SYLLABUS

B.B.A. V SEM

Subject – Banking & Insurance

UNIT – I	RISK AND INSURANCE — Defining risk, nature and types of risk, risk management process, Risk and its relation with insurance. Concept and significance of insurance, classification of insurance life and non life, general principles of insurance.
UNIT – II	LIFE INSURANCE — Life - principles, products term insurance endowment, insurance, pensions, Group Insurance, IRDA.

Unit – 1

RISK

The chance that an investment's actual return will be different than expected. Risk includes the possibility of losing some or all of the original investment. Different versions of risk are usually measured by calculating the standard deviation of the historical returns or average returns of a specific investment. A high standard deviation indicates a high degree of risk.

A fundamental idea in finance is the relationship between risk and return. The greater the amount of risk that an investor is willing to take on, the greater the potential return. The reason for this is that investors need to be compensated for taking on additional risk.

Financial risk is an umbrella term for multiple types of risk associated with financing, including financial transactions that include company loans in risk of default. Risk is a term often used to imply downside risk, meaning the uncertainty of a return and the potential for financial loss. In addition to financial risks, there are five broad categories of investment risks known as five risks.

NATURE OF RISK:

i. Uncertainty
ii. Directly proportional to return.
iii. Temporal Dimension
iv. Variable in character.
v. Related to growth and development.

vi. Quantitative and Qualitative both.
vii. Omnipresent.
viii. Cannot be nil.
ix. Insurable and Non-Insurable
x. Fundamental and Particular Risk
xi. Dynamic and Static Risk
xii. Speculative and Pure Risk
xiii. Systematic and Unsystematic Risk.

TYPES OF RISK:

Risk implies the extent to which any chosen action or an inaction that may lead to a loss or some unwanted outcome. The notion implies that a choice may have an influence on the outcome that exists or has existed.

However, in financial management, risk relates to any material loss attached to the project that may affect the productivity, tenure, legal issues, etc. of the project.

In finance, different types of risk can be classified under two main groups, viz.,

1. Systematic risk.
2. Unsystematic risk.

The meaning of systematic and unsystematic risk in finance:

1. Systematic risk is uncontrollable by an organization and macro in nature.
2. Unsystematic risk is controllable by an organization and micro in nature.

A. Systematic Risk

Systematic risk is due to the influence of external factors on an organization. Such factors are normally uncontrollable from an organization's point of view.

It is a macro in nature as it affects a large number of organizations operating under a similar stream or same domain. It cannot be planned by the organization.

The types of systematic risk are depicted and listed below.

1. Interest rate risk,
2. Market risk and
3. Purchasing power or inflationary risk.

Now let's discuss each risk classified under this group.

1. Interest rate risk

Interest-rate risk arises due to variability in the interest rates from time to time. It particularly affects debt securities as they carry the fixed rate of interest.

The types of interest-rate risk are depicted and listed below.

1. Price risk and
2. Reinvestment rate risk.

The meaning of price and reinvestment rate risk is as follows:

1. Price risk arises due to the possibility that the price of the shares, commodity, investment, etc. may decline or fall in the future.
2. Reinvestment rate risk results from fact that the interest or dividend earned from an investment can't be reinvested with the same rate of return as it was acquiring earlier.

2. Market risk

Market risk is associated with consistent fluctuations seen in the trading price of any particular shares or securities. That is, it arises due to rise or fall in the trading price of listed shares or securities in the stock market.

The types of market risk are depicted and listed below.

1. Absolute risk,
2. Relative risk,
3. Directional risk,
4. Non-directional risk,
5. Basis risk and
6. Volatility risk.

The meaning of different types of market risk is as follows:

1. Absolute risk is without any content. For e.g., if a coin is tossed, there is fifty percentage chance of getting a head and vice-versa.

2. Relative risk is the assessment or evaluation of risk at different levels of business functions. For e.g. a relative-risk from a foreign exchange fluctuation may be higher if the maximum sales accounted by an organization are of export sales.
3. Directional risks are those risks where the loss arises from an exposure to the particular assets of a market. For e.g. an investor holding some shares experience a loss when the market price of those shares falls down.
4. Non-Directional risk arises where the method of trading is not consistently followed by the trader. For e.g. the dealer will buy and sell the share simultaneously to mitigate the risk
5. Basis risk is due to the possibility of loss arising from imperfectly matched risks. For e.g. the risks which are in offsetting positions in two related but non-identical markets.
6. Volatility risk is of a change in the price of securities as a result of changes in the volatility of a risk-factor. For e.g. it applies to the portfolios of derivative instruments, where the volatility of its underlying is a major influence of prices.

3. Purchasing power or inflationary risk

Purchasing power risk is also known as inflation risk. It is so, since it emanates (originates) from the fact that it affects a purchasing power adversely. It is not desirable to invest in securities during an inflationary period.

The types of power or inflationary risk are depicted and listed below.

1. Demand inflation risk and
2. Cost inflation risk.

The meaning of demand and cost inflation risk is as follows:

1. Demand inflation risk arises due to increase in price, which result from an excess of demand over supply. It occurs when supply fails to cope with the demand and hence cannot expand anymore. In other words, demand inflation occurs when production factors are under maximum utilization.
2. Cost inflation risk arises due to sustained increase in the prices of goods and services. It is actually caused by higher production cost. A high cost of production inflates the final price of finished goods consumed by people.

B. Unsystematic Risk:

Unsystematic risk is due to the influence of internal factors prevailing within an organization. Such factors are normally controllable from an organization's point of view.

It is a micro in nature as it affects only a particular organization. It can be planned, so that necessary actions can be taken by the organization to mitigate (reduce the effect of) the risk.

The types of unsystematic risk are depicted and listed below.

1. Business or liquidity risk,
2. Financial or credit risk and
3. Operational risk.

Now let's discuss each risk classified under this group.

1. Business or liquidity risk:

Business risk is also known as liquidity risk. It is so, since it emanates (originates) from the sale and purchase of securities affected by business cycles, technological changes, etc.

The types of business or liquidity risk are depicted and listed below.

1. Asset liquidity risk and
2. Funding liquidity risk.

The meaning of asset and funding liquidity risk is as follows:

1. Asset liquidity risk is due to losses arising from an inability to sell or pledge assets at, or near, their carrying value when needed. For e.g. assets sold at a lesser value than their book value.
2. Funding liquidity risk exists for not having an access to the sufficient-funds to make a payment on time. For e.g. when commitments made to customers are not fulfilled as discussed in the SLA (service level agreements).

2. Financial or credit risk:

Financial risk is also known as credit risk. It arises due to change in the capital structure of the organization. The capital structure mainly comprises of three ways by which funds are sourced for the projects. These are as follows:

1. Owned funds. For e.g. share capital.
2. Borrowed funds. For e.g. loan funds.
3. Retained earnings. For e.g. reserve and surplus.

The types of financial or credit risk are depicted and listed below.

1. Exchange rate risk,
2. Recovery rate risk,
3. Credit event risk,
4. Non-Directional risk,
5. Sovereign risk and
6. Settlement risk.

The meaning of types of financial or credit risk is as follows:

1. Exchange rate risk is also called as exposure rate risk. It is a form of financial risk that arises from a potential change seen in the exchange rate of one country's currency in relation to another country's currency and vice-versa. For e.g. investors or businesses face it either when they have assets or operations across national borders, or if they have loans or borrowings in a foreign currency.
2. Recovery rate risk is an often neglected aspect of a credit-risk analysis. The recovery rate is normally needed to be evaluated. For e.g. the expected recovery rate of the funds tendered (given) as a loan to the customers by banks, non-banking financial companies (NBFC), etc.

