

LIFE INSURANCE - PRACTICES, PROCEDURES

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LEARNING OBJECTIVES

Insurance can be defined in many different ways, from many different points of view. For example, from an economic viewpoint, insurance is a system for reducing financial risk by transferring it from a policy owner to an insurer. The social aspect of insurance involves the collective bearing of losses through contributions by all members of a group to pay for losses suffered by some group members. From a business viewpoint, insurance achieves the sharing of risk by transferring risks from individuals and businesses to financial institutions specializing in risk. The insurer is not in fact paying for the loss. The insurer writes the claim check, but is actually transferring funds from individuals who as part of a pool, paid premiums that created the fund from which the claims are paid. Life insurance is based on several basic principles that apply to all types of insurance, and that form the foundation of the insurance contract. Insurance contract is nothing but a legally binding contract, the possibility of an unknown large financial loss is exchanged for a comparatively small certain payment. This contract is not a guarantee against a loss occurring, but a method of ensuring that payment is made for a loss that does occur. Understanding these principles will help one to understand better how life insurance works. In this chapter we will study the basic principles which govern insurance contract.

LESSON OUTLINE

BASIC PRINCIPLES OF LIFE INSURANCE

Life insurance is based on several basic principles that apply to all types of insurance, and that form the foundation of the insurance contract. Understanding these principles will help one to understand better how life insurance works. Few of the Basic Principles of Life insurance are discussed below.

Risk Pooling

Risk pooling Life insurance is based on a concept called risk pooling, or a group sharing of losses. People exposed to a risk agree to share losses fairly or on an equitable basis. They transfer the economic risk of loss to an insurance company. Insurance companies collect and pool the premiums of thousands of people, spreading the risk of losses across the entire pool. By carefully calculating the probability of losses that will be sustained by the members of the pool, insurance companies can equitably spread the cost of the losses to all the members. The risk of loss is transferred from one to many and shared by all insured in the pool.

Example of Risk Pooling

Ten thousand males aged 35 contribute to a life insurance pool. If Twenty-one of them are expected to die this year and each of the 10,000 contributes `210 to fund death benefits (ignoring costs of operation), a death benefit of `100,000 could be paid for each of the 21 expected deaths.

The Law of Large Numbers

The law of large numbers states that as the size of the sample (insured population) increases, the actual loss experience will more and more closely approximate the true underlying probability. This means that the insurer's statistical group must be large enough to produce reliable results, and that the group actually insured must be large enough to produce results that are consistent with what probability predicts. Insurance relies on the law of large numbers to minimize the speculative element and reduce volatile fluctuations in year-to-year losses. The greater the number of exposures (lives insured) to a peril (cause of loss/death), the less the observed loss experience (actual results) will deviate from expected loss experience (probabilities). Uncertainty diminishes and predictability increases as the number of exposure units increases. It would be a gamble to insure one life, but insuring 500,000 similar persons will result in death rates that will vary little from the expected. A peril is a cause of a loss. In life insurance, the event against which protection is granted, death is uncertain for any one year, but the probability of death increases with age until it becomes a certainty. If a life insurance policy is to protect an insured during his or her entire life, an adequate fund must be accumulated to meet a claim that is certain to occur.

Principle of Utmost Faith

Insurance contract is one of utmost good faith. The rule of caveat emptor [let the buyer beware] does not generally apply. This doctrine is supported by Representation through an application Concealment Warranty

The application and its interpretation

An application for life and health insurance is the applicant's proposal to the insurer for protection and is the beginning of the policy contract. The proposed insured is required to give accurate answers to questions in the application relating to his personal and family history, habits, employment, insurance already in force, and other applications for insurance that either are pending or have been postponed or refused etc. A failure to do so leads the insurer being estopped [i.e., prevented] from denying the correctness or truth of information in the application. Insurers place great reliance on this information to issue the requested policy. This principle of insurance stems from the doctrine of "Uberrimae Fides" which is essential for a valid insurance contract. It implies that in a contract of insurance, the concerned contracting parties must rely on each other's honesty. Insurance contracts are different from other contracts. Normally the doctrine of "Caveat Emptor" governs the formation of commercial contracts which means 'let the buyer beware'. The buyer is responsible for examining the good or service and its features and functions. It is not binding upon the parties to disclose the information, which is not asked for.

However in case of insurance, the products sold are intangible. Here the required facts relate to the proposer, those that are very personal and known only to him. The law imposes a greater duty on the parties to an insurance contract than those involved in commercial contracts. They need to have utmost good faith in each other, which implies full and correct disclosure of all material facts by both parties to the contract of insurance. The term "material fact" refers to every fact or information, which has a bearing on the decisions with respect to the determination of the severity of risk involved and the amount of premium. The disclosure of material facts determines the terms of coverage of the policy.

Any concealment of material facts may lead to negative repercussions on the functioning of the insurance company's normal business. For instance life insurance companies normally segregate the quality of lives depending upon the state of health of the people. Healthy people are accorded a higher status in the table and different (lower) rates of premium are applicable to them since their risk of ill health is lower. If a person suppresses facts about his ill health and manages to buy a policy at rates applicable to the low risk group then other policyholders in the same group have to share his risk. This results in adverse selection.

Hence as per the principle of utmost good faith it is binding on the part of parties, the insured and the insurer, to expressly disclose all the relevant material facts pertaining to the contract. This doctrine is incorporated in insurance law and both the parties are expected to adhere to a high degree of honesty. Based on such faith, the insurer and the insured execute the contract of insurance. Thus each party believes that on fulfillment of the conditions for which the insurance policy was purchased, the other party would perform his duties as promised by him. Non-compliance by either party or any non-disclosure of the relevant facts renders the contract null and void.

INSURABLE INTEREST

The Insurance Act 1938 doesn't define the insurable interest but it has been defined by Mac-Gillivray as follows:

“Where the assured is so situated that the happening of the event on which the Insurance money is to become payable would as a proximity cause, involve the assured in the loss or diminution of any right recognised by law or in any legal liability there is an insurable interest in the happening of that event to the extent of the possible loss or liability.” The object of Insurance should be lawful for this purpose; the person proposing for Insurance must have interest in the continued life of the insured & would suffer pecuniary loss if the insured dies. If there is no insurable interest, the contract becomes wagering (gambling) contract. All wagering contracts are illegal & therefore null & void.

