person who is about to retire will require at least 75% of his pre-retirement income to maintain the same lifestyle after he retires. The wage replacement ratio is the term for this proportion (WRR). The basis of one's retirement requirements is provided by Social Security payments, but most people discover that they require far more than their Social Security checks. If a person's retirement funds are insufficient, he may have to consider delaying retirement or working part-time after retirement. It is critical to plan on paying off as many debts and mortgages as possible between now and the time of retirement. Debt reduction or elimination is an essential element of retirement planning. Older retirees are less likely to spend money than younger retirees. They usually don't have a mortgage and don't have any costs related to travel or other hobbies they liked when they were younger. Older individuals are less active and spend less money as a result.
6. **Money requirements:** The first stage in planning a person's retirement is to determine how much income he will require to support his retirement. Retirement planning isn't an exact science, so it's not as simple as it seems. The precise requirements are determined by the objectives and a variety of other variables. As a starting point, it is preferable to use current income. It's typical to talk about desired yearly retirement income in terms of a proportion of current earnings. Depending on who you ask, that figure could range from 60% to 90% or even higher. The appeal of this approach is its simplicity, as well as the fact that it is based on a fairly common-sense analysis: current income supports a current lifestyle, so taking that income and reducing it by a certain percentage to reflect the fact that certain expenses will no longer be liable for (e.g., payroll taxes), will theoretically allow one to maintain the lifestyle. The difficulty with this strategy is that it fails to account for unique circumstances. For example, if a retiree plans to travel extensively in retirement, he may require 100

percent (or more) of his current salary to make ends meet. It's OK to use a percentage of current income as a baseline, but it's also good to go through all of your current costs in detail and consider how they'll change as you approach retirement.

7. **Projected retirement expenditures**: During retirement, your yearly income should be sufficient (or more than sufficient) to cover your expenses. Estimating such costs is an important part of retirement planning. However, recognizing all the costs and predicting how much would be spent in each area may be difficult, especially if retirement is still a long way off. Here are some common retirement expenditures to get you started:
   - Food and clothing.
   - Housing: Rent or mortgage payments, property taxes, homeowners insurance, property upkeep and repairs.
   - Utilities: Gas, electric, water, telephone, cable TV.
   - Transportation: Car payments, auto insurance, gas, maintenance and repairs, public transportation.
   - Insurance: Medical, dental, life, disability, long-termcare.
   - Health-care costs not covered by insurance: Deductibles, co-payments, prescription drugs.
   - Taxes: Federal and state income tax, capital gainstax.
   - Debts: Personal loans, business loans, credit card payments.
   - Education: Children's or grandchildren's college expenses.
   - Gifts: Charitable and personal.
   - Savings and investments: Contributions to IRAs, annuities, and other investment accounts.
   - Recreation: Travel, dining out, hobbies, leisureactivities.
   - Care for self, parents, or others: Costs for a nursing home, home health aide, or other type of assisted living.
   - Miscellaneous: Personal grooming, pets, club memberships.

13.8.1 Decide when to retire

To determine the total retirement needs, one can't just

estimate how much annual income need. One has to estimate how long will be retired. Why? The longer the retirement, the more years of income need to fund it. The length of retirement will depend partly on when one plan to retire. This important decision typically revolves around personal goals and financial situation.

Estimation of life expectancy

The age at which one retire isn't the only factor that determines how long will be retired. The other important factor is lifespan. People hope to live to an old age, but a longer life means that one has even more years of retirement to fund. One may even run the risk of outliving savings and other income sources. To guard against that risk, it will need to estimate the life expectancy. One can use government statistics, life insurance tables, or a life expectancy calculator to get a reasonable estimate of how long one will live. Experts base these estimates on age, gender, race, health, lifestyle, occupation, and family history. But these are just estimates. There's no way to predict how long one will actually live, but with life expectancies on the rise, it's probably best to assume one will live longer than the expectation.

Identify the sources of retirement income

Once one has an idea of retirement income needs, next step is to assess how prepared are to meet those needs. In other words, what sources of retirement income will be available for one? The employer may offer a traditional pension that will pay monthly benefits. In addition, one can likely count on Social Security to provide a portion of retirement income. Additional sources of retirement income may include other retirement plan, annuities, and other investments. The amount of income one receives from those sources will depend on the amount the investment, the rate of investment return, and other factors. Finally, if one plans to work during retirement, the amount of job earnings will be another source of income.

Make up of income shortfall

A financial professional can help to figure out the best ways

when the expected income sources will be shorter than enough to fund retirement. The following are few suggestions:

- Try to cut current expenses so to have more money to save for retirement.
- Shift assets to investments that have the potential to substantially outpace inflation. (but keep in mind that investments that offer higher potential returns may involve greater risk of loss)
- Lower expectations for retirement so that won't need as much money.
- Work part-time during retirement for extra income.
- Consider delaying the retirement for a few years (or longer).