3. Sovereign risk is associated with the government. Here, a government is unable to meet its loan obligations, reneging (to break a promise) on loans it guarantees, etc.
4. Settlement risk exists when counterparty does not deliver a security or its value in cash as per the agreement of trade or business.

3. Operational risk

Operational risks are the business process risks failing due to human errors. This risk will change from industry to industry. It occurs due to breakdowns in the internal procedures, people, policies and systems.

The types of operational risk are depicted and listed below.

1. Model risk,
2. People risk,
3. Legal risk and
4. Political risk.

The meaning of types of operational risk is as follows:

1. Model risk is involved in using various models to value financial securities. It is due to probability of loss resulting from the weaknesses in the financial-model used in assessing and managing a risk.
2. People risk arises when people do not follow the organization's procedures, practices and/or rules. That is, they deviate from their expected behavior.
3. Legal risk arises when parties are not lawfully competent to enter an agreement among themselves. Furthermore, this relates to the regulatory-risk, where a transaction could conflict with a government policy or particular legislation (law) might be amended in the future with retrospective effect.
4. Political risk occurs due to changes in government policies. Such changes may have an unfavorable impact on an investor. It is especially prevalent in the third-world countries.

Following three statements highlight the gist of risk:

1. Every organization must properly group the types of risk under two main broad categories viz.,
    a. Systematic risk and
    b. Unsystematic risk.
2. Systematic risk is uncontrollable, and the organization has to suffer from the same. However, an organization can reduce its impact, to a certain extent, by properly planning the risk attached to the project.
3. Unsystematic risk is controllable, and the organization shall try to mitigate the adverse consequences of the same by proper and prompt planning.

RISK MANAGEMENT PROCESS:

Risk management is a 5 stage process. These processes go simultaneously. These steps are to be followed for having a good risk management. These steps are listed and explained below:-

1- Risk Identification:-

This is the first and the most important step of risk management. One cannot do anything with the risk unless and until that risk has been clearly identified. Risk identification starts from where the problem originates. Risk identification can be objective based, scenario based, taxonomy based and common risk checking.

2- Risk Analysis:-

Risk analysis includes analyzing the risk and measuring its vulnerability or its impact. Frequency and severity of the risk will be analyzed as well. Risk management can be quantitative as well as qualitative. Numerically determining the probabilities of various adverse events and expected extent of losses if any unexpected event occurs is a **Quantitative Analysis** where as defining the various threats, devising countermeasures and determining the extent of vulnerabilities is referred to as **Qualitative Risk Analysis**.

3- Risk Control:-

After analyzing the risk then decided that how can the risk be controlled. If the risk can be controlled by in house then well and good, if not then decide on how to transfer that risk. Risk control is the entire process of procedures, systems, policies an organization needs to manage prudently for all the risks which are arising.

4- Risk Transfer:-

If the risk is not manageable and one cannot retain that risk, then we have to transfer that risk to a third party. This is the stage where insurance comes in action. Insurance will be willing to take on those risks which the organization can't handle.

5- Risk Review:-

Risk review is the last step in which all the above mentioned steps are evaluated. Review must be regular as the conditions and the circumstances of the business and organizations changes continuously. It should be monitored that the desired results of the risk management are being achieved or not and if not then identifying that where the problem occurred and then reviewing all the steps and making the changed in the management according to scenario.

RISK AND INSURANCE:

How Insurance Works

Insurance is an agreement where, for a stipulated payment called the *premium*, one party (the insurer) agrees to pay to the other (the policyholder or his designated beneficiary) a defined amount (the *claim payment* or *benefit*) upon the occurrence of a specific loss. This defined claim payment amount can be a fixed amount or can reimburse all or a part of the loss that occurred.

The insurer considers the losses expected for the insurance pool and the potential for variation in order to charge premiums that, in total, will be sufficient to cover all of the projected claim payments for the insurance pool. The premium charged to each of the pool participants is that participant's share of the total premium for the pool. Each premium may be adjusted to reflect any special characteristics of the particular policy. As will be seen in the next section, the larger the policy pool, the more predictable its results.

Normally, only a small percentage of policyholders suffer losses. Their losses are paid out of the premiums collected from the pool of policyholders. Thus, the entire pool compensates the unfortunate few. Each policyholder exchanges an unknown loss for the payment of a known premium.

Under the formal arrangement, the party agreeing to make the claim payments is the insurance company or the *insurer*. The pool participant is the policyholder. The payments that the policyholder makes to the insurer are premiums. The insurance contract is the policy. The risk of any unanticipated losses is transferred from the policyholder to the insurer who has the right to specify the rules and conditions for participating in the insurance pool.

The insurer may restrict the particular kinds of losses covered. For example, a *peril* is a potential cause of a loss. Perils may include fires, hurricanes, theft, and heart attack. The insurance policy may define specific perils that are covered, or it may cover all perils with certain named exclusions (for example, loss as a result of war or loss of life due to suicide).

Hazards are conditions that increase the probability or expected magnitude of a loss. Examples include smoking when considering potential healthcare losses, poor wiring in a house when considering losses due to fires, or a California residence when considering earthquake damage.

In summary, an insurance contract covers a policyholder for economic loss caused by a peril named in the policy. The policyholder pays a known premium to have the insurer guarantee payment for the unknown loss. In this manner, the policyholder transfers the economic risk to the insurance company. Risk is the variation in potential economic outcomes. It is measured by the variation between possible outcomes and the expected outcome: the greater the standard deviation, the greater the risk.

Insurability:

Risk which can be insured by private companies typically shares seven common characteristics:[2]

1. **Large number of similar exposure units**: Since insurance operates through pooling resources, the majority of insurance policies are provided for individual members of large classes, allowing insurers to benefit from the law of large numbers in which predicted losses are similar to the actual losses. Exceptions include Lloyd's of London, which is famous for insuring the life or health of actors, sports figures, and other famous individuals. However, all exposures will have particular differences, which may lead to different premium rates.

2. **Definite loss**: The loss takes place at a known time, in a known place, and from a known cause. The classic example is death of an insured person on a life insurance policy. Fire, automobile accidents, and worker injuries may all easily meet this criterion. Other types of losses may only be definite in theory. Occupational disease, for instance, may involve prolonged exposure to injurious conditions where no specific time, place, or cause is identifiable. Ideally, the time, place, and cause of a loss should be clear enough that a reasonable person, with sufficient information, could objectively verify all three elements.

3. **Accidental loss**: The event that constitutes the trigger of a claim should be fortuitous, or at least outside the control of the beneficiary of the insurance. The loss should be pure, in the sense that it results from an event for which there is only the opportunity for cost. Events that contain speculative elements, such as ordinary business risks or even purchasing a lottery ticket, are generally not considered insurable.

4. **Large loss**: The size of the loss must be meaningful from the perspective of the insured. Insurance premiums need to cover both the expected cost of losses, plus the cost of issuing and administering the policy, adjusting losses, and supplying the capital needed to reasonably assure that the insurer will be able to pay claims. For small losses, these latter costs may be several times the size of the expected cost of losses. There is hardly any point in paying such costs unless the protection offered has real value to a buyer.

5. **Affordable premium**: If the likelihood of an insured event is so high, or the cost of the event so large, that the resulting premium is large relative to the amount of protection offered, then it is not likely that the insurance will be purchased, even if on offer. Furthermore, as the accounting profession formally recognizes in financial accounting standards, the premium cannot be so large that there is not a reasonable chance of a significant loss to the insurer. If there is no such chance of loss, then the transaction may have the form of insurance, but not the substance.

6. **Calculable loss**: There are two elements that must be at least estimable, if not formally calculable: the probability of loss, and the attendant cost. Probability of loss is generally an empirical exercise, while cost has more to do with the ability of a reasonable person in possession of a copy of the insurance policy and a proof of loss associated with a claim presented under that policy to make a reasonably definite and objective evaluation of the amount of the loss recoverable as a result of the claim.