Insurable interest in Own Life Policy

So long as the Insurance is on one's own life, the “Insurance Interest” presents no difficulty. A person has insurable interest in his own life to an unlimited extent. The absence of a limit in this case is reasonable. When a person insures his life he obtains protection against loss to his estate; for in the event of his untimely death the estate would not benefit by the future accumulation he hopes to make during the normal span of life. It is not easy to compute with any degree of certainty what the future earnings of a person would be.

Hence no limit may be fixed in respect of life Insurance he may effect. Where, however, insurer rejects a proposal for an amount of assurance, which is disproportionate to the means of the proposer, it is not normally for lack of Insurable interest but on considerations of “moral hazard”. Indeed it may also be presumed in a case where a person proposes for a policy for a large amount, which he may not be able to maintain having regard to his income, that it will be financed by some other person and that there is no insurable interest

Insurance on the Life of Spouse

As a wife is normally supported by her husband, she can validly affect insurance on her life for adequate amount. The service and help rendered by the wife used to be thought of as the basis of insurable interest which supports any policy which a man takes on the life of his wife. In *Griffiths v. Elemming* the Court of Appeal in England stated that it was difficult to uphold such interest on the basis of pecuniary interest but thought that such interest could be presumed on broader grounds.

Insurable Interest on the Insurance taken on the Life of Parent and Child

Following the practice in U.K. in India also a parent is not considered to have insurable interest in the life of the child. The same is the case with a child in respect of his parent's life. Whether this position requires to be reviewed now appears to be engaging the attention of people here.

A Hindu is under a legal obligation to maintain his parents. Even as per traditional law Sec.20 of the Hindu Adoption and Maintenance Act has given statutory form to the legal

obligation. The parents have, therefore, a right to maintenance subject to their being aged or infirm. An order for maintenance of parents may also be passed under Sec. 125 of the Code of Criminal Procedure, 1973. It may be stated, therefore, that a parent has pecuniary interest in the life of the child, and an assurance effected on that basis cannot be hit by Sec.30 of the Contract Act as a wagering contract. However, it may be noted that the pecuniary interest is not a present interest unless the parent is unable to maintain himself or herself at the time when the Insurance is effected. It may therefore, be argued that a parent cannot have insurable interest in the life of the child until the right to maintenance arises; but when a person is not able to maintain oneself how can he be expected to have the means to insure the life of his children?

As a matter of fact in India, even today a child is a potential breadwinner for the parents in their old age. The present affluent circumstances of a parent do not alter that situation. Under the traditional law a right to maintenance could be claimed only against the sons; the statute has now extended the obligation to the daughters as well. Having regard to the social and economic set up of the people in the country a review of the question seems to be appropriate.

Insurable Interest on the life of Other Relations

In the case of other relations, insurable interest cannot be presumed from the mere existence of their relationship. Moral obligations or duties are not sufficient to sustain an insurable interest.

In every other case, the insurable interest must be a pecuniary interest and must be founded on a right or obligation capable of being enforced by Courts of law. The following are illustrations of such cases of insurable interest:

(a) Employer – Employee: An employer has insurable interest in the life of his employee, and the employee in the life of the employer; An employer can create insurable interest in the lives of his employees by undertaking to provide monetary benefit to the family or estate of the employees in the event of death. Group Insurances effected by companies on the lives of their employees are on the basis of such insurable interest.

(b) Creditor – debtor: A creditor has insurable interest in the life of his debtor upto the amount of the debt; This is not a satisfactory basis; for in the event of death of the debtor after the debt has been repaid, the creditor would still be entitled to the policy moneys and thus can be in a position to gain by the death of the debtor once the loan is repaid. The better arrangement would be for the debtor to take out a policy for the required amount and mortgage the policy to the creditor. The creditor then cannot take benefits under the policy in excess of his dues.

(c) Partner: A partner has insurable interest in the life of his co-partner to the extent of the capital to be brought in by the latter.

(d) Surety and principal debtor-Co-surety: A surety has insurable interest in the life of his co-surety to the extent of the proportion of his debt and also in the life of his principal debtor.

Effect on Contract when Insurable interest is not present: Where, therefore, the proposal is on the life of another, unless the proposer has insurable interest in the life to be assured, the contract shall be void. Lack of insurable interest is a defence, which the insurer may plead in resisting a claim. There may be also cases where Insurance on one's own life is surreptitiously financed and held by another for his benefit, which if detected by the insurer, may be declared void. As a life Insurance contract is not one of indemnity, the existence of insurable interest and the amount thereof will have to be considered at the time of effecting the contract since lack of such interest would render the contract void. If insurable interest existed at the inception of the policy, the contract would be enforceable though such interest might cease later.

REPRESENTATION

All disclosures relating to an insurance policy must be made at the time of entering into the insurance contract. The insurance company hands over the application proforma to the person buying insurance seeking complete details. The person has to mention his profession, income, age, family, history of family, general health, ailments suffered, medical reports, matters relating to conduct and character, any criminal record, etc. Similarly in case of general insurance while insuring an asset all facts regarding the condition, frequency of usage, wear and tear that may have occurred have to be disclosed by the buyer. These details given by the proposer known as representations demand correct and full disclosure by the buyer of insurance. Though it may not be possible in the proforma to ask all the required questions since the details vary from person to person, the insurance company determines the materiality of the given facts by exercising due diligence through proper scrutiny.

It is also open to an insurer to seek clarification regarding gaps in information to be furnished. If required, further enquiry is made. This is important, because based on this, the severity of risk is assessed and the amount of premium to be charged can be determined.