13.9 RETIREMENT PLANNING STRATEGIES

1) **Save more**: Financial professionals recommend saving 15 percent or more of annual income throughout the career for retirement. If it hasn't done so and time is running short, one should try drastically by increasing savings rate. Reduce current expenses wherever possible and funnel the savings into retirement accounts.
2) **Take more risk:** consider taking more risk by investing in investment portfolio
3) **Delay in retirement:** working longer also gives additional time to add to retirement fund and build savings.
4) **Be Frugal:** Most people want to live a lifestyle in retirement at least equal to the one they enjoyed during their working career. However, if savings are inadequate, one may have to cut expenses to increase savings.
5) **Taking combo approach:** From delaying retirement to moving to a cheaper place for moderating life style can produce substantial savings in retirement. Along with that, more and more retirees are choosing part-time employment, which not only supplements retirement savings, but provides an opportunity to stay mentally and physically active and engaged in the community.

13.10 INVESTMENT FOR RETIREMENT:

Retirement Making the greatest possible use of one's retirement funds in order to reduce tax obligations and provide a steady source of income is critical for a retiree. Many seniors face a difficult time putting up a retirement portfolio that includes both fixed income and market-linked investments. Retirees can invest in the following options:

1) **Senior Citizen Savings Scheme (SCSS):** The Senior Citizen Savings Scheme (SCSS) is a government-run programme that encourages senior citizens to save money. SCSS (Senior Citizens Savings Scheme) is a government-sponsored savings programme for Indian citizens over the age of 60. The deposit matures after 5 years from the date of the account's opening, although it can be extended for another 3 years once. The interest rate on the SCSS has been fixed at 7.4 percent for the months of April to June 2020. Among India's numerous modest savings plans, this offers the highest interest rate. SCSS may be obtained through public and private banks as well as India Post Offices. The SCSS has the same terms and conditions regardless of whatever bank or post office you invest through because it is a government-backed savings vehicle.
2) **POMIS Account (Post Office Monthly Income Scheme):** It is one of the highest-earning plans, with an interest rate of 7.6%, among others such as Post Office Savings Account, Post Office Recurring Deposit, and Post Office Time Deposit. This scheme's interest is paid out monthly, as the name implies. The Ministry of Finance recognises and validates this programme, as it does all other post office programmes.
3) **Bank Fixed Deposits:** A bank or NBFC fixed deposit is a financial product that pays a greater rate of interest to investors than a standard savings account until the maturity date. A separate account may or may not be required. In Canada, Australia, New Zealand, India, and the United States, it is known as a term deposit or time deposit, and in the United Kingdom, it is known as a bond. The difference between a recurring deposit or a demand deposit and a fixed deposit is that the

money cannot be withdrawn from the FD before maturity. Some banks may provide FD holders with extra services, such as competitively priced loans secured by FD certificates. It's worth noting that in uncertain economic times, banks may offer lower interest rates. The interest rate ranges from 4% to 7.5%.

4) **Mutual funds**: It provide access to professionally managed portfolios of stocks, bonds, and other assets for small and individual investors. As a result, each stakeholder shares in the fund's gains and losses in a proportional manner. Mutual funds invest in a diverse range of assets, and their success is often measured by the change in the fund's total market capitalization, which is calculated by combining the performance of the underlying investments.

5) **Tax-free Bonds**: A government enterprise issues tax-free bonds to raise cash for a specific purpose. Municipal bonds are an example of this type of bond. They have a fixed rate of interest, making them a low-risk investment option. The absolute tax exemption under Section 10 of the Income Tax Act of India, 1961, is its most appealing feature, as the name indicates. Bonds that are tax-free have a ten-year or longer maturity. The money raised from these bonds is used to fund infrastructure and housing projects in the United States. These are a great option for investors looking for a steady stream of income, such as retirees. Because government entities normally issue these bonds for a longer period of time, the danger of default is lower, and you are guaranteed a fixed income for a longer period of time, usually 10 years or more. The money raised from the sale of these bonds is invested in infrastructure and housing projects by government businesses.

6) **Immediate Annuities:** An immediate annuity is a way to ensure a steady income stream. It's most commonly utilised to ensure retirees have a steady income. However, whether it is a suitable fit for your requirements is contingent on your own circumstances. A contractual financial product is an annuity. It takes and develops cash from individuals in most situations before paying out an agreed-upon sum each year. Annuities are sometimes funded over years before they

begin to pay out. An instant payout annuity, on the other hand, is bought with a single lump-sum payment and immediately begins paying out.

13.11 PENSION PLANS

A pension plan is an arrangement to provide income to participants in the plan when they retire. Pension plans are generally sponsored by private employers, government as an employer, and labour unions. The PPs may be funded or may be unfunded. Funded PPs are those where the benefits promised by the PP are secured by assets specifically dedicated for that purpose. Unfunded PPs are those, where fulfillment of the promised benefits by the sponsor depends on the general credit and not by any specific contribution to be made year afteryear.

Some pension plans are said to be insured where, the sponsor pays premiums to a life insurance company in exchange for a group annuity that would pay retirement benefits to the participants.

Pension plans may also be classified into the following categories:

- Public sectors banks pension plan.
- Central civil services pension plan.
- Pay-as-you-go Pension Plan (PAYGPP): Under this the current employees pay a percentage of their income to provide for the old, and, this, along with the contribution of the state, goes as a pension that sustains the older generation. This plan is popular in European countries including France and Germany.