7. **Limited risk of catastrophically large losses**: Insurable losses are ideally independent and non-catastrophic, meaning that the losses do not happen all at once and individual losses are not severe enough to bankrupt the insurer; insurers may prefer to limit their exposure to a loss from a single event to some small portion of their capital base. Capital constrains insurers' ability to sell earthquake insurance as well as wind insurance in hurricane zones. In the US, flood risk is insured by the federal government. In commercial fire insurance, it is possible to find single properties whose total exposed value is well in excess of any individual insurer's capital constraint. Such properties are generally shared among several insurers, or are insured by a single insurer who syndicates the risk into the reinsurance market.

<u>CONCEPT OF INSURANCE</u>:

On the one hand, human life is subject to various risks—risk of death or disability due to natural or accidental causes. Humans are also prone to diseases, the treatment of which may involve huge expenditure. On the other hand, property owned by man is exposed to various hazards, natural and man-made.

When human life is lost or a person is disabled permanently or temporarily, there is a loss of income to the household. The family is put to hardship. Sometimes survival itself is at stake for the dependants.

When it comes to property, loss or damage to property results in either whole or partial loss in income to the person or entity.

Risk has the element of unpredictability. Death/disability or loss/damage could occur at anytime. Losses can be mitigated through insurance. Insurance is a commodity which offers protection against various contingencies.

Insurance products available for life and non-life are many. In non-life, apart form personal covers such as accident covers and health insurance, there are products covering liabilities under a particular law and or common law. The various products are designed to cater to different needs of an individual or industry such as fire insurance policy on multi-storeyed building, householder's policy.

An insurance contract promises to make good to the insured a certain sum in consideration for a payment in the form of premium from the insured.

Human life cannot be valued. Hence the sum assured (or the amount guaranteed to be paid in the event of a loss) is by way of a 'benefit' in the case of life insurance. Life insurance products provide a definite amount of money to the dependants of the insured in case the life insured dies during his active income earning period or becomes disabled on account of an accident causing reduction/complete loss in his income earnings. An individual can also protect his old age when he ceases to earn and has no other means of income by purchasing an annuity product.

A Personal Accident cover is also for protection. In the event of death or disability, permanent or temporary, of the insured, it provides for compensation which is either the whole or a percentage of the Capital Sum Insured depending on the kind of loss.

In the case of Health Insurance, the policy seeks to cover expenses towards of treatment of diseases and or injury upto the Sum Insured opted for by the insured.

In respect of insurance relating to property, there are many products available. Property may be covered against fire and perils of nature including flood, earthquake etc. Machinery may be insured for breakdown. Goods in transit can be insured under a marine cargo insurance cover. Insurance covers are also available for ships and other vessels. A motor insurance policy covers third party damage as well as damage to the vehicle.

Insurance of property is based on the principle of indemnity. The idea is to bring the insured to the same financial position as he /she was before the loss occurred. It safeguards the investment in the property. Where there is no insurance, losses can mar a project or an industry. General Insurance offers stability to the economy and to the society.

Insurance offers security and so peace of mind to the individual. The concept of insurance is that the losses of a few are made good by contribution from many. It is based on the law of large numbers. It stemmed from the need of man to find a solution for mitigation of losses. It also reflects the nature of man to find a solution collectively.

It is important for all to understand the various products that life and general insurance companies offer before they make a choice as to the product they want to buy.

As per regulations, insurers have to give the various features of the products at the point of sale. The insured should also go through the various terms and conditions of the products and understand what they have bought and met their insurance needs. They ought to understand the claim procedures so that they know what to do in the event of a loss.

SIGNIFICANCE OF INSURANCE:

The process of insurance has been evolved to safeguard the interests of people from uncertainty by providing certainty of payment at a given contingency. The insurance principle comes to be more and more used and useful in modern affairs.

Not only does it serve the ends of individuals, or of special groups of individuals, it tends to pervade and to transform our modern social order, too. The role and importance of insurance, here, has been discussed in three phases: (i) uses to individual, (ii) uses to a special group of individuals, viz., to business or industry, and (iii) uses to the society.

Uses to an individual:

1. Insurance provides Security and Safety:
The insurance provides safety and security against the loss on a particular event. In case of life insurance payment is made when death occurs or the term of insurance is expired. The loss to the family at a premature death and payment in old age are adequately provided by insurance. In other words, security against premature death and old age sufferings are provided by life insurance.

Similarly, the property of insured is secured against loss on a fire in fire insurance. In other insurance, too, this security is provided against the loss at a given contingency.

The insurance provides safety and security against the loss of earning at death or in golden age, against the loss at fire, against the loss at damage, destruction or disappearance of property, goods, furniture and machines, etc.

2. Insurance affords Peace of Mind:
The security wish is the prime motivating factor. This is the wish which tends to stimulate to more work, if this wish is unsatisfied, it will create a tension which manifests itself to the individual in the form of an unpleasant reaction causing reduction in work.

The security banishes fear and uncertainty, fire, windstorm, auto-mobile accident, damage and death are almost beyond the control human agency and in occurrence of any of these events may frustrate or weaken the human mind. By means of insurance, however, much of the uncertainty that centers about the wish for security and its attainment may be eliminated.

3. Insurance protects Mortgaged Property:
At the death of the owner of the mortgaged property, the property is taken over by the lender of money and the family will be deprived of the uses of the property. On the other hand, the mortgagee wishes to get the property insured because at the damage or destruction of the property he will lose his right to get the loan replayed.

The insurance will provide adequate amount to the dependents at the early death of the property-owner to pay off the unpaid loans. Similarly, the mortgagee gets adequate amount at the destruction of the property.
4. Insurance eliminates dependency:
At the death of the husband or father, the destruction of family needs no elaboration. Similarly, at destruction of, property and goods, the family would suffer a lot. It brings reduced standards of living and the suffering may go to any extent of begging from the relatives, neighbors or friends.

The economic independence of the family is reduced or, sometimes, lost totally. What can be more pitiable condition than this that the wife and children are looking others more benevolent than the husband and father, in absence of protection against such dependency? The insurance is here to assist them and provides adequate amount at the time of sufferings.

5. Life Insurance encourages saving:
The elements of protection and investment are present only in case of life insurance. In property insurance, only protection element exists. In most of the life policies elements of saving predominates. These policies combine the programs of insurance and savings.

The saving with insurance has certain extra advantages:
(i) Systematic saving am possible because regular premiums are required to be compulsorily paid. The saving with a bank is voluntary and one can easily omit a month or two and then abandon the program entirely.

(ii) In insurance the deposited premium cannot be withdrawn easily before the expiry of the term of the policy. As contrast to this, the saving which can be withdrawn at any moment will finish within no time.

(iii) The insurance will pay the policy money irrespective of the premium deposited while in case of bank-deposit; only the deposited amount along with the interest is paid. The insurance, thus, provides the wished amount of insurance and the bank provides only the deposited amount,

(iv)The compulsion or force to premium in insurance is so high that if the policy-holder fails to pay premiums within the days of grace, he subjects his policy to causation and may get back only a very nominal portion of the total premiums paid on the policy.

For the preservation of the policy, he has to try his level best to pay the premium. After a certain period, it would be a part of necessary expenditure of the insured. In absence of such forceful compulsion elsewhere life insurance is the best media of saving.

6. Life Insurance provides profitable Investment:
Individuals unwilling or unable to handle their own funds have been pleased to find an outlet for their investment in life insurance policies. Endowment policies, multipurpose policies, deferred annuities are certain better form of investment.

The elements of investment i.e., regular saving, capital formation, and return of the capital along with certain additional return are perfectly observed, in life insurance.