The application also mentions the stipulations and conditions which when fulfilled obligate the insurance company to fulfill its promises. It has to be noted that it is the duty of the insurer to inform and explain the insured about the working of those stipulations and broadly set the conditions in which the insurer may be relieved of such obligations to give the insured an idea about the performance of the contract. This helps in dispelling any misunderstanding or ignorance. Of course certain information, which is normally assumed to be of common knowledge to everyone, need not be disclosed. Thus while buying insurance for an electric generator in India it is not necessary to mention that power failure is common in India and that the gadget will be used more often. Also when a person buys a second policy from the same insurer it is presumed that the insurer will check for the relevant facts about him by referring to the first policy and without seeking explanation all over again. Information related to following matters need not be disclosed:

1. Facts related to law
2. Facts of common knowledge to all
3. Facts which can reasonably be discovered by the insurer
4. Facts which could have been revealed by a survey
5. Facts which have been covered by policy conditions
6. Facts which reduce the risk

Implications of concealment, non disclosure or misrepresentation by the insured

It may turn out from the representations furnished by the customer that the details are incomplete or any important information is concealed or is misleading. In such circumstances it is the choice of the insurer whether to:

1. Incorporate the required changes in the contract and charge a different premium.
2. Accept the policy and pay compensation especially if the facts have negligible importance.
3. Avoid any obligation on its part as per the policy.

It has to be proved by the insurer that the non-disclosure or misrepresentation was intentional on the part of the insured to commit fraud and deceive the insurer before it can stop payment of compensation. As per section 45 of the Insurance Act the insurance company can resort to this stance before the passage of two years after which it cannot take such recourse. Non-disclosure may be unintentional on the part of the insured. Even so such a contract is rendered voidable at the insurers option and it can refuse any compensation. Any concealment of material facts is considered intentional. In this case also the policy is considered void. Suppose a person discovers that he has cancer, which is in its last stages and is hopeless to go for medical treatment. Immediately he buys a life insurance policy where he conceals this fact from the insurers. He dies four months after buying the policy. The insurance company can contest the claim for payment of policy proceeds to his beneficiary on the ground that a vital fact material to the contract was concealed.

Implications of non-disclosure by the insurer

It is true that in a contract of insurance the insured has to furnish more information about him. But there are certain covenants in a contract, which have to be thoroughly elaborated to the insured. These relate to the conditions in which the insurance company may or may not perform its promises.

It has to be noted that it is the duty of both the insurance agent and the company authorities that this particular aspect is looked into. Any laxity at this point may tilt the judgments in favor of the insured in case of a dispute.

Example

In the case of LIC vs. Shakuntalabai, the insured had availed a life insurance policy from LIC. Before taking the policy he had suffered from indigestion for a few days and at the first instance had availed treatment from an ayurvedic doctor. This fact was not disclosed by the insured.

The insured died of jaundice within a few months after buying the policy. Eventually LIC refused to accept the claim on the ground of non-disclosure of information. However the court rejected this stand of LIC since it had not explained this covenant clearly to the insured, which amounts to non-compliance of its responsibilities. Such casual ailments are common and occur many times over and they can be treated by over the counter drugs. It is normally not possible for a person to distinguish a potentially serious ailment inherent in such symptoms. Also it is not possible for a person to remember the details of all such illnesses like cough, cold, headaches, etc., and the medications taken for them after a few months. So these facts are not to be considered as material to the contract and thus their nondisclosure does not invalidate the contract.

ASSIGNMENT

Assignment is the transfer of the rights to receive the benefits under a contract accruing to the party to that contract. In life insurance parlance, assignment is the transfer of rights to receive benefits stated in the life insurance policy from the Policyholder to the Assignee. The benefits under an insurance policy accrue by way of survival benefits and death benefits. While death benefits accrue in every insurance policy, survival benefits typically relate to maturity benefits under an insurance policy with an underlying investment component, e.g. Endowment Policy, Money-back Policy, Unit Linked Insurance Policy etc.

The concept and procedure for Assignment is dealt with under Section 38 of the Insurance Act, 1938. The Section treats an Assignment and a Transfer at par. It lays down that a transfer or assignment of a policy of life insurance, whether with or without consideration, may be made only by an endorsement upon the policy itself or by a separate instrument, signed in either case by the transferor or by the assignor or his duly authorised agent and attested by at least one witness, specifically setting forth the fact of transfer or assignment.

In practice, a 'space for endorsements' is provided in the insurance policy contract where the Policyholder (Assignor) affixes the statement of assignment alongwith reasons therefor. This endorsement is required to be signed by the Policyholder and the signature should be witnessed by any person competent to contract. An assignment can be only for valid reasons.

The insurance policy can be assigned for reasons of 'love and affection' within the immediate family members, or for a 'valid consideration' to any external person or entity. A majority of insurance policy assignments are carried out towards providing the insurance policy as a collateral security towards loans taken from financial institutions. In these cases, a condition is added to the endorsement which states that on the repayment of the loan, the policy shall stand automatically re-assigned to the policyholder and the future benefits shall become payable to the policyholder. Assignment of an insurance policy to an unrelated person without a valid consideration is also viewed as a possible route for money laundering, thereby attracting enhanced scrutiny.

Under the current laws, the Insurer has the limited authority of ensuring that the assignment documents are in order and has the obligation to register the assignment. The Insurer cannot deny an assignment. An assignment is effective on the date when the assignment documents in proper order are received by the Insurer.

Upon registration of the assignment with the Insurer, the Assignee becomes the absolute owner of the benefits under the policy. Any nominations made by the Assignor (Policyholder) stands cancelled. However some insurance policies enable granting of a loan by the Insurer, in which case the Policy gets assigned to the Insurer. Under such assignments, if the policy is reassigned or if the assignment is cancelled, the nomination made earlier by the policyholder survives and the policyholder is not required to make a fresh nomination after reassignment.

NOMINATION

Nomination is a facility that enables a Policyholder to nominate an individual, who can claim the proceeds of the Policy, upon the demise of the Policyholder.

Nomination is dealt with under Section 39 of the Insurance Act, 1938. It lays down that the Policyholder who holds a policy of life insurance on his own life, may nominate the person or persons to whom the money secured by the policy shall be paid in the event of his death.

Where any nominee is a minor, a major should be appointed to receive the money secured by the policy in the event of death of the policyholder during the minority of the nominee.

A nomination can be made either at the time of buying the policy or at any time before the policy matures for payment. Any nomination made earlier can be replaced by a new nomination during the term of the policy. Any such nomination in order to be effectual is required to be incorporated within the policy either by way of a text in the policy itself or by way of an endorsement to the policy. While it is the right of the Policyholder to effect the endorsement, in order to be effective, such nomination should be communicated by the policyholder to the Insurer and registered by the Insurer in the records relating to the policy.

Where a nomination is cancelled or changed by an endorsement or a will and a notice of such change in nomination is given by the policyholder to the Insurer, the Insurer is not liable for any payment made under the policy to a nominee mentioned in the text of the policy or registered in records of the insurer.

Where the policy matures for payment during the lifetime of the Policyholder or where the nominee(s) die before the policy matures for payment, the amount secured by the policy shall be payable to the policyholder or his heirs or legal representatives or the holder of a succession certificate, as the case may be.

Where the policy matures for payment during the lifetime of the person whose life is insured or where the nominee or, if there are more nominees than one, all the nominees

die before the policy-holder or his heirs or legal representatives or the holder of a succession certificate, as the case may be.

Where the nominee or, if there are more nominees than one, a nominee or nominees survive the person whose life is insured, the amount secured by the policy shall be payable to such survivor or survivors.

The legal position of a nominee in an insurance policy, has been well laid down by the Supreme Court in the Smt. Sarabati Devi & Anr v/s Smt. Usha Devi case where it held that a mere nomination made under Section 39 of the Insurance Act, 1938 does not have the effect of conferring on the nominee any beneficial interest in the amount payable under the life insurance policy on the death of the assured. The nomination only indicates the hand which is authorised to receive the amount, on the payment of which the insurer gets a valid discharge of its liability under the policy. The amount, however, can be claimed by the heirs of the assured in accordance with the law of succession governing them.

Difference between Nomination and Assignment:-

Nomination Assignment

1. Nomination is appointing some person(s) to receive policy benefits only when the policy has a death claim.

Assignment is transfer of rights, title and interest of the policy to some person(s).

2. In other words, by merely nominating someone, the right, title and interest of the insured over the policy is not transferred straight forwardly to that nominated person and remains with the insured person only.

In other words, the insurer is bound to pass over the benefits, claims and/or interests to the assigned person(s). Even during the time the insured is alive (or even prior to the death of the insured person). since the policy benefits are assigned till the time the assignment is revoked once again.

3. We can also say that Nominee is taken to be one of the named custodian of the insured (after his death) to whom the insurer are suppose to handover the policy benefits, claim proceeds subject to "No Objection" being raised by the legal heirs of the insured after his death. That means, the right of the legal heirs to recover the money from the nominee is protected by law.

4. Nomination is done at the instance of the insured

Along with the instance of the insured, consent of insurer is also required

5. It can be changed or revoked several times. Normally assignment is done once or twice during the policy period. Assignment can be normally revoked after obtaining the "no objection certificate" from the concerned Assignees.

TITLE AND CLAIMS IN LIFE INSURANCE

Title

A life insurance contract provides both survival and death benefits. Hence it is important to ascertain the ownership title to the contract at all stages of benefit payment. While usually the title to the insurance contract is held by the Policyholder, where the policy has been assigned, the title to the contract passes on to the Assignee and therefore the Assignee assumes the right to receive all survival and death benefits under the contract. In case of a benefit payable on death, the title to the contract passes on to the Assignee or nominee as the case may be. As discussed earlier, where a policy is assigned, the nomination is treated as cancelled and accordingly, the death benefits become payable to the Assignee. The title to the contract is always determined based on the policy records as available with the Insurer.

There are policies taken by the parent/legal guardian covering the life of a minor child where the benefits are intended to be passed on to the child when the child attains the age of majority. These are typically termed 'juvenile' policies. In these policies, the parent/legal guardian holds the title to the policy on behalf of the minor child till the child attains the age of majority. The policy provisions are designed in a manner such that the title to the policy automatically vests in the life assured, upon the child attaining the age of majority.

Claim:

A claim under a life insurance contract is triggered by the happening of one or more of the events covered under the insurance contract. Claims can be survival claims and death claim. While a death claim arises only upon the death of the life assured, survival claims can be caused by one or more events. Examples of events triggering survival claims are:

- (a) Maturity of the policy;
- (b) Surrender of the policy either by the policyholder or Assignee;
- (c) An instalment payable upon reaching the milestone under a money-back policy;
- (d) Critical illnesses covered under the policy as a rider benefit;

For payment of a survival claim, the Insurer has to ascertain that the event has occurred as per the conditions stipulated in the policy. Maturity claims, money-back instalment claims and surrender claims are easier to be established as they are based on dates and positive action by the policyholder. Critical illness claims are ascertained based on the medical and other records provided by the policyholder in support of his claim. The complexity arises in case of a policy that has a critical illness claim rider and such policy is assigned. It is intended that a critical illness benefit should be paid to the policyholder so as to enable him defray his expenses. However where the policy is assigned, all benefits are payable to the assignee which, although legally correct, may not meet the intended purpose. In order to avoid such situation, it is important to educate the policyholder of such policies on the extent of benefits that the policyholder may assign, by way of a conditional assignment.

The triggering of a maturity or death claim leads to termination of the insurance cover under the contract and no further insurance cover is available. This is irrespective of whether the claim is actually paid or not. Non payment of a claim does not assure the continuity of insurance cover under the contract.

While in most cases, a claim is disputed by the Insurer on the basis of such claim not meeting the policy conditions, there are times where the insurer has ascertained that the death claim is payable but is unable to settle the same due to conflicting claims or insufficiency of proof of title of the rightful claimant. This happens under the following circumstances:

1. Absence of nomination by the policyholder;
2. Registration of an assignment;
3. Multiple claimants with conflicting claims with insufficient proof of title;
4. Where the claimant has approached the Court for settlement of property disputes including insurance claims;
5. Circumstances where it is impossible for the Insurer to obtain a satisfactory discharge from the claimant.

Under these circumstances, Section 47 of the Insurance Act, 1938 provides as follows:

47. (1) Where in respect of any policy of life insurance maturing for payment an insurer is of opinion that by reason of conflicting claims to or insufficiency of proof of title to the amount secured thereby or for any other adequate reason it is impossible otherwise for the insurer to obtain a satisfactory discharge for the payment of such amount, the insurer may, apply to pay the amount into the Court within the jurisdiction of which is situated the place at which such amount is payable under the terms of the policy or otherwise.

(2) A receipt granted by the Court for any such payment shall be a satisfactory discharge to the insurer for the payment of such amount.

(3) An application for permission to make a payment into Court under this section, shall be made by a petition verified by an affidavit signed by a principal officer of the insurer setting forth the following particulars, namely:

- (a) the name of the insured person and his address;
- (b) if the insured person is deceased, the date and place of his death;
- (c) the nature of the policy and the amount secured by it;
- (d) the name and address of each claimant so far as is known to the insurer with details of every notice of claim received;
- (e) the reasons why in the opinion of the insurer satisfactory discharge cannot be obtained for the payment of the amount; and
- (f) the address at which the insurer may be served with notice of any proceeding relating to disposal of the amount paid into Court.

(4) An application under this section shall not be entertained by the Court if the application is made before the expiry of six months from the maturing of the policy by

survival, or from the date of receipt of notice by the insurer of the death of the insured, as the case may be.

(5) If it appears to the Court that a satisfactory discharge for the payment of the amount cannot otherwise be obtained by the insurer it shall allow the amount to be paid into Court and shall invest the amount in Government securities pending its disposal.

(6) The insurer shall transmit to the Court every notice of claim received after the making of the application under sub-section (3), and any payment required by the Court as costs of the proceedings or otherwise in connection with the disposal of the amount paid into Court shall as to the cost of the application under sub-section (3) be borne by the insurer and as to any other costs be in the discretion of the Court.

(7) The Court shall cause notice to be given to every ascertained claimant of the fact that the amount has been paid into Court, and shall cause notice at the cost of any claimant applying to withdraw the amount to be given to every other ascertained claimant.

(8) The Court shall decide all questions relating to the disposal of claims to the amount paid into Court.

Claims on small life insurance policies

47A (1) In the event of any dispute relating to the settlement of a claim on a policy of life insurance assuring a sum not exceeding two thousand rupees (exclusive of any profit or bonus not being a guaranteed profit or bonus) issued by an insurer in respect of insurance business transacted in India, arising between a claimant under the policy and the insurer who issued the policy or has otherwise assumed liability in respect thereof, the dispute may at the option of the claimant be referred to the Authority for decision and the Authority may, after giving an opportunity to the parties to be heard and after making such further inquiries as he may think fit, decide the matter.

(2) The decision of the Authority under this sub-section shall be final and shall not be called in question in any Court, and may be executed by the Court which would have been competent to decide the dispute if it had not been referred to the Authority as if it wore a decree passed by that Court.

(3) There shall be charged and collected in respect of the duties of the Authority under this section such fees whether by way of percentage or otherwise as may be prescribed. The IRDA (Protection of Policyholders Interests) Regulations, 2002 also provides as follows:

Regulation 8. Claims procedure in respect of a life insurance policy

(1) A life insurance policy shall state the primary documents which are normally required to be submitted by a claimant in support of a claim.

(2) A life insurance company, upon receiving a claim, shall process the claim without delay. Any queries or requirement of additional documents, to the extent possible, shall be raised all at once and not in a piecemeal manner, within a period of 15 days of the receipt of the claim.

(3) A claim under a life policy shall be paid or be disputed giving all the relevant reasons, within 30 days from the date of receipt of all relevant papers and clarifications required. However, where the circumstances of a claim warrant an investigation in the opinion of the insurance company, it shall initiate and complete such investigation at the earliest. Where in the opinion of the insurance company the circumstances of a claim warrant an investigation, it shall initiate and complete such investigation at the earliest, in any case not later than 6 months from the time of lodging the claim.

(4) Subject to the provisions of section 47 of the Act, where a claim is ready for payment but the payment cannot be made due to any reasons of a proper identification of the payee, the life insurer shall hold the amount for the benefit of the payee and such an amount shall earn interest at the rate applicable to a savings bank account with a scheduled bank (effective from 30 days following the submission of all papers and information).

(5) Where there is a delay on the part of the insurer in processing a claim for a reason other than the one covered by sub-regulation (4), the life insurance company shall pay interest on the claim amount at a rate which is 2% above the bank rate prevalent at the beginning of the financial year in which the claim is reviewed by it.

TAX LAW IMPLICATIONS IN LIFE INSURANCE:

Historically life insurance in India has been driven mainly by benefits doled out under the Income Tax Act, 1961. Different sections under the Income Tax Act, 1961 deal with benefits at the purchase, renewal and claim stages of a life insurance policy. Life insurance policies have been used as effective tax planning tools. Following are some of the sections under the Income Tax Act, 1961 dealing with tax benefits for life insurance policies:

Deductions under Sections 80C/80CCC/80D:

Under Section 80C of the Act, premiums paid by the Assessee on policies held by himself, spouse or children is eligible for deduction from gross total income. This is also applicable to a Hindu Undivided Family (HUF) where the Karta of the HUF pays premiums on policies held by any member of the HUF. Where the premiums payable under the policy exceeds 10% of the actual capital sum assured, the deduction is limited to 10% of the sum assured.

Section 80CCC deals with contributions to approved pension products. It lays down that an individual assessee who has paid premiums out of his income chargeable to tax to effect or keep in force a contract for any annuity plan of Life Insurance Corporation of India or any other insurer for receiving pension from the fund approved under Section 10 (23AAB), he shall be allowed a deduction in the computation of his total income, of the whole of the amount paid or deposited (excluding interest or bonus accrued or credited to the assessee's account, if any) upto a maximum of Rs.10000/- in the previous year.

However any amount received under the policy by the assessee either by way of surrender of the policy or pension from the annuity plan, such amount shall be treated as income chargeable to tax during the year of receipt.

Section 80CCD deals with contributions to approved pension products by an individual assessee. It lays down that where an assessee, being an individual has in the previous year paid or deposited any amount in his account under a notified pension scheme, he shall be allowed a deduction in the computation of his total income, of the whole of the amount so paid or deposited as does not exceed 10% of his salary (in case of Central Government employees) or 10% of his gross total income (in any other case) in the previous year.

However any amount received under the policy by the assessee either by way of surrender of the policy or pension from the annuity plan, such amount shall be treated as income chargeable to tax during the year of receipt.

CONCEPT OF TRUSTS IN LIFE POLICY

The concept of Trusts in a Life policy is necessitated by the applicability of estate duty on transfer/inheritance of benefits under a life insurance policy, including annuities. While with the abolition of estate duty in India, the concept of Trusts may no longer be preferred, it is beneficial to understand the subject in detail. Further Section 6 of the Married Women's Property Act, 1874 provides for security of benefits under a Life insurance policy to the wife and children and this is also been discussed later in this chapter.

A Trust under a life insurance policy is created by the Policyholder holding the policy on his own life and where the survival benefits inure to the policyholder. The Trust is set-up under a irrevocable, non-amendable Trust Deed and can hold one or more insurance policies. It is important to appoint a trustee for administration of the Trust property, being benefits under the life policy. By creating a Trust to hold the insurance policies, the policyholder gives up his rights under the policy and upon the death of the life insured, the Trustee invests the insurance proceeds and administers the Trust for one or more beneficiaries. While, it is a practice to create the Trust for the benefit of the spouse and children, the beneficiaries can be any other legal person. Creating a Trust ensures that the policy proceeds are invested wisely during the minority of the beneficiary and also secures the benefits against future creditors.

Section 6 of the Married Women's Property Act, 1874 also provides for creation of a Trust. It lays down that a policy of insurance effected by any married man on his own life, and expressed on the face of it to be for the benefit of his wife, or of his wife and children, or any of them, shall ensure and be deemed to be a trust for the benefit of his wife, or of his wife and children, or any of them, according to the interest so expressed, and shall not, so long any object of the trust remains, be subject to the control of the husband, or to his creditors, or form part of his estate.

If the Policyholder does not appoint a special trustee to receive and administer the benefits under the policy, the sum secured under the policy becomes payable to the Official Trustee of the State in which the office at which the insurance was effected is situated.

Creation of a Trust under the Act does not destroy or impede the right of any creditor to be paid out of the proceeds of any policy of assurance, which may have been effected with intent to defraud creditors.

STAMP DUTIES

Stamp duty payable on a policy of life insurance is governed by the Indian Stamp Act, 1899.

Section 2(19) of the Act defines a Policy of insurance to include a life-policy, and any policy insuring any person against accident or sickness, and any other personal insurance; Section 2(19A) of the Act defines a policy of group insurance to mean any instrument covering not less than fifty or such smaller number as the Central Government may approve, either generally or with reference to any particular case, by which an insurer, in consideration of a premium paid by an employer or by an employer and his employees jointly, engages to cover, with or without medical examination and for the sole benefit of persons other than the employer, the lives of all the employees or of any class of them, determined by conditions pertaining to the employment, for amounts of insurance based upon a plan which precludes individual selection;

Schedule 47(D) of Schedule 1 to the Indian Stamp Act, 1899 lays down the manner of calculation of stamp duty on a policy of life insurance. The stamp duty is calculated at 0.02% per Rs.1000/- sum assured. If a policy of group insurance is renewed or otherwise modified whereby the sum insured exceeds the sum previously insured, duty is payable on the excess sum so insured.

On a Policy of annuity, stamp duty is calculated as follows:

1. Annuity Certain – Where the annuity is guaranteed for a predetermined period, the amount of stamp duty will be based on the total annuity amount payable during such certain period i.e. the annuity per annum multiplied by number of years.
2. Annuity for Life – Where the annuity is payable during the lifetime of the annuitant, the amount of stamp duty will be based on the annuity amount payable for 12 years.

ROLE AND FUNCTION OF LIFE INSURANCE COMPANIES

Life Insurance Companies in India have a big role to play. It is the life insurance Companies which collects the savings of a person and converts into the wealth. The functions and role of Life Insurance Company may be understood as:

1. Saving Institution:

Life insurance companies both promote and mobilises saving in the country. The income tax concession provides further incentive to higher income persons to save through LIC's

policies. The total volume of insurance business has also been growing with the spread of insurance-consciousness in the country.

2. Term Financing Institution:

Life Insurance Companies also function as a large term financing institution (or a capital market) in the country. The annual net accrual of investible funds from life insurance business (after making all kinds of payments liabilities to the policy holders) and net income from its vast investment are quite large. During 1994-95, LIC's total income was ₹18,102.92 crore, consisting of premium income of ₹1152,80 crore investment income of ₹6336.19 crore, and miscellaneous income of ₹238.33 crore.

3. Investment Institutions:

LIC is a big investor of funds in government securities. Under the law, LIC is required to invest at least 50% of its accruals in the form of premium income in government and other approved securities.

LIC funds are also made available directly to the private sector through investment in shares, debentures, and loans. LIC also plays a significant role in developing the business of underwriting of new issues.

4. Stabiliser in Share Market:

LIC acts as a downward stabiliser in the share market. The continuous inflow of new funds enables LIC to buy shares when the market is weak. However, the LIC does not usually sell shares when the market is overshot. This is partly due to the continuous pressure for investing new funds and partly due to the disincentive of the capital gains tax.

5. Biggest Employers in economy

Life Insurance Companies in India are one of the biggest employers. In addition to direct employment, Lakhs of People are getting the employment as Agents.

LESSON ROUND UP

- Risk pooling Life insurance is based on a concept called risk pooling, or a group sharing of losses.
- People exposed to a risk agree to share losses fairly or on an equitable basis.
- The law of large numbers states that as the size of the sample (insured population) increases, the actual loss experience will more and more closely approximate the true underlying probability.
- The object of Insurance should be lawful; the person proposing for Insurance must have interest in the continued life of the insured & would suffer pecuniary loss if the insured dies.
- Where the proposal is on the life of another, unless the proposer has insurable interest in the life to be assured, the contract shall be void.

- Assignment is the transfer of the rights to receive the benefits under a contract accruing to the party to that contract.
- In life insurance parlance, assignment is the transfer of rights to receive benefits stated in the life insurance policy from the Policyholder to the Assignee.
- Nomination is a facility that enables a Policyholder to nominate an individual, who can claim the proceeds of the Policy, upon the demise of the Policyholder.
- While usually the title to the insurance contract is held by the Policyholder, where the policy has been assigned, the title to the contract passes on to the Assignee and therefore the Assignee assumes the right to receive all survival and death benefits under the contract.
- A claim under a life insurance contract is triggered by the happening of one or more of the events covered under the insurance contract.
- Claims under Section 80C of the Act, premiums paid by the assessee on policies held by himself, spouse or children is eligible for deduction from gross total income.
- The concept of Trusts in a Life policy is necessitated by the applicability of estate duty on transfer/inheritance of benefits under a life insurance policy, including annuities.

SELF TEST QUESTIONS

These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation.

1. Explain the basic principles of life insurance with examples.
2. What do you mean by Nomination? Explain the difference between Assignment and Nomination.
3. Describe Titles and Claims in insurance contracts.
4. What are the tax implications in life insurance under the Income Tax Act of India?
5. Write a short note on role and functions of Insurance companies.

LIFE INSURANCE & PENSION PRODUCTS

- Life Insurance Products Pure Protection Insurance Protection + Savings Insurance Pure Savings And Pensions
- Proposal Form
- Policy Contract And Documentation
- Lesson Round Up
- Self Test Questions

LEARNING OBJECTIVES

The main risks in respect of life insurance are:

1. Risk of dying too young;
2. Risk of living too long

While the risk of dying too young can be addressed by taking a pure term life insurance cover that protects the financial loss to the family on the death of the member, the risk of living too long is addressed by savings and pension plans that helps accumulate a corpus to be received as annuity during the old age. Pure protection plans provide a financial benefit for the family while pension plans provide a benefit for the policyholder himself.

In this chapter we will discuss about the various types of life insurance products that can be designed as per the regulations issued by the Insurance Regulatory and Development Authority. We further discuss the design and contents of a Proposal form, Policy contract and the documentation required at various stages of the Policy life cycle.

LIFE INSURANCE PRODUCTS

Section 2(11) of the Insurance Act, 1938 defines Life Insurance Business as follows: "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 contingency dependent on human life, and any contract which is subject to payment of premiums for a term dependent on human life and shall be deemed to include--

- (a) the granting of disability and double or triple indemnity accident benefits, if so provided in the contract of insurance,
- (b) the granting of annuities upon human life; and
- (c) the granting of superannuation allowances and annuities payable out of any fund applicable solely to the relief and maintenance of persons engaged or who have been engaged in any particular profession, trade or employment or of the dependents of such persons;

This definition is proposed to be amended in the Insurance Law Amendment Bill, 2008 where for the words "annuities payable out of any fund", the words "benefit payable out of any fund" have been substituted;

While under the current Act, health insurance has not been identified as a separate sector, the Bill proposes to introduce a separate sub-section to define health insurance business as follows:

(6C) "health insurance business" means the effecting of contracts which provide for sickness benefits or medical, surgical or hospital expense benefits, whether in-patient or out-patient on an indemnity, reimbursement, service, prepaid, hospital or other plans basis including assured benefits, long term care, overseas travel cover and personal accident cover

Given the above, life insurance products can be broadly classified into:

- (a) Pure protection plans;
- (b) Protection cum savings plans;
- (c) Pure savings and pension plans;

These can be further classified into:

- I. Term insurance & Health Insurance plans
- II. Endowment & Money-back plans
- III. Whole life plans
- IV. Pension and savings plans
- V. Unit linked insurance plans (ULIPs)
- VI. Variable Insurance plans (VIPs)

Further, apart from stand-alone health insurance companies providing health insurance products, health insurance is also provided by life insurance companies both as riders to other products as well as standalone health plans.

A graphical representation of the different types of life insurance plans is reproduced below:

Pure term insurance as well as Pension plans are also structured as Group insurance policies where a homogenous group of lives are covered. Variants of Group insurance are employer-employee groups, lender-borrower groups (credit life), social sector groups etc. In order to effectively regulate the sector, the IRDA has issued various regulations for different types of life insurance products. These regulations stipulate the structure and broad features of different types of products with a view to ensuring protection of policyholders interests as well as robust development of the industry.

The broad features of different types of insurance are discussed below:

A. PURE PROTECTION INSURANCE

A pure protection plan is a simple risk cover insurance product where the sum assured becomes payable upon the happening of the risk event during the term of the policy. The two variants of a pure protection plan are:

1. Term Insurance plan

A term insurance plan provides a pure risk cover where the sum assured becomes payable upon death of the life assured during the term of the policy. Since there is only a risk cover, the premiums are usually low and affordable and the policy assures a financial security to the family members upon death of the life assured. The term of the policy is fixed and where the life assured survives the full term, no amount is payable. Some variants of pure protection plans also assure a return of some or whole of the premiums paid if the life assured survives the term of the policy. The benefit arising to the insurance company in such case is the income out of the premiums invested during the term.

2. Health Insurance plan

A health insurance plan provides a pure risk cover where the sum assured becomes payable upon the life assured being diagnosed of certain identified illness during the term of the policy. Health insurance is also popularly known as Medical Insurance or Mediclaim that covers medical expenses including hospitalization expenses. The type and amount of health insurance depends upon the scope of illnesses covered and the extent of expenses required to be covered. Health insurance benefits are also available as riders in group insurance plans.

While life is very uncertain, a person may not stay healthy & fit throughout their life. Therefore it is prudent to have health cover at every stage of life. If a major illness like heart failure is diagnosed & the funds for treatment cannot be immediately arranged. It may lead to loss of life. If the family resorts to costly personal loans for treatment & the life of the person cannot be saved then the family could incur huge debts. Having health insurance cover can help to overcome this problem.

The age of a person at the time of taking the health cover is very vital. Usually health plans are annually renewable policies, the cost will increase as the person gets older, regardless of the age of the policyholder when the policy commences.

Some of the critical illnesses that are usually covered under a health insurance plan are:

– Blindness – Stroke – Major organ transplant – Multiple Sclerosis – Paraplegia – Aorta Surgery – Kidney failure – Heart attack – Cancer – Coma

The list of illnesses differs between various health plans of different insurance companies and the premium would also differ according to the illnesses covered.

B. PROTECTION + SAVINGS INSURANCE

Life insurance is usually a long term contract and thus is used world over as an effective investment instrument. In Protection cum Savings insurance products, in addition to getting a pure term insurance cover, the policyholder is also able to leverage long term savings. Life insurance plans are an excellent choice for providing for Protection needs, Long term goals such like children's education and marriage, retirement and others.

In such plans, the premium payable is divided into two parts:

– Premium for life coverage – provides financial protection in case of death
– Premium for savings element – Is invested by the insurance company on behalf of the policyholders.

The returns earned from investment are set-off against the expenses and the surplus is shared among policyholders in the form of bonuses. Here the investment risk is borne by the Insurance company.

(1) Endowment Insurance – An endowment insurance offers death cover if the life insured dies during the term of the policy and also offers a Survival benefit if the life insured survives until the maturity of the policy.

Some of the key features of an Endowment insurance plan are -

- If the life insured survives the entire term of the plan, then a specified amount is paid to him/her on maturity of the plan
- If the life insured dies before the maturity of the plan, then the death cover benefit is paid to the nominee/beneficiary
- Savings element: After deducting the death cover charges & administration charges from the premium, the remaining amount is invested by the insurance company. The returns earned are later paid back to the life insured in the form of bonuses.
- Goal-based investment: Helps in accumulating money for specific plans like a child's higher education or marriage, etc.
- Some insurance companies also allow partial withdrawal or loans against these policies
- There are different variants under this plan –
 - Higher death cover than the maturity benefit

– Maturity benefit is double the death cover, known as a double endowment insurance plan

(2) Whole of Life Insurance – A term insurance plan with an unspecified period is called a whole life plan. Some plans also have a savings element to them. The insurance company declares bonuses for these plans based on the returns earned on investments. As the name of the plan specifies, this plan covers the individual throughout their entire life. On the death of the life insured, the nominee/beneficiary is paid the sum insured along with the bonuses accumulated up until that point in time. During the individual's lifetime they can make partial withdrawals to meet emergency requirements. An individual can also take out loans against the policy. Although, in case of Whole Life Plans, sum assured is payable only on death, some insurers pay the sum assured when life insured completes a certain age. For example, 80 years, 90 years, 100 years, etc.

3. Unit Linked Insurance Plan

A Unit Linked Insurance Plan or 'ULIP' as it is popularly known is basically a combination of insurance as well as investments, similar to a protection cum savings plan. While a part of the premium paid is utilized to provide insurance cover to the policy holder the remaining portion is invested in various equity and debt schemes. A fund is created from a pool of premiums collected from policyholders and the fund is used to invest in various market instruments (debt and equity) in varying proportions similar to mutual funds. The significant difference between a protection cum savings plan and a ULIP is that the investment risk in a ULIP is borne by the policyholder (similar to a Mutual Fund), whereas the risk is borne by the Insurance company in the other case. The Policy holders can select the type of funds (debt or equity) or a mix of both based on their investment need and risk appetite. ULIP policy holders are allotted units and each unit has a net asset value (NAV) that is declared on a daily basis. The NAV is the value based on which the net rate of returns on ULIPs are determined. The NAV varies from one ULIP to another based on market conditions and the fund's performance.

Features - ULIP policy holders can make use of features such as top-up facilities, switching between various funds during the tenure of the policy, reduce or increase the level of protection, options to surrender, additional riders to enhance coverage and returns as well as tax benefits.

Types - There are a variety of ULIP plans to choose from based on the investment objectives of the investor, his risk appetite as well as the investment horizon. Some ULIPs allocate a larger portion of the invested capital in debt instruments while others purely invest in equity. Again, all this is totally based on the type of ULIP chosen for investment and the investor preference and risk appetite.

Charges - Unlike traditional insurance policies, ULIP schemes have a list of applicable charges that are deducted from the payable premium. The notable ones include policy

administration charges, premium allocation charges, fund switching charges, mortality charges, and a policy surrender or withdrawal charge. Some Insurer also charge "Guarantee Charge" as a percentage of Fund Value for built in minimum guarantee under the policy.

Risks - Since ULIP returns are directly linked to market performance and the investment risk in investment portfolio is borne entirely by the policy holder, one needs to thoroughly understand the risks involved and one's own risk absorption capacity before deciding to invest in ULIPs.

4. Variable Insurance Plan Variable life insurance is a permanent life insurance policy with an investment component. Variable universal life insurance can help meet the needs of those who want life insurance protection with the potential to build cash value. The policy has a cash value account, which is invested in a number of sub-accounts available in the policy. A sub-account act similar to a mutual fund, except it's only available within a variable life insurance policy. A typical variable life policy will have several sub-accounts to choose from, with some offering upwards of 50 different options. The cash value account has the potential to grow as the underlying investments in the policy's sub-accounts grow - at the same time, as the underlying investments drop, so may the cash value. The appeal to variable life insurance lies in the investment element available in the policy and the favorable tax treatment of the policy's cash value growth. Annual growth of the cash value account is not taxable as ordinary income. Furthermore, these values can be accessed in later years and, when done properly through loans using the account as collateral, instead of direct withdrawals, they may be received free of any income taxation. Similar to mutual funds and other types of investments, a variable life insurance policy must be presented with a prospectus detailing all policy charges, fees and sub-account expenses.

C. PURE SAVINGS AND PENSIONS

Pure savings and Pension plans address the risk of living too long. In the age of medical advancement where the mortality rates have declined and life span has increased significantly, it is important that the individual saves enough to meet his financial needs during the age when his earning capacity diminishes. In the Indian context, with the growth of the Indian economy, the nuclear family system is fast spreading and therefore old aged parents are left to fend for themselves. In order to mitigate the risