Introduction

Life insurance is like multi-headed hydra of financial services. For some, it is what it should be – an instrument to manage risk. For some more, it is an investment instrument. For some others, it is a tax planning tool. Another set of people may use it to plan for their investment and retirement and some may use it to plan for their children education. In spite of all these possibilities, penetration of insurance in India is abysmally low. India boasts of largest number of life insurance policies in force in the world. However, the penetration of life insurance in India as a percentage of Gross Domestic Product (GDP) stands at meager 4.1 per cent, as on February 2008. Compare this with 8.21 per cent in case of South Korea, 8.45 per cent in case of France and 11.61 percent in case of UK (OECD insurance statistics for 2007). According to IBEF.org, "eighty per cent of the country's 1.1 billion people have no insurance cover and 88 per cent of the workforce doesn't contribute to pension schemes".

It has been often repeated by insurance industry people that insurance is always sold and never bought. This mindset only emphasises the existing realities about the awareness of insurance in managing life's risks.

The Regulator

Insurance Regulatory Development Authority (IRDA) has been set up through an act of Parliament, to protect the interests of the policy holders, to regulate, promote and ensure orderly growth of the insurance industry.

Some of the functions of IRDA and the power vested with the authorities are,

- Issue to the applicant a certificate of registration, renew, modify, withdraw, suspend or cancel such registration
- Protection of the interests of the policy holders in matters concerning assigning of policy, nomination by policy holders, insurable interest, settlement of insurance claim, surrender value of policy and other terms and conditions of contracts of insurance
- Specifying requisite qualifications, code of conduct and practical training for intermediary or insurance intermediaries and agents
- Specifying the code of conduct for surveyors and loss assessors
- Promoting and regulating professional organisations connected with the insurance and re-insurance business
- Specifying the form and manner in which books of account shall be maintained and statement of accounts shall be rendered by insurers and other insurance intermediaries
- Regulating investment of funds by insurance companies
- Regulating maintenance of margin of solvency

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What is insurance?

Insurance is defined as the equitable transfer of the risk of a loss, from one entity to another, in exchange for a premium. This means that for a guaranteed small loss (premium) a large, possibly devastating loss can be prevented.

Insurance can protect only an economic loss. Insurance, by itself, cannot prevent the occurrence of loss itself. In the context of life insurance, insurance can only provide a monetary safety net to the dependents (beneficiaries) of the person who bought a policy.

Generally, life insurance companies offer products to meet two situations any individual might face. One is un-anticipated early death. The other is living too longer.

The economic loss because of un-anticipated early death of bread-winner may be protected by a life insurance product. Other situation of living too longer can be managed using life annuity products offered by life insurance companies.

What is life insurance?

Life insurance is a contract between the individual (policy owner) and the insurance company (insurer), where the insurer agrees to pay a particular sum of money upon the occurrence of the insured individual's or individuals' death or other event, such as critical illness. In return, the policy owner agrees to pay a stipulated amount called a premium at regular intervals or in lump sums.

Life insurance business means the business of effecting contracts of insurance upon human life, including any contract whereby the payment of money is assured on death (except death by accident only) or the happening of any.

Risk covered in a life insurance policy is death of the policy holder(s) before the stipulated date.

Types of life insurance policies

With the advent of private life insurance companies in Indian life insurance market, the types of insurance products available to Indian population have changed dramatically. In this section, we provide you brief details of very basic insurance products. These products may be modified in order to meet various needs of the buyers. What will be offered in the market place will usually be a hybrid product.

Term Insurance

Insurance is provided for a specific term, such as 30 years. If the policyholder dies during that period, a pre-specified sum of money is paid to the beneficiaries. If policyholder outlives the

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term, no money is paid out at the end of the term. There is no investment component in a pure term insurance product and hence it is often most inexpensive option to get substantial death benefit cover per rupee of premium paid.

Whole Life Insurance

A form of term insurance in which the policy is in effect for the entire duration of the policyholder's life. There are several variations in whole life insurance, for example, option to pay premium for a limited period and with and without profit plans.

Unit Linked Insurance Plan (ULIP)

Following is the abridged version of FAQ on ULIPs given out by IRDA:

A ULIP is a life insurance policy which provides a combination of risk cover and investment.