13.11.1 Basic Principles of Pension Plans

The following are the principles of a pension plan-

- In terms of coverage, adequacy, security, efficiency, and sustainability, pension systems should have clear and well-defined objectives. The achievement of these goals should be tracked on a regular basis. To achieve these goals, an effective legal framework, a strong institutional and financial market infrastructure, and a good regulatory and supervisory system for pensions should be in place.

- Policy objectives for pension plans' coverage, adequacy, security, efficiency, and sustainability, as well as their role in overall retirement income support, should be clear and well-defined. These goals should be enshrined in law, and their attainment should be monitored on a regular basis as part of the policy and regulatory process.
- The regulatory and supervisory system, institutional and financial market structure, and the behaviour of the various actors should all be in sync, so that they support and complement each other in attaining the system's ultimate goals. The regulatory framework should take into account the extent to which pension plans are integrated with other retirement income provision systems, particularly public systems.
- Legal provisions should enhance the safety of pension plan participants and beneficiaries, as well as the financial stability of pension plans and funds.
- Legal measures should make it easier to run and develop pension plans by encouraging good governance and prudent management, providing proper and clear regulatory handling of various types of operators, and encouraging the supply of cost-effective pension arrangements.
- To facilitate the development of new financial instruments and markets to support pension provision, the development of well-functioning and transparent capital markets and financial institutions should be encouraged (e.g., inflation-indexed instruments and retirement annuity markets).
- The legal system should make it possible to enforce pension contracts. There should be a body of ethical, professional, and trained lawyers and judges, as well as an enforced judicial system. In circumstances where other dispute mechanisms exist, comparable criteria should be applied.
- Accounting, auditing, and actuarial standards for pension funds and pension corporations should be thorough documented,

transparent, and consistent with international standards, where applicable.

Through proper reporting and disclosure methods, legal provisions should enhance the availability of data. The availability of this data, which includes economic and demographic data, will allow regulators and stakeholders to assess the design and operation of the pension system in relation to its objectives, ensuring that private pension plans are consistent with the goals set for them and their role in overall retirement provision. Data should be stored and supplied in a way that respects its potentially sensitive nature.



CHECK IN PROGRESS

Q 1: What are the main four steps to generate wealth?

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Q 2: What are the four categories of wealth?

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Q 3: What are the 5 stages of investing?

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Q 4: How do you build wealth from nothing?

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Q 5: What is an accumulation plan?

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13.12 LET US SUM UP

- A wealth accumulation strategy is a broad financial approach to increasing the value of a portfolio. By doing so, the investor builds up a

greater and larger stake in the mutual fund as the fund's portfolio grows in value.

Wealth accumulation planning refers to the act of preparing with patience and making sound financial decisions.

- An accumulation plan is a general financial strategy in which an investor attempts to build the value of his or her portfolio.
- The strategy to sustaining an asset from construction to disposal is known as lifecycle planning. It entails predicting the future performance of a single asset or a group of assets using investment scenarios and maintenance methods.
- The plan for accumulation involves the objectives of wealth accumulation, purchase of insurance and accumulation planning and investment.
- The easiest method to accumulate money over time is via an investment strategy. A variety of investing plans are available from life insurance providers. These are the goods that will generate money in the future when it is needed.
- The word "tax-advantaged" refers to any form of investment, bank account, or savings plan that is either tax-free, tax-deferred, or gives additional tax advantages. Municipal bonds, partnerships, UITs, and annuities are examples of tax-advantaged investments.
- Individuals and corporations who invest in real estate can also benefit from depreciation. Depreciation is a tax deduction that allows a taxpayer to reclaim the cost basis of certain assets.
- Making the greatest possible use of one's retirement funds in order to reduce tax obligations and provide a steady source of income is critical for a retiree.
- A pension plan is an arrangement to provide income to participants in the plan when they retire.



13.13 FURTHER READINGS

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2) Dun & Bradstreet (2017). *Wealth management*, TATA McGraw Hill Publishing Company Limited.

3) Sen, Joydeep (2018*). Wealth Management: A Guide for Affluent and Middle Income Classes*, Shroff Publishers & Distributers Pvt.Ltd.

4) Sen, Joydeep (2020): *Financial Planning & Wealth Management: Concepts and Practice*, Shroff Publishers & Distributers Pvt.Ltd.

5) Sen, Kaushik (2020). *7 Smart Steps of Wealth Management*.

13.14 ANSWERS TO CHECK YOUR PROGRESS

Ans to Q No 1: 4 step to generate wealth are

Step 1: Save Smartly. Saving is the first step towards wealth creation.

Step 2: Turn your monthly saving into investment through SIPs. Saving is not enough; based on your financial needs channelize your monthly savings into investments.

Step 3: Increase your investment periodically.

Step 4: Invest lumpsum when possible.

Ans to Q No 2: There are 4 types of wealth:

1. Financial wealth (Money)
2. Social wealth (Status)
3. Time wealth (Freedom)
4. Physical wealth (Health)

Ans to Q No 3: There are five (5) main stage of investments, They are:

- Step One: Put-and-Take Account. This is the first savings you should establish when you begin making money.
- Step Two: Beginning to Invest.
- Step Three: Systematic Investing.
- Step Four: Strategic Investing.
- Step Five: Speculative Investing.