In India the insurance policies carry a special exemption from income-tax, wealth tax, and gift tax and estate duty. An individual from his own capacity cannot invest regularly with enough of security and profitability. The life insurance fulfils all these requirements with a lower cost. The beneficiary of the policy-holder can get a regular income from the life-insurer; if the insured amount is left with him.

7. Life Insurance fulfils the needs of a person:
The needs of a person are divided into (A) Family needs, (B) Old-age needs, (C) Re-adjustment needs, (D) Special needs, (E) The clean-up needs.

(A) Family Needs:
Death is certain, but the time is uncertain. So, there is uncertainty of the time when the sufferings and financial stringencies may be fall on the family. Moreover, every person is responsible to provide for the family.

It would be a more pathetic sight in the world to see the wife and children of a man looking for someone more considerate arid benevolent than the husband or the father, who left them unprovoked.

Therefore, the provision for children up to their reaching earning period and for widow up to long life should he made. Any other provision except life insurance will not adequately meet this financial requirement of the family. Whole life policies are the better means of meeting such requirements.

(B) Old-age heeds:
The provision for old-age is required where the person is surviving more than his earning period. The reduction of income in old-age is serious to the person and his family.

If no other family member starts earning, they will be left with nothing and if there is no property, it would be more piteous state. The life insurance provides old age funds along with the protection of the family by issuing various policies.

(C) Re-adjustment Needs:
At the time of reduction in income whether by loss of unemployment, disability, or death, adjustment in the standard of living of family is required. The family members will have to be satisfied with meager income and they have to settle down to lower income and social obligations.

Before coming down to the lower standard and to be satisfied with that, they require certain adjustment income so that the primary obstacles may be reduced to minimum. The life insurance helps to accumulate adequate funds. Endowment policy anticipated endowment policy and guaranteed triple benefit policies are seemed to be a good substitute for old age needs.

(D) Special Needs:
There is certain special requirement of the family which is fulfilled by the earning member of the family. If the member becomes disable to earn the income due to old age or death, those needs may remain unfulfilled and the family will suffer.

(i) Need for Education. There are certain insurance policies, and annuities which are useful for education of the children irrespective of the death or survival of the father or guardian.
(ii) Marriage. The daughter may remain unmarried in case of father's death or in case of inadequate provision for meeting the expenses of marriage. The insurance can provide funds for the marriage if policy is taken for the purpose.

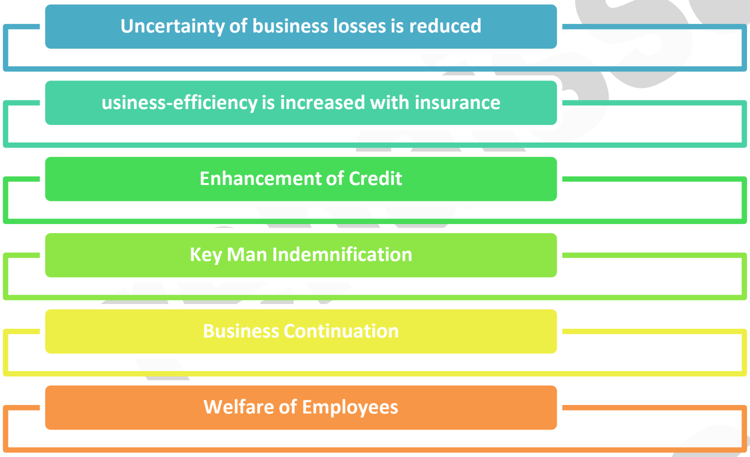
(iii) Insurance needs for settlement of children. After education, settlement of children takes time and in absence of adequate funds, the children cannot be well placed and all the education go to waste.

(E) Clean-up funds:

After death, ritual ceremonies, payment of wealth taxes and income taxes are certain requirements which decrease the amount of funds of the family member. Insurance comes to help for meeting these requirements. Multipurpose policy, education and marriage policies, capital redemption policies are the better policies for the special needs.

Uses to business :

The insurance has been useful to the business society also. Some of the uses are discussed below:



1. Uncertainty of business losses is reduced:

In world of business, commerce and industry a huge number of properties are employed. With a slight slackness or negligence, the property may be turned into ashes. The accident may be fatal not only to the individual or property but to the third party also. New construction and new establishment are possible only with the help of insurance.

In absence of it, uncertainty will be to the maximum level and nobody would like to invest a huge amount in the business or industry. A person may not be sure of his life and health and cannot continue the business up to longer period to support his dependents. By purchasing policy, he can be sure of his earning because the insurer will pay a fed amount at the time of death.

Again, the owner of a business might foresee contingencies that would bring great loss. To meet such situations they might decide to set aside annually a reserve, but it could not be accumulated due to death. However, by making an annual payment, to secure immediately, insure policy can be taken.

2. Business-efficiency is increased with insurance:

When the owner of a business is free from the botheration of losses, he will certainly devote much time to the business. The care free owner can work better for the maximisation of the profit. The new as well as old businessmen are guaranteed payment of certain amount with the insurance policies at the death of the person; at the damage, destruction or disappearance of the property or goods.

The uncertainty of loss may affect the mind of the businessmen adversely. The insurance, removing the uncertainty, stimulates the businessmen to work hard.

3. Key Man Indemnification:
Key man is that particular man whose capital, expertise, experience, energy, ability to control, goodwill and dutifulness make him the most valuable asset in the business and whose absence will reduce the income of the employer tremendously and up to that time when such employee is not substituted.

The death or disability of such valuable lives will, in many instances, prove a more serious loss than that by fire or any hazard. The potential loss to be suffered and the compensation to the dependents of such employee require an adequate provision which is met by purchasing adequate life-policies.

The amount of loss may be up to the amount of reduced profit, expenses involved in appointing and training, of such persons and payment to the dependents of the key man. The Term Insurance Policy or Convertible Term Insurance Policy is more suitable in this case.

4. Enhancement of Credit:
The business can obtain loan by pledging the policy as collateral for the loan. The insured persons are getting more loans due to certainty of payment at their deaths. The amount of loan that can be obtained with such pledging of policy, with interest thereon will not exceed the cash value of the policy. In case of death, this value can be utilised for setting of the loan along with the interest.

If the borrower is unwilling to repay the loan and interest, the lender can surrender the policy and get the amount of loan and interest thereon repaid. The redeemable debentures can be issued on the collateral of capital redemption policies. The' insurance properties are the best collateral and adequate loans are granted by the lenders.

5. Business Continuation:
In any business particularly partnership business may discontinue at the death of any partner although the surviving partners can restart the business, but in both the cases the business and the partners will suffer economically.

The insurance policies provide adequate funds at the time of death. Each partner may be insured for the amount of his interest in the partnership and his dependents may get that amount at the death of the partner.

With the help of property insurance, the property of the business is protected against disasters and the chance of disclosure of the business due to the tremendous waste or loss.

6. Welfare of Employees:
The welfare of employees is the responsibility of the employer. The former are working for the latter. Therefore, the latter has to look after the welfare of the former which can be provision for early death, provision for disability and provision for old age.

These requirements are easily met by the life insurance, accident and sickness benefit, and pensions which are generally provided by group insurance. The premium for group insurance is generally paid by the employer. This plan is the cheapest form of insurance for employers to fulfill their responsibilities.

The employees will devote their maximum capacities to complete their jobs when they are assured of the above benefits. The struggle and strife between employees and employer can be minimised easily with the help of such schemes.

Uses of society:
Some of the uses of insurance to society are discussed in the following sections.

1. Wealth of the society is protected :
The loss of a particular wealth can be protected with the insurance. Life insurance provides loss of human wealth. The human material, if it is strong, educated and care-free, will generate more income.

Similarly, the loss of damage of property at fire, accident, etc., can be well indemnified by the property insurance; cattle, crop, profit and machines are also protected against their accidental and economic losses.
With the advancement of the society, the wealth or the property of the society attracts more hazardous and, so new types of insurance are also invented to protect them against the possible losses.

Each and every member will have financial security against old age, death, damage, destruction and disappearance of his wealth including the life wealth. Through prevention of economic losses, instance protects the society against degradation.

Through stabilization and expansion of business and industry, the economic security is maximized. The present, future and potential human and property resources are well-protected. The children are getting expertise education, working classes are free from botherations and older people are guiding at ease. The happiness and prosperity are observed everywhere with the help of insurance.

2. Economic Growth of the Country:
For the economic growth of the country, insurance provides strong hand and mind, protection against loss of property and adequate capital to produce more wealth. The agriculture will experience protection against losses of cattle, machines, tools and crop.

This sort of protection stimulates more production hi agriculture, in industry, the factory premises, machines, boilers and profit insurances provide more confidence to start and operate the industry welfare of employees create a conducive atmosphere to work: Adequate capital from insurers accelerate the production cycle.

Similarly in business, too, the property and human material are protected against certain losses; capital and credit are expanded with the help of insurance. Thus, the insurance meets all the requirements of the economic growth of a country.

3. Reduction in Inflation:
The insurance reduces the inflationary resource in two ways. First, by extracting money in supply to the amount of premium collected and secondly, by providing sufficient funds for production narrow down the inflationary gap.

With reference to Indian context it has been observed that about 5.0 per cent of the money in supply was collected in form of premium.

The share of premium contributed to the total investment of the country was about 10.0 per cent. The two main causes of inflation, namely, increased money in supply and decreased production are properly controlled by insurance business, Insurance Need and Selling.

TYPES OF INSURANCE:

The insurance can be divided from two angles: first, from the business point of view and the second, from the risk point of view.

Business Point of View:
The insurance can be classified into three categories from business point of view: (i) Life Insurance, (ii) General Insurance, and (iii) Social Insurance.

(i) Life Insurance:
Life Insurance is different from other insurance in the sense that, here, the subject matter of insurance is life of human being. The insurer will pay the fixed amount of insurance at the time of death or at the expiry of certain period.

At present, life insurance enjoys maximum scope because the life is the most important property of the society or an individual. Each and every person requires the insurance.

This insurance provides protection to the family at the premature death or gives adequate amount at the old age when earning capacities are reduced. Under personal insurance a payment is made at the accident.

The insurance is not only a protection but is a sort of investment because a certain sum is returnable to the insured at the death or at the expiry of a period. The business of life insurance is wholly done by that Life insurance Corporation of India.

(ii) General Insurance :

The general insurance includes property insurance, liability insurance and other forms of insurance. Fire and marine insurances are strictly called property insurance. Motor, theft, fidelity and machine insurances include the extent of liability insurance to a certain extent.

The strictest form of liability insurance is fidelity insurance, whereby the insurer compensates the loss to the insured when he is under the liability of payment to the third party.

(iii) Social Insurance:
The social insurance is to provide protection to the weaker section of the society who is unable to pay the premium for adequate insurance. Pension plans, disability benefits, unemployment benefits, sickness insurance and industrial insurance are the various forms of social insurance.

With the increase of the socialistic ideas, the social insurance is an obligatory duty of the nation. The Government of a country must provide social insurance to its masses.

Risk Point of View:
Insurance is divided into property liability and other form from high point of view
A. Property Insurance:
Under the property insurance property of person/persons are insured against a certain specified risk. The risk may be fire or marine perils, theft of property or goods, damage to property at accident.

(a) Marine Insurance:
Marine insurance provides protection against loss of marine perils. The marine perils are collision with rock, or ship attacks by enemies, fire and capture by pirates, etc. These perils cause damage, destruction or disappearance of the ship and cargo and non-payment of freight.

So, marine insurance insures ship (Hull), cargo and freight. Previously only certain nominal risks were insured but now the scope of marine insurance had been divided into two parts: (i) Ocean Marine Insurance and (ii) Inland Marine Insurance.

The former insures only the marine perils while the latter covers inland peril which may arise with the delivery of cargo (goods) from the godown of the insured and may extend up to the receipt of the cargo by the buyer (importer) at his godown.

(b) Fire Insurance:
Fire insurance covers risks of fire. In the absence of fire insurance, the fire waste will increase not only to the individual but to the society as well. With the help of fire insurance, the losses, arising due to fire are compensated and the society is not losing much.

The individual is protected from such losses and his property or business or industry will remain approximately in the same position in which it was before the loss. The fire insurance does not protect only losses but it provides certain consequential losses also. War risk, turmoil, riots, etc., can be insured under this insurance, too.

(c) Miscellaneous Insurance:
The Property, goods, machine, furniture, automobile, valuable articles, etc., can be insured against the damage or destruction due to accident or disappearance due to theft. There are different forms of insurances for each type of the said property whereby not only property insurance exists but liability insurance and personal injuries are also insured.

B. Liability Insurance:
I he general insurance also includes liability insurance thereby the insured is liable to pay the damage of property or to compensate the less of personal injury or death. This insurance is seen in the form of fidelity insurance, automobile insurance and machine insurance, etc.

C. Other Forms:
Besides the property and liability insurances, there are certain other insurances which are included under general insurance. The examples of such insurances are export-credit insurances, State employees insurance, etc., whereby the insurer guarantees to pay certain amount at the certain events. This insurance is extending rapidly these days.

1. Personal Insurance:
The personal insurance includes insurance of human life which may suffer loss due to death, accident and disease. Therefore, the personal insurance is further sub-classified into life insurance, personal accident insurance and health insurance.

2. Property Insurance:
The property of an individual and of the society is insured against the loss of fire and marine perils, the crop is insured against unexpected decline in production, unexpected death of the animals engaged in business, break-down of machines and theft of the property and goods.

3. Liability Insurance:
The liability insurance covers the risks of third party, compensation to employees, liability of the automobile owners and reinsurances.

4. Guarantee Insurance:
The guarantee insurance covers the loss arising due to dishonesty, disappearance and disloyalty of the employers or second. The party must be a party of the contract. His failure causes loss to the first party. For example, in export insurance, the insurer will compensate the loss at the failure of the importers to pay the amount of debt.

GENERAL PRINCIPLES OF INSURANCE:

(i) Principles of Co-operation:
Insurance is a co-operation device. If one person is providing for his own losses, it cannot be strictly insurance because in insurance, the loss is shared by a group of persons who are willing to co-operate. In ancient period, the persons of a group were willingly sharing the loss to a member of the group. They used to share the loss to a member of the group.

They used to share the loss at the time of damage. They collected enough funds from the society and paid to the dependents of the deceased or the persons suffering property losses. The mutual co-operation was prevailing from the very beginning up to the era of Christ in most of the countries. Lately, the cooperation took another form where it was agreed between the individual and the society to pay a certain sum in advance to be a member of the society.

The society by accumulating the funds, guarantees payment of certain amount at the time of loss to any member of the society. The accumulation of funds and charging of the share from the member in advance became the job of one institution called insurer.

Now it became the duty and responsibility of the insurer to obtain adequate funds from the members of the society to pay them at the happening of the insured risk. Thus, the shares of loss took the form of premium. Today, all the insured give a premium to join the scheme of insurance. Thus, the insured are co-operating to share the loss of an individual by payment of a premium in advance.

(ii) Principles and Theory of Probability:
The loss in the shape of premium can be distributed only on the basis of theory of probability. The chances of loss are estimated in advance to affix the amount of premium. Since the degree of loss depends upon various factors, the affecting factors are analysed before determining the amount of loss. With the help of this principle, the uncertainty of loss is converted into certainty.

The insurer will have not to suffer loss as well have to gain windfall. Therefore, the insurer has to charge only so much of amount which is adequate to meet the losses. The probability tells what the chances of losses are and what will be the amount of losses.

The inertia of large number is applied while calculating the probability. The larger the number of exposed persons, the better and the more practical would be the findings of the probability. Therefore, the law of large number is applied in the principle of probability.

In each and every field of insurance the law of large number is essential. These principles keep in account that the past events will incur in the same inertia. The insurance, on the basis of past experience, present conditions and future prospects, fixes the amount of premium.
Without premium, no co-operation is possible and the premium cannot be calculated without the help of theory of probability, and .consequently no insurance is possible. So these two principles are the two main legs of insurance.

(iii) Indemnity

A contract of insurance contained in a fire, marine, burglary or any other policy (excepting life assurance and personal accident and sickness insurance) is a contract of indemnity. This means that the insured, in case of loss against which the policy has been issued, shall be paid the actual amount of loss not exceeding the amount of the policy, i.e. he shall be fully indemnified. The object of every contract of insurance is to place the insured in the same financial position, as nearly as possible, after the loss, as if he loss had not taken place at all. It would be against public policy to allow an insured to make a profit out of his loss or damage.

(iv) Utmost Good Faith

Since insurance shifts risk from one party to another, it is essential that there must be utmost good faith and mutual confidence between the insured and the insurer. In a contract of insurance the insured knows more about the subject matter of the contract than the insurer. Consequently, he is duty bound to disclose accurately all material facts and nothing should be withheld or concealed. Any fact is material, which goes to the root of the contract of insurance and has a bearing on the risk involved. It is only when the insurer knows the whole truth that he is in a position to judge (a) whether he should accept the risk and (b) what premium he should charge.
If that were so, the insured might be tempted to bring about the event insured against in order to get money.

(v) Insurable Interest - A contract of insurance effected without insurable interest is void. It means that the insured must have an actual pecuniary interest and not a mere anxiety or sentimental interest in the subject matter of the insurance. The insured must be so situated with regard to the thing insured that he would have benefit by its existence and loss from its destruction. The owner of a ship run a risk of losing his ship, the charterer of the ship runs a risk of losing his freight and the owner of the cargo incurs the risk of losing his goods and profit. So, all these persons have something at stake and all of them have insurable interest. It is the existence of insurable interest in a contract of insurance, which distinguishes it from a mere watering agreement.

(vi) Causa Proxima - The rule of causa proxima means that the cause of the loss must be proximate or immediate and not remote. If the proximate cause of the loss is a peril insured against, the insured can recover. When a loss has been brought about by two or more causes, the question arises as to which is the causa proxima, although the result could not have happened without the remote cause. But if the loss is brought about by any cause attributable to the misconduct of the insured, the insurer is not liable.

(vii) Risk - In a contract of insurance the insurer undertakes to protect the insured from a specified loss and the insurer receive a premium for running the risk of such loss. Thus, risk must attach to a policy.

(viii) Mitigation of Loss - In the event of some mishap to the insured property, the insured must take all necessary steps to mitigate or minimize the loss, just as any prudent person would do in those circumstances. If he does not do so, the insurer can avoid the payment of loss attributable to his negligence. But it must be remembered that though the insured is bound to do his best for his insurer, he is, not bound to do so at the risk of his life.

(ix) Subrogation - The doctrine of subrogation is a corollary to the principle of indemnity and applies only to fire and marine insurance. According to it, when an insured has received full indemnity in respect of his loss, all rights and remedies which he has against third person will pass on to the insurer and will be exercised for his benefit until he (the insurer) recoups the amount he has paid under the policy. It must be clarified here that the insurer's right of subrogation arises only when he has paid for the loss for which he is liable under the policy and this right extend only to the rights and remedies available to the insured in respect of the thing to which the contract of insurance relates.

(x) Contribution - Where there are two or more insurance on one risk, the principle of contribution comes into play. The aim of contribution is to distribute the actual amount of loss among the different insurers who are liable for the same risk under different policies in respect of the same subject matter. Any one insurer may pay to the insured the full amount of the loss covered by the policy and then become entitled to contribution from his co-insurers in proportion to the amount which each has undertaken to pay in case of loss of the same subject-matter.

In other words, the right of contribution arises when (I) there are different policies which relate to the same subject-matter (ii) the policies cover the same peril which caused the loss, and (iii) all the policies are in force at the time of the loss, and (iv) one of the insurers has paid to the insured more than his share of the loss.

UNIT-2

LIFE INSURANCE

<u>CONCEPT</u>:

Life insurance provides a monetary benefit to a decedent's family or other designated beneficiary, and may specifically provide for income to an insured person's family, burial, funeral and other final expenses. Life insurance policies often allow the option of having the proceeds paid to the beneficiary either in a lump sum cash payment or an annuity. In most states, a person cannot purchase a policy on another person without their knowledge.

Annuities provide a stream of payments and are generally classified as insurance because they are issued by insurance companies, are regulated as insurance, and require the same kinds of actuarial and investment management expertise that life insurance requires. Annuities and pensions that pay a benefit for life are sometimes regarded as insurance against the possibility that a retiree will outlive his or her financial resources. In that sense, they are the complement of life insurance and, from an underwriting perspective, are the mirror image of life insurance.

Certain life insurance contracts accumulate cash values, which may be taken by the insured if the policy is surrendered or which may be borrowed against. Some policies, such as annuities and endowment policies, are financial instruments to accumulate or liquidate wealth when it is needed.

<u>PRODUCTS</u>

Life-based contracts tend to fall into two major categories:

- <u>Protection</u> policies – designed to provide a benefit in the event of specified event, typically a lump sum payment. A common form of this design is term insurance.

- <u>Investment</u> policies – where the main objective is to facilitate the growth of capital by regular or single premiums. Common forms (in the US) are <u>whole life</u>, <u>universal life</u> and <u>variable life</u> policies.

<u>Types of Life Insurance:</u>

The life insurance policies are of many types. The principal types of policies are discussed below:

(1) Whole life Policy :
Under this policy premiums are paid throughout life and the sum insured becomes payable only at the death of the insured. The policy remains in force throughout the life of the assured and he continues to pay the premium till his death. This is the cheapest policy as the premium till his death. This is the cheapest policy as the premium charged is the lowest under this policy. This is also known as 'ordinary life policy'. This policy is suitable to persons who want to provide for payment of estate duty, make bequeathments for charitable purposes and to provide for their families after their death.

(2) Limited payment life policy:
In the case of whole life policy there is one disadvantage in that the assured must continue to pay the premium even during his old age when he is no more employed. Under the limited payment life policy premiums are payable for a selected number of years or until death, if, earlier. The assured knows how much he will be required to payable only at the how long he lives. The sum insured becomes payable only at the how long he lives. The sum insured becomes payable only at the death of the insured. It is a suitable policy to meet the family needs.

(3) Endowment policy:
It runs only for a limited period or up to a particular age. Under this policy the sum assured becomes payable if the assured reaches a particular age or after the expiry of a fixed period called the endowment period or at the death of the assured whichever is earlier. The premium under this policy is to be paid up to the maturity of the policy, i.e., the time when the policy becomes payable. Premium is naturally a little higher in the case of this policy than the whole life policy. This is a very popular policy these days as it serves the dual purpose of family and ole age pension.

(4) Double endowment policy:
Under this policy the insurer agrees to pay to the assured double the amount of the insured sum if he lives on beyond the date of maturity of the policy. This policy is suitable for persons with physical disability who are otherwise not acceptable for other classes of assurance at the normal tabular rates. Premiums are to be paid for a selected term of years or until death, if earlier.

(5) Joint Life Policy:
This policy covers the risk on two lives and is generally available to partners in business. Policies are however, issued on the lives of husband and wife under specified circumstances. Sum assured becomes payable at the end of the selected term or on the death of either of the two lives assured, if earlier.

(6) With or without profit policies:
Under the "with profit or participating policies," the policy holder is allowed a share in the profits of the corporation in the form of bonus and it is added to the total sum assured and paid at the time of maturity of the policy. In the case of 'without profit or non-participating policies, no such profit is allowed. Premium in the first case is higher and is lower in the later case.

(7) Convertible whole life policy:
This policy initially provides maximum insurance protection at minimum cost and offers a flexible contract which can be altered at the end of five years from the commencement of the policy to an endowment insurance.

(8) Convertible term assurance policy:
This policy meets the needs of those who are initially unable to pay the larger premium required for a whole life or endowment assurance policy but hope to be able to do so within a few years. It would also enable such persons to take final decision at a later date about the plan suitable for their future needs.

(9) Fixed term (marriage) Endowment policy & education annuity policy:

It is a policy suitable for making provisions for the marriage or education of children. Premiums are payable for a selected term or till prior death. The benefits are payable for selected term or till prior death. The benefits are payable only at the end of selected term. In case of the marriage endowment, the sum assured is paid in lump sum, but in case of the educational annuity, it is paid in equal half-yearly installments over a period of five years.

(10) Annuities:

It is a policy under which the insured amount is payable to the assured by monthly or annual installments after he attains a certain age. The assured may pay the premium regularly over a certain period or he may pay the premium regularly over a certain period or he may pay a lump sum of money at the outset. These policies are useful to persons who wish to provide a regular income for themselves and their dependants.

(11) Sinking fund policy:

Such a policy is taken with a view to providing for the payment of liability or replacement of an asset.

(12) Multipurpose policy :

This policy meets several insurance needs of a person – like provision for himself in old age, income for his family and provision for the education, marriage or the start in life of his children. It gives maximum protection to the beneficiaries in the event of the early death of the assured, as it provides:

i) Regular monthly income during the unexpired term;

ii) Additional monthly income for a period of two years from the date of death;

iii) Payment of a part of the sum assured on death and

iv) Payment of the balance sum assured at the end of the selected period

On maturity the assured may get the sum assured in cash, in the form of monthly pension, or an increased sum payable on death. Premiums are payable during the selected term or till death, it earlier.

TERM LIFE INSURANCE:

Term life insurance or **term assurance** is life insurance which provides coverage at a fixed rate of payments for a limited period of time, the relevant term. After that period expires, coverage at the previous rate of premiums is no longer guaranteed and the client must either forgo coverage or potentially obtain further coverage with different payments or conditions. If the insured dies during the term, the death benefit will be paid to the beneficiary. Term insurance is the least expensive way to purchase a substantial death benefit on a coverage amount per premium dollar basis over a specific period of time.

Term life insurance is the original form of life insurance and can be contrasted to permanent life insurance such as whole life, universal life, and variable universal life, which guarantee coverage at fixed premiums for the lifetime of the covered individual. Term insurance is not generally used for estate planning needs or charitable giving strategies but is used for pure income replacement needs for an individual. Term insurance functions in a manner similar to most other types of insurance in that it satisfies claims against what is insured if the premiums are up to date and the contract has not expired, and does not provide for a return of premium dollars if no claims are filed. As an example, auto insurance will satisfy claims against the insured in the event of an accident and a home owner policy will satisfy claims against the home if it is damaged or destroyed by, for example, a fire. Whether or not these events will occur is uncertain. If the policy holder discontinues coverage because he has sold the insured car or home, the insurance company will not refund the premium. This is purely risk protection.

Usage:
Because term life insurance is a pure death benefit, its primary use is to provide coverage of financial responsibilities for the insured or his or her beneficiaries. Such responsibilities may include, but are not limited to, consumer debt, dependent care, university education for dependents, funeral costs, and mortgages. Term life insurance is generally chosen in favor of permanent life insurance because term insurance is usually much less expensive (depending on the length of the term. For example, an individual might choose to obtain a policy whose term expires near his or her retirement age based on the premise that, by the time the individual retires, he or she would have amassed sufficient funds in retirement savings to provide financial security for the claims.

ENDOWMENT PLAN:

An endowment policy is a combination of insurance and investment: The life of the individual taking the policy is insured for a certain amount. This life cover is referred to as the sum assured. A certain part of the premium gets allocated towards this sum assured. Some portion of the premium is allocated towards the administrative expenses of the insurance company selling the policy. The remaining portion of the premium gets invested.

An endowment policy may declare a bonus every year: The money that is invested generates a certain return every year. This return may be declared as a bonus. The bonus is typically generated as a certain proportion of sum assured or life cover as it is popularly known. So if an individual taking the policy has a policy of sum assured Rs 10 lakh (Rs 1 million) and the company declares a bonus of Rs 50 per thousand of sum assured, then the bonus works out to be Rs 50,000.

The bonus declared is not payable immediately: Like is the case with a stock dividend or a mutual fund dividend which is payable immediately after it is declared, the bonus declared accumulates and is payable only when the policy matures or in case the policy holder dies.

The bonus declared does not compound it, only accumulates: Let us take the case of a 35 year old individual who takes a policy with a sum assured of Rs 10 lakh with a term of 20 years.

The premium for this would be around Rs 49,000 per year. At the end of the first year, the insurance company declares a bonus of Rs 50 per thousand of sum assured or 5% of sum assured. This amounts to Rs 50,000. This Rs 50,000 remains Rs 50,000 for the next nineteen years till the end of the policy. The same thing happens to the bonuses declared for the remaining period of the policy as well.

Since the bonus declared does not compound returns are low: Extending the example taken above, let us assume that the insurance company declares an average bonus of 5% every year. What this means is that every year on an average a bonus of Rs 50,000 is declared. So at the end of twenty years, the total accumulated bonus would amount to Rs 10 lakh (Rs 50,000 x 20).

Chances of an insurance company declaring an average bonus of more than 5% over a period of twenty years are very less. This is primarily because endowment policies largely invest in government securities and after taking into account the administrative expenses of the insurance companies, a greater bonus is highly unlikely.

So at the end of twenty years, the individual gets Rs 10 lakh of accumulated bonus and Rs 10 lakh of sum assured, making a total of Rs 20 lakh (Rs 2 million).

On this he has been paying a premium of Rs 49,000 every year. This amounts to a return of 6.39% per annum, which is not great. If the individual expires during the period the policy his nominee gets the Rs 10 lakh of sum assured as well the accumulated bonus till that point of time.

Take a term insurance policy and invest in the public provident fund: A better way out for an individual is to take a term insurance policy. A term insurance policy is a pure insurance policy.

If the policy holder dies during the period of the policy, his nominee gets the amount of the sum assured. If he survives the period of the policy, he does not get anything. Given this, the premiums on a term insurance policy tend to be the least among all insurance policies and they provide an adequate life cover.

A term insurance policy for a period of 20 years, for a 35 year old individual, would cost around Rs 4,600 per annum. So instead of taking an endowment policy it makes more sense to take a term policy of Rs 10 lakh.

The remaining money i.e. the difference between what needs to be paid on taking an endowment policy of similar sum assured and the premium on the term policy, can be invested in the public provident fund (PPF). The difference in the example taken here works out to Rs 44,400 every year.

If this is invested every year into the PPF, at the current interest rate of 8%, the individual is likely to accumulate Rs 21.94 lakh (Rs 2.194 million) at the end of 20 years, which is nearly Rs 2 lakh (Rs 200,000) more than Rs 20 lakh he is likely to accumulate in case of the endowment insurance policy. Also the bonus on the insurance policy is not guaranteed whereas PPF guarantees an interest of 8% every year.

PENSION:

A **pension** is a contract for a fixed sum to be paid regularly to a person, typically following retirement from service. There are many different types of pensions, including defined benefit plans, defined contribution plans, as well as several others. Pensions should not be confused with severance pay; the former is paid in regular installments, while the latter is paid in one lump sum.

The terms retirement plan and superannuation refer to a pension granted upon retirement of the individual. Retirement plans may be set up by employers, insurance companies, the government or other institutions such as employer associations or trade unions. Called *retirement plans* in the United States, they are commonly known as *pension schemes* in the United Kingdom and Ireland and *superannuation plans* (or *super* in Australia and New Zealand. Retirement pensions are typically in the form of a guaranteed life annuity, thus insuring against the risk of longevity.

A pension created by an employer for the benefit of an employee is commonly referred to as an occupational or employer pension. Labor unions, the government, or other organizations may also fund pensions. Occupational pensions are a form of deferred compensation, usually advantageous to employee and employer for tax reasons. Many pensions also contain an additional insurance aspect, since they often will pay benefits to survivors or disabled beneficiaries. Other vehicles (certain lottery payouts, for example, or an annuity) may provide a similar stream of payments.

The common use of the term *pension* is to describe the payments a person receives upon retirement, usually under pre-determined legal or contractual terms. A recipient of a retirement pension is known as a *pensioner* or *retiree*.

GROUP INSURANCE:

Group insurance' is an insurance that covers a group of people, usually who are the members of societies, employees of a common employer, or professionals in a common group. 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* for the purposes of obtaining insurance. In other words, people belong to the group not because they possess some high-risk factor which makes them more apt to purchase insurance (thus increasing adverse selection); instead they are in the group for reasons unrelated to insurance, such as all working for a particular employer.

Investopedia defines Group Life Insurance as "Life insurance offered by an employer or large-scale entity (i.e. association or labor organization) to its workers or members. Group life insurance is typically offered as a piece of a larger employer or membership benefit package.By purchasing coverage through a provider on a "wholesale" basis for its members, the coverage costs each individual worker/member much less than if they had to purchase an individual policy. . People who elect coverage through the group policy receive a "certificate of credible coverage," which will be necessary to provide to a subsequent insurance company in the event that the individual leaves the company or organization and terminates their coverage."

From the above paragraphs we can infer the following are the characteristics of Group Life Insurance

a. there must be a group of people to be insured which should have something in common other than the purpose of obtaining insurance
b. there must be a Master Policy Holder who will retain the contract on the behalf of the member and the carriers
c. Such covers are typically available at a discount to the respective individual rates.

Insurable Groups can broadly be classified as mainly two types - " employer - employee " groups where all members work for the employer proposing to cover them or "affinity" groups, whose members have a commonality other than employment - say deposit holders of a bank.

The Master Policy Holder of a Group Life Insurance Plan in the case of an "Employer Employee Group" is basically the Employer and for other groups would be the entity that has an insurable interest in the lives of its members. So in the case of a bank it could be said to have an insurable interest in the lives of its members who hold a deposit or have taken a loan. The Master Policy Holder also ensures each member gets their certificate of coverage stating the details of the premium paid, cover available, term of the cover and the claims process.

A feature which is sometimes common in group insurance is that the premium cost on an individual basis is not individually risk-based. Instead it is the same amount for all the insured persons in the group. So, for example, in the United States, often all employees of an employer receiving health or life insurance coverage pay the same premium amount for the same coverage regardless of their age or other factors. In contrast, under private individual health or life insurance coverage in the U.S., different insured persons will pay different premium amounts for the same coverage based on their age, location, pre-existing conditions, etc. Group policies are also attractive to consumers because the average price per policy is often lower. Carriers are interested in gaining customers and will cut prices a bit to accommodate members of group. Data shows that, for example, drivers save 29% on average by attaching themselves to a group policy.

All members for whom the premium is paid for the period and the risks in respect of such members accepted by the underwriters of the insurance company are generally eligible to purchase or renew coverage all whilst he or she is a member of the group subject to certain conditions. Again, using U.S. health coverage as an example, under group insurance a person will normally remain covered as long as he or she continues to work for a certain employer and pays the required insurance premiums, whereas under individual coverage, the insurance company often has the right to non-renew a person's individual health insurance policy when the policy is up for renewal, which it may do if the person's risk profile changes (though some states limit the insurance company's ability to non-renew after the person has been under individual coverage with a given company for a certain number of years).

In Canada group insurance is usually purchased through larger brokerage firms because brokers receive better rates than individual companies or unions. There may be slight differences in terms of administration and market related practices world wide, even though the concept may be the same. For example, In India, broker procured group term insurance, unlike Canada, does not intrinsically have any price advantage to the buyer i.e. the Master Policy Holder.

Group Life Insurance covers may be either compulsory - in which case every member has no say in opting for the cover or voluntary where all eligible members may decide within an enrolment window to opt for the available Group Insurance. This is irrespective of who pays the premium.

Since compulsory covers offer no scope for adverse selection they come with far relaxed underwriting requirements than voluntary covers, Underwriting requirements even for Voluntary Group Life Covers are far lower than the respective requirements for individual lives.

Group Health Insurance is also provided in India. It provides healthcare coverage to a group of people belonging to a common community (typically as employees of a company). These plans are generally uniform in nature, offering the same benefits to all employees or members of the group.

Most professionally run companies today provide Group Health Insurance as a part of their Employee Welfare program. Each company however gets the plan customized based on the employee demographics.

INSURANCE REGULATORY DEVELOPMENT AUTHORITY:

Insurance Regulatory and Development Authority (IRDA) is an autonomous apex statutory body which regulates and develops the insurance industry in India. It was constituted by a Parliament of India act called *Insurance Regulatory and Development Authority Act, 1999* and duly passed by the Government of India.

The agency operates its headquarters at Hyderabad, Andhra Pradesh where it shifted from Delhi in 2001. The Insurance regulatory and Development Authority (IRDA), batted for a hike in the foreign direct investment (FDI) limit to 49 per cent in the sector from the present 26 per cent.

The *IRDA Act, 1999* was passed as per the major recommendation of the *Malhotra Committee* report (1994) which recommended establishment of an independent regulatory authority for insurance sector in India. Later, It was incorporated as a statutory body in April, 2000. The *IRDA Act, 1999* also allows private players to enter the insurance sector in India besides a maximum foreign equity of 26 per cent in a private insurance company having operations in India. The FDI limit in insurance sector was raised to 49% in July 2013. It serves as an Authority to protect the interests of holders of insurance policies, to regulate, promote and ensure orderly growth of the insurance industry and for matters connected therewith. IRDA role is to protect rights of policy holders & they provides registration certification to life insurance companies & responsible for renewal, modification, cancellation & suspension of this registered certificate.

Organizational structure

IRDA is a ten member body consisting of:

- A Chairman,
- Five whole-time members and
- Four part-time members.

All members are appointed by the Government of India

Duties, Powers and Functions:

Section 14 of the IRDA Act, 1999 lays down the duties, powers and functions of IRDA.

- Registering and regulating insurance companies

- Protecting policyholders' interests
- Licensing and establishing norms for insurance intermediaries
- Promoting professional organisations in insurance
- Regulating and overseeing premium rates and terms of non-life insurance covers
- Specifying financial reporting norms of insurance companies
- Regulating investment of policyholders' funds by insurance companies
- Ensuring the maintenance of solvency margin by insurance companies
- Ensuring insurance coverage in rural areas and of vulnerable sections of society