The allocated (invested) portions of the premiums after deducting all the charges and premium for risk cover under all policies in a particular fund as chosen by the policy holders are pooled together to form a Unit fund.

Most insurers offer a wide range of funds to suit one's investment objectives, risk profile and time horizons. Different funds have different risk profiles. The potential for returns also varies from fund to fund.

The following are some of the common types of funds available along with an indication of their risk characteristics.

Fund type	Nature of Investments	Risk Category
Equity Funds	Primarily invested in company stocks with the general aim of capital appreciation	Medium to High
Income, Fixed Interest and Bond Funds	Invested in corporate bonds, government securities and other fixed income instruments	Medium
Cash Funds	Sometimes known as Money Market Funds — invested in cash, bank deposits and money market instruments	Low
Balanced Funds	Combining equity investment with fixed interest instruments	Medium

In unit linked products/policies, the investment risk in investment portfolio is borne by the policy holder.

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Endowment Policies

One of the most popular traditional insurance plans, these are insurance policies in which a lump sum is paid out at the end of the pre-specified term, or when the policyholder dies whichever is earlier. Traditional with-profit Endowment Policies pay out a specific sum, called 'the sum assured'. This amount can be increased through investment performance through bonuses declared from time to time. Since this policy type has additional benefits, it carries higher premium costs as compared to a term insurance plan.

Riders

Riders are additions to the policy provisions that offer benefits not found in the original contract, or that modify it. These special provisions then become attached to the main policy. Because all riders provide some kind of benefit to the policy owner, an extra premium may be charged for them. A rider is an option to be chosen by the policy owner at the inception of the policy and there may be policies or plans without any rider option attached to them.

According to IRDA regulations, "riders" or "rider benefit" is defined as add-on benefits, which are in addition to basic benefits under a policy. Hence, the rider should be related exclusively to the life insured under the basic policy.

Underwriting

Underwriting refers to the process that an insurer uses to evaluate the risk and exposures of potential clients. Through the process of underwriting, an insurance company would decide how much coverage the client should receive, how much they should pay for it, or whether even to accept the risk and insure them. Underwriting involves measuring risk exposure and determining the premium that needs to be charged to insure that risk. The function of the underwriter is to acquire—or to "write"—business that will make the insurance company money, and to protect the company's book of business from risks that they feel will make a loss.

There are two types of underwriting usually any insurer would adopt; medical underwriting and financial underwriting.

While medical underwriting evaluates a person's past medical history, present health conditions and probability of adverse health conditions developing in the future, financial underwriting evaluates the financial standings of the person to rule out any moral hazard.

Underwriting is used to classify a person and identify the risk group to which he belongs to so that appropriate decision could be taken by the insurer. Outcome of an underwriting process may be manifold such as, accepting the proposal at normal rates, declining to accept the proposal, accepting the proposal at increased rates, reducing the sum insured, reducing the term, offering another product or a combination of such decisions.

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Life Annuity

A life annuity is a contract in which an insurer agrees in consideration of a certain payment or payments, to pay to the beneficiary, a fixed sum during a given period of years or until his death. The periodical payment is called the annuity and the person who receives it is the annuitant.

Life annuities are mostly pensions provided by the annuitants from out of their own savings. A person who has built up a capital sum by life insurance or otherwise may wish to enjoy the whole of it himself during the rest of his life. It is uncertain how long he lives. It is only an insurer who can calculate the value of the risk, receive the lump sum and agree to pay the appropriate annuity throughout the annuitant's lifetime or for any fixed period.

Types of annuity plan offered by most of the life insurance companies are listed below:

Annuity for life

Payable for annuitant's life.

Life Annuity with return of purchase price

Payable for annuitant's life and return of original purchase price to beneficiary on annuitant's death.

Life Annuity guaranteed for 5, 10, 15 years

Payable to annuitant/beneficiary for 5/10/15 years irrespective of the annuitant's existence. If annuitant lives beyond the stated years, annuities payable for his/her life.

Joint Life Last survivor

Payable to annuitant for life and after death to his/her spouse (if alive) for life

Joint Life Last survivor with return of purchase price

Payable to annuitant for life and after death to his/her spouse (if alive) for life.

Original purchase price returned to beneficiary on spouse & annuitant's death

Group Life Insurance

Insurance companies have structured products that cater to large homogenous groups such as group of employees of a company. Group life insurance has several advantages over individual policies.

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- Group members need not undergo any medical examination either at inception or during renewal subject to the limits applied by an insurance company. For higher sum assured, however, the insured has to undergo the required medical examination.
- Also unlike individual policies, there is no need for financial underwriting if the group is for employees. The employer would be able to confirm the financial status of his employee.
- Administration costs of group insurance covers are low and insurer usually passes on this saving as reduction in premium rates.
- Individuals need not worry about renewing the policy every year as the group managers take care of such issues.
- Group insurance policies would have a higher critical illness cover than an individual plan
- Group insurance policies may have wider scope than an individual policy such as covering gratuity, superannuation and so on.

Because of these advantages, group life insurance has become very popular.

However, group insurance has one major disadvantage: One can enjoy the group insurance benefit as long he remains a member of the group. The moment his relationship with the group is terminated, so is the insurance cover. This creates great uncertainty upon depending solely on group life insurance in order to manage an individual or household's health insurance needs.

Tax benefits

Government, in order to boost penetration of insurance culture amongst the masses and also to incentivise savings through insurance and pension products provides many tax benefits. Income Tax Act has a list of provisions that give exemptions and deductions while computing tax on income.

- Under Section 10(10A) (iii) of the Income Tax Act, any payment received by way of commutations of pension out of the Jeevan Suraksha annuity plans is exempt from tax
- Under Section 10(10D), any sum received under a Life Insurance policy (not being a Key Man policy) is exempt from taxation.
- Under Section 10(13), the payments received from an approved Superannuation Fund made are exempt from income tax

  -on the death of a beneficiary

  -to an employee in lieu of or in commutations of an annuity on his retirement or after a specified age

  -by way of refund of contributions on the death of a beneficiary

- Section 80C provides a deduction to an individual assessee for any amount paid or deposited up to a maximum limit of Rs.1,00,000/-

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-to effect or to keep in force an insurance on the life

-to effect or to keep in force a contract for a deferred annuity

-as a contribution for participation in the specified Unit-linked Insurance Plans

-to effect or to keep in force a contract for annuity plan

- Section 80 CCC provides a deduction of up to Rs.1,00,000/- to an individual assessee for any amount paid or deposited to effect or keeping in force any annuity plan.

It should be noted here that in case of a pension plan, annuities received from a pension plan are taxable.

Insurance Regulatory and Development Authority (Protection of Policyholders' Interests) Regulations, 2002

Through its notification dated 16/10/2002, IRDA has imposed a list of do's and don'ts for insurance companies to follow when dealing with policy owners. The regulation covers many areas such as,

- Point of sale
- Proposal of insurance
- Grievance redressal procedure
- Matters to be stated in the life and general insurance policies
- Claim procedures in respect of life and general insurance policies
- Policy holder's servicing

Insurance Ombudsman

The institution of Insurance Ombudsman was created by a Government of India with the purpose of quick disposal of the grievances of the insured customers and to mitigate their problems involved in redressal of those grievances.

Insurance Ombudsman has two types of functions to perform

- Conciliation
- Award making

The insurance Ombudsman is empowered to receive and consider complaints in respect of personal lines of insurance from any person who has any grievance against an insurer. The complaint may relate to any grievance against the insurer i.e.

- Any partial or total repudiation of claims by the insurance companies,

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- Dispute with regard to premium paid or payable in terms of the policy,
- Dispute on the legal construction of the policy wordings in case such dispute relates to claims;
- Delay in settlement of claims and
- Non-issuance of any insurance document to customers after receipt of premium.

Ombudsman's powers are restricted to insurance contracts of value not exceeding Rs. 20 lakhs. The insurance companies are required to honour the awards passed by an Insurance Ombudsman within three months.

Disclaimer:

The above material is provided for general information only and do not constitute legal or other professional advice. This information may be subject to change without notice and accordingly, may not be up to date at the time of viewing. Information specific to a product may be obtained from the concerned Insurer.

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