Ans to Q no 4: Steps to change your fortunes from zero to riches, they are:

1. Educate yourself about money.
2. Get a regular income source.
3. Create a budget.
4. Have enough insurance (but don't over-insure)
5. Practice extreme savings from your income.
6. Build an emergency fund.
7. Improve your skill set.
8. Explore passive income ideas.

Ans to Q no 5: An accumulation plan is a general financial strategy in which an investor attempts to build the value of a portfolio. In the context of mutual funds, an accumulation plan is a formal arrangement in which an investor contributes a specified amount of money to the fund on a periodic basis.



13.15 MODEL QUESTIONS

Short Questions: (Answers each question in about 150 wards)

Q 1: What is wealth accumulation plans?

Q 2: What do you mean by Life cycle planning in wealth accumulation?

Q 3: Mention the five advantage of Investment.

Q 4: What is Pensions Plans?

Q 5: What are the processes of purchase of insurance in India?

Long Questions: (Answers each question in about 300 to 500 wards)

Q 1: Write the basics principle of pensions plans.

Q 2: Explain the types of retirement investment plans.

Q 3: What are the essentials elements of individual retirement planning?

Q 4: Explains the advantage and disadvantage of investment.

Q 5: What are the difference between purchase of insurance and accumulation planning?

*** ***** ***

UNIT 14: THE INSURANCE MARKET IN INDIAN CONTEXT

UNIT STRUCTURE

14.1 Learning Objectives

14.2 Introduction

14.3 Insurance Institutes in Indian capital Market

- 14.3.1 Meaning of Capital Market
- 14.3.2 Importance of capital market
- 14.3.3 Role of Insurance Company in Indian capital market

14.4. Regulation Governing Investment of Insurance in India

- 14.4.1 Insurance Regulation
- 14.4.2 Objective of insurance regulation
- 14.4.3 Principle of insurance Investment

14.5. Purpose of government intervention in market

14.6. Relevant IRDA rules

- 14.6.1 Purpose of IRDA
- 14.6.2 Important Functions of IRDA
- 14.6.3 Duties and powers of IRDA
- 14.6.4 Effect of Insurance Regulatory and Development Authority (IRDA)

14.7 Let Us Sum UP

14.8 Further Reading

14.9 Answer to Check Your Progress

14.10 Model Questions

14.1 LEARNING OBJECTIVES

After going through this unit, you will be able to-

- understand the meaning of capital market
- know the importance of capital market
- elaborate the role of insurance institute in capital market
- explain the need and purpose of Insurance regulation in India

- understand the purpose of Government intervention in insurance market
- explain the relevant IRDA rules.

14.2 INTRODUCTION

The insurance companies are important participants in the financial market, especially in the capital market. They have a very important role as they contribute to the strengthening of competition in the financial market. Like all other financial institution, insurance is an activity that needs to be regulated as health of the insurance sector reflects a country's economy. This sector not only generates long terms funds for infrastructural development but also increase risk taking capacity. The basic rational to regulate this sector is to maintain the confidence of the financial system and to provide appropriate degree of consumer protection. Moreover, the smooth functioning of the insurance business depends on the trust and confidence reposed in the solvency of the financial institutions. A proper regulatory mechanism is therefore the sine qua non of success and growth of insurance industry as it inspires the confidence of all stockholders.

This unit will familiarize you with the meaning and importance of capital market, role of insurance company in capital market, regulation governing investment in insurance in India, purpose of government intervention and also the relevant rules of IRDA.

14.3 INSURANCE INSTITUTE IN INDIAN CAPITAL MARKET

14.3.1 Meaning of capital market

There are broadly two types of financial market in an economy- capital market and money market. Money market deals short term securities and capital market deals in financial instruments and commodities that are long-term securities .They

have a maturity of at least more than one year. Capital markets performed the same function as the money market. It provides a link between the investors and the wealth creators. The funds will be used for productive purpose and create wealth in the economy in the long term. The three main components of capital market in India are-

- Primary markets which are involved in the buying and selling of new issues of stocks and Securities
- Secondary markets which are involved in the trade of existing securities and stocks
- Financial Institutions (e.g UTI, LIC ,GIC etc.)

14.3.2 Importance of Capital Market

The capital market plays an important role in mobilizing savings and channels it in the productive investment for the development of commerce and industry. Capital market helps in capital formation and economic growth of the country.

The capital market acts as an important link between savers and investors .The savers are lenders of fund while investors are borrowers of funds. The saver who do not spend all their income are called ''surplus unit'' and the borrowers are known as ' deficit units'' the capital market is the transmission mechanism between surplus unit and deficit unit .This market provide excellent investment opportunities to the members of the public. The Capital market play very important role in Indian financial system such as-

- To mobilize long-term savings to finance long terms investment
- To inspire broader ownership of productive assets
- To improve the efficiency of capital allocation through a competitive pricing mechanism
- To provide liquidity with mechanism enabling the investor to see financial assets
- To make lower the costs of transaction and information
- To make bridge between investors and companies
- To make quick valuation of financial instruments both equity

and debt

- To provide operational efficiency
- To direct the flow of funds into efficient channels through investment, disinvestment and reinvestment.
- To make integration between financial sector and non-financial sectors, long term fund and short term fund.

Thus a Capital market serves as an important link between those save and those who aspire to invest their savings.

14.3.3 Role of insurance company in the capital market

In any economy, a well functioning capital market helps channel savings to the productive sectors of the economy in an efficient and transparent manner. An efficient capital market provides appropriate returns on the savings while the productive sectors get capital at market determined rates.

Among the Institutional framework for channeling the savings of the economy, banks have been the pre-dominant channel for garnering and deploying the savings. Insurance companies have largely played a second fiddle to the banking channel in respect of garnering savings. The traditional channel of financial savings like banks have been slowly and steadily yielding ground to the mutual funds and insurance industry as distributor reach continues to expand and the awareness among the general public about the available alternative, increases.

While the Insurance space was dominated by a single large public sector firm, the opening up of the space in the year 2000 bought in many private sector players.

Over the last two decades the private insurance has been in operation, this space has grown at a respectable rate of growth of insurance sector.



CHECK IN PROGRESS

Q. 1: State whether the following statements are True or False.

(a) Capital market deals with the short term securities.(True/False)

.....

(b) Capital provides a link between the savings /investors and the wealth creators. (True/False)

.....

(c) Financial institution is one of the main components of capital market in India. (True/False)

.....

Q. 2: State the meaning of Capital Market.

.....

.....

Q. 3: Mention the five important role played the capital market in Indian Financial system.

.....

.....

14.4 REGULATION GOVERNING INVESTMENTS OF INSURANCE INSTITUTIONS IN INDIA

14.4.1 Insurance Regulation

Regulation defines the requirements of an insurer, provide consumer protection through the supervision of insurers to safeguard their solvency and thus shield the customer from buying insurance from an unsuitable company. The main regulations that regulate the insurance business in India are the Insurance Act, 1938, the Life Insurance Act, 1956, the general insurance business (Nationalization) Act ,1971, The Marine Insurance Act , 1963, and the Motor vehicles Act,1988. The Indian Contract Act,1872 and

companies law governs most of the aspects of insurance contract. Additionally, the Foreign Exchange and Indian Succession Act also govern some aspects involved in insurance.

The purpose of regulation of insurance investments is clearly to assure the solvency of insurer. Regulation of insurance industry is necessary due to the externalities from insolvency of insurance companies and the presence of asymmetric information between insurance companies and consumers. Investment regulation save insurers from risky and fraudulent investment, fuelling the priority sectors and thus recline public faith and interest in the insurance Industry.

14.4.2 The Objective of Insurance Regulation

The basic objectives of insurance regulations are as under

- To protect customers from misleading sellers (by regulating the delivery channel, e.g. through standards for agents/ licensing agents and brokers)and unfair claims practices; for example by requiring disclosure and by regulating complaints; or by regulating rate setting/pricing (some jurisdictions have limits for rate or require prior approval);and by regulating policies (forms/contracts and exclusions)
- To protect the financial viability of insurer, e.g. by requiring standards for qualification, solvency, performance, risk limitation, disclosure, reserve, reporting (periodicity, accounting and information system), auditors, investment restrictions.
- To define general features of insurance: e.g. the provision of insurance, the types of products and the different types of insurance e.g. (short and long term ; national or cross border operation ;life insurance and general insurance)
- To define duties and responsibilities, e.g. the person permitted to engage in insurance activities, ownership (management domicile, holdings, and foreign investors); the regulatory agency responsibilities for insurance regulations and compliance, sanctions

and penalties for non compliance or omission.

- To define the conditions for the entry and exit of players in the market.

14.4.3 Principles of Investment in Insurance Companies

Investment management assumes great in the case of insurance companies where huge funds are collected by means of premium. Since these funds are not immediately required to meet the liabilities, insurance companies are able to invest a major portion in funds in investable assets and earn optimum rate of return from these investment. Investment operation of insurance companies can reduce the cost of insurance and increase the profitability of business. While making investment the insurance company generally follows the following principle-

- **Principle of safety and security:** Security of capital must be the prime consideration for insurance companies in making their investment decision because they are entrusted with the responsibility to pay claim as and when arises. The initial focus on insurance companies is not to earn maximum return on their investment but to ensure security of funds. Therefore, speculative investments involving potential of abnormal profit/loss are not acceptable for insurance funds .To ensure safety of policyholder's funds; the investment must be in safe and risk free securities. The policy holder money should be remained secure and their right to get sum assured on time must be granted.
- **The Principle of Profitability:** The ability of insurance companies to run its business on a solvent basis depend to a large extent on how they are invested their fund. The obligation of insurers is not merely the security of fund, but earning a rate of return not less than that on which premium are based. In addition to adequate amount of return, regularity and stability of return are also essential. The investment of insurance fund therefore calls for a rate of return adequate to honors insurer's

liability arising from the claims of insured, establishment expenditure of insurer's besides leaving insurer with a normal surplus necessary to continue insurance business. Therefore, investment of insurance fund it is required to establish a proper balance between safety and profitability.

- **The Principle of Liquidity:** Liquidity represents convertibility of investments into cash without undue loss of capital. The principle is crucial because of pressing requirement of money for payment of claims. The investment of insurance company should be made according to the requirement of insurers i.e. investment are so made the maturity of investment should match maturity of obligation. Insurers are not required to keep maximum amount in form of cash or readily convertible securities because they have substantial inflow of money by way of premium, return on investment and sale of securities. Liquidity of funds is not a very big concern for the established and financially strong insurers. Moreover, insurers can add a clause of delay in payment of claim for a specified period.
  - **Principle of Diversification:** Diversification of investment simply means spreading investment over different channels. It can be viewed as a sound policy of not relying unnecessarily on a single class of investment. Insurance investment assets should be broaden in different directions, viz -a)according to different geographical distribution (b) according to economic enterprises of the country, political changes and time and(c)according to number of investment in a security, maturity of security and duration of security.

14.5 PURPOSE OF GOVERNMENT INTERVENTION IN MARKET

Government intervention into insurance markets takes many forms, some direct and some indirect. Its stated purposes are always noble: to

protect consumers, to raise revenue to support worthwhile social objectives, or to ensure orderly, well functioning markets. However, in reality, regulation does not always serve noble purposes.

Various factors influence regulatory policies and behavior. These factors include market problems that regulators are seeking to rectify, ideology, special interests, and regulatory resources. The goal of regulation should be to protect consumers and to promote the public interest. This objective is achieved by appropriate government measures designed to address significant market difficulties which, in turn, aids market efficiency Regulation unduly influenced the special interests which is characterized by-

- Restrictions on entry of new national and especially foreign insurers
- Suppression of price and product competition
- Control of inter-industry competition from those selling similar or complementary products.

Insurance regulation that exhibits these characteristics is subject to “capture” by the local industry, with the result that both individual and commercial insured are penalized through high prices, lack of product innovation, and poor product choice.

All markets have imperfections, but they are generally not significant enough to warrant government intervention. However, in instances where market imperfections are significant, government intervention might be needed to protect consumers and promote workable competition. In insurance, the justification for regulatory intervention stems primarily from the existence of information problems and principal agent conflicts, and occasionally from excessive market power. Sometimes insurance market problems are not inherent to the industry, but are caused by government policies. The efficiency of government intervention to address a particular market imperfection must be evaluated from a cost benefit standpoint. Private insurance cannot flourish without public confidence that it will function as promised. Government’s duty is to ensure that this confidence is neither misplaced nor undermined. Consequently, every country has insurance laws and regulations to determine who may sell and underwrite insurance and the circumstances under which they may continue to do so. Countries

usually establish minimum reserve, asset quality and quantity, and capital requirements. In many countries, regulators also control prices and policy provisions.

It is possible to distinguish three fundamental types of government intervention in insurance. One approach emphasizes competitive markets and minimal intrusion with respect to market forces and insurers 'decisions. Chile, and to a lesser extent the U.S., are examples of this approach. The second approach relies on more restrictive regulation of market forces and the partial or complete sheltering of private insurers from competition. Historically, Japan, Korea, some European countries, and developing countries fell into this category. Countries that delegate the provision of insurance to the government fall into the third category. Most such countries (for example, China and India) are moving toward a role for private insurance providers, although other countries have yet to make meaningful progress.



CHECK IN PROGRESS

Q 4: State whether the following statements are True or False.

(a) The purpose of regulation of insurance investments is clearly to assure the solvency of insurer. (True/False)

.....

(b) Protection of the financial viability of insurer is one of the objective of insurance regulation. (True/False)

.....

(c) Restrictions on entry of new national and especially foreign insurers is one of the purpose of government intervention in insurance market. (True/False)

.....

Q 5: Write four principle of investment in insurance industry.

.....

.....

Q 6: Write three objective of insurance regulation.

.....

.....

.....

Q 7: Mention three purpose of Government intervention in Insurance Mark.

.....

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14.6 INSURANCE REGULATORY AND DEVELOPMENT AUTHORITY ACT (IRDA)

After the Liberalization of the financial sector in the year 1991, the Government of India constituted the 'Malhotra Committee' for suggesting reform in the insurance sector. This committee recommended the opening up of the insurance sector and suggested setting up of a statutory body called Insurance Regulatory Authority. In 1996, Interim IRA was formed and in 1999, the IRDA bill was passed IRA was renamed as Insurance Regulatory and Development Authority (IRDA) to reflect on the development of the insurance sector.

IRDA Act provides for the establishment of an Authority to protect the interests of holders of insurance policies, to regulate, to promote and ensure orderly growth of the insurance industry and for matters connected or incidental thereto. The insurance Regulatory and Development Authority called IRDA has been established under this Act.

14.6.1 Purpose of IRDA

The enacting the act and setting up of the IRDA has following purpose:

- To protect the interests of and secure fair treatment of policy holders.
- To bring about speedy and orderly growth of insurance industry (including annuities and superannuation) for the benefit of the common man and to provide long term funds for growth of the economy.

- To set, promote, monitor and enforce high standards of integrity, financial soundness, fair dealing and competence of those it regulates.
- To ensure that insurance customers receive precise, clear and correct information about products and services and make them
  aware of rights and responsibilities in this regard.
- To ensure speedy settlement of genuine claims to prevent insurance frauds and other malpractices and put in place effective grievance redressed machinery.
- To promote fairness, transparency andorderly conduct in financial markets dealing with insurance and build a reliable management information system to enforce high standards of financial soundness among market players.
- To take action where such standards are inadequate or ineffectively enforced
- To bring about optimal amount of self regulation in a day to day working of industry consistent with standards of prudential regulation.

14.6.2 Important Functions of IRDA

- To exercise all powers and functions of the controller under insurance Act, 1938.
- To Protection of the interests of policyholders.
- To issue, renew, modify, withdraw or suspend certificate of registration.
- To specify requisite qualification and training for insurance intermediaries and agents and to specify code of conduct, practical training of international surveyors and loss assessors.
- To promote and regulate professional organizations connected with insurance.
- To conduct inspection, investigation etc.
- To prescribe the method of insurance Accounting.

- To regulate investment of funds and margin of solvency.
- To adjudicate upon disputes.
- To call for information and to conduct inspection and audit of insurance intermediaries and other organizations concerned with insurance.
- Specify percentage of life insurance and general insurance business in rural and social sector.

14.6.3 Duties and powers of IRDA

For smooth running of insurance business, the regulatory authority has been vested with adequate power and duties.

The duties and powers of the IRDA are:

- To regulate, promote and ensure orderly growth of the insurance business.
- To exercise all powers and functions of the controller of insurance.
- To protect the interest of the policy holders in settlement of claims and terms and conditions of policies.
- To promote and regulate professional organizations connected with insurance business.
- To call for information from, undertake inspection and conduct investigations including audit of the insurer, intermediaries and other connected organisations and persons.
- 6.To control and regulate the rates and terms and conditions that may offered by the insurers in respect of general insurance matters, not so controlled by the Tariff Advisory Committee under section 64(u)of the insurance Act.
- To prescribe the manner and form in which accounts will be maintained and submitted by insurers and intermediaries.
- To regulate investment of funds.
- To regulate margins of solvency.
- To adjudicate disputes between insurers and intermediaries.

14.6.4 Effect of Insurance Regulatory and Development Authority (IRDA)

- Effect on Regulation of Insurance Industry: Insurance Regulatory and Development Authority regulates the Insurance sector. It aims to protect the interest of the insurance policy holders. It also encourages and ensure the systematic growth of the insurance industry.Effect over protection of policyholders: IRDA has great impact over the protection of policyholders. The Authority aims to
  provide fair treatment to all the policyholders.
- Effect over Awareness about Insurance: IRDA is taking steps to increase awareness amongst the masses about the benefits of insurance. There is a separate Consumer education website of IRDA to educate people about insurance.
- Effect over Insurance Market: There is a drastic effect of Insurance Regulatory and Development Authority over insurance market. IRDA regulates the insurance market and ensure the systematic and speedy growth of the insurance market
- Effect over Development of Insurance Product: All the insurance companies must take approval from Insurance Regulatory and Development Authority before launching any new product or before making any changes in the existing product or withdrawing a product. The insurers who wishes to launch a new product or make changes to the existing product or withdrawing a product shall submit an application to the Authority in the prescribed form along with the necessary details and reasons for the change reasons. The authority may ask for additional information if required. If no information is asked for then the insurer can start selling the product.
- Effect on Competition between Private and Public sector: As there is more demand from the customer for new, beneficial

and improved insurance products, there is a healthy competition amongst the insurers. This acts as a boon to the customer. Improved products along with attractive schemes have been designed by the public sector to give tough competition to the private sector.

Effect over Banks and Post Offices: With the increasing awareness amongst people about the benefits of insurance, the flow of funds have shifted to the insurance industry from Banks and Post Offices. Insurance has become a medium for not only covering losses and risks but has also become a popular way to save tax.



CHECK IN PROGRESS

Q. 8: Write three purpose of IRDA.

.....

.....

Q. 9: Mention three duties and powers of IRDA.

.....

.....

Q. 10: Write the effect of IRDA on Development of Insurance product.

.....

.....



14.7 LET US SUM UP

- We have discussed above the meaning of capital market, the Market which deals in financial instruments and commodities that are long – term securities .They have a maturity of at least more than one year.
- The three main components of capital market in India are-a)Primary markets which are involved in the buying and selling of new issues of stocks and Securities(b) Secondary markets which are involved in the trade of existing securities and stocks 'c) Financial Institutions

(e.g UTI, LIC ,GIC etc.).

- Capital market serves as an important link between those save and those who aspire to invest their savings
- An efficient capital market provides appropriate returns on the savings while the productive sectors get capital at market determined rates.
- Among the Institutional framework for channeling the savings of the economy, banks have been the pre-dominant channel for garnering and deploying the savings. Insurance company have largely played a second fiddle to the banking channel in respect of garnering savings.
- The purpose of regulation of insurance investments is clearly to assure the solvency of insurer. This is the primary concern of regulation because insurance is a business affected with the public as insurance consumer and policy holders.
- The main purpose of Government intervention in insurance market are (a) Restrictions on entry of new national and especially foreign insurers; (b) Suppression of price and product competition; and (c) Control of inter-industry competition from those selling similar complementary products.
- IRDA Act provides for the establishment of an Authority to protect the interests of holders of insurance policies, to regulate, to promote and ensure orderly growth of the insurance industry and for matters connected or incidental thereto.



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14.9 ANSWER TO CHECK YOUR PROGRESS

Ans to Q No 1: False

Ans. to Q No 2: True

Ans to Q No 3: Capital market deals in financial instruments and commodities that are long–term securities. They have a maturity of at least more than one year. Capital markets performed the same function as the money market .It provides a link between the savings /investors and the wealth creators.

Ans to Q No 4: The five roles played by capital market are:

- To mobilize long-term savings to finance long terms investment.
- To inspiration broader ownership of productive assets.
- To improve the efficiency of capital allocation through a competitive pricing mechanism.
- To provide liquidity with mechanism enabling the investor to see financial assets.
- To make lower the costs of transaction and information.

Ans to Q No 5: Principle of safety and security , Principle of Liquidity, Principle of Profitability, Principle of Diversification.

Ans to Q No 6:

- To mobilize long-term savings to finance long terms investment.
- To mobilize long-term savings to finance long terms investment.To protect customers from misleading sellers (by regulating the delivery channel,e.g. through standards for agents/licensing agents and brokers)and unfair claims practices; for example by requiring disclosure and by regulating complaints; or by regulating rate setting/pricing (some jurisdictions have limits for rate or require prior approval);and by regulating policies (forms/contracts and exclusions)

- To protect the financial viability of insurer, e.g by requiring standards for qualification, solvency, performance, risk limitation, disclosure, reserve, reporting (periodicity, accounting and information system), auditors, investment restrictions.
- To define general features of insurance: e.g. the provision of insurance, the types of products and the different types of insurance e.g. (short and long term; national or cross border operation; life insurance and general insurance)

Ans to Q No 7:

- Restrictions on entry of new national and especially foreign insurers;
- Suppression of price and product competition; and
- Control of inter-industry competition from those selling similar or complementary products

Ans to Q No 8:

- To protect the interests of and secure fair treatment of policy holders.
- To bring about speedy and orderly growth of insurance industry (including annuities and superannuation) for the benefit of the common man and to provide long term funds for growth of the economy.
- To set, promote, monitor and enforce high standards of integrity, financial soundness, fair dealing and competence of those it regulates.

Ans to Q No 9:

- To regulate, promote and ensure orderly growth of the insurance business.
- To exercise all powers and functions of the controller of insurance.
- To protect the interest of the policy holders in settlement of claims and terms and conditions of policies.

Ans to Q No 10 : IRDA affect the development of Insurance Product because all the insurance companies must take approval from Insurance

Regulatory and Development Authority before launching any new product or before making any changes in the existing product or withdrawing a product. The insurers who wishes to launch a new product or make changes to the existing product or withdrawing a product shall submit an application to the Authority in the prescribed form along with the necessary details and reasons for the change reasons. The authority may ask for additional information if required. If no information is asked for then the insurer can start selling the product.



14.10 MODEL QUESTIONS

Very Short Questions (Answer each question in about 75 words)

Q 1: Write the meaning of capital market:

Q 2: Write short notes on insurance regulation.

Short Questions (Answer each question in about 100-150 words)

Q 1: Write the notes on Important of capital Market in Indian financial system.

Q 2: Write the Objective of Insurance Regulation for development of insurance market.

Q 3: Discuss the effect of Insurance Regulatory and Development Authority (IRDA)

Essay Type Questions Answer (each question in about 300-500 words)

Q 1: Discuss the role of insurance company in the capital market.

Q 2: Discuss the Purpose of government intervention in insurance market.

Q 3: Write a brief notes on IRDA.

*** ***** ***



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1. Approximately how many hours did you spend for studying the units in the course? | | | |
2. Please give your opinions (by √ mark) to the following items based on your reading of the block:

Sl. No.	Statements	Strongly Agree	Agree	Neither Agree nor Disagree	Disagree	Strongly Disagree
I.	The SLMs of the course fulfil the learning objectives set out in the beginning of each unit					
II.	The units of the SLM could satisfy my academic needs and expectations					
III.	The Unit writers have excellent knowledge about the course contents					
IV.	Language and contents of the units were presented at a level which I could readily understand					
V.	Ample opportunity for participation in the activities provided in the units					
VI.	Used enough Illustrations (Diagrams, tables etc.) for conceptual clarity					
VII.	Quality of content is engaging, relevant, and up-to-date					
VIII.	The self check questions are very helpful					
IX.	The Possible/model questions and the answers to check my progress have benefited me a lot					

Additional Comments: *(Please feel free to provide your open comments)*

1. Which aspects of the SLM, according to you, worked well?

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2. What sort of changes/improvements do you feel KKHSOU could implement to improve the overall quality of the SLM?

Thank you for taking the time to complete this form.

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(To be inserted as last page after the end of the last unit of the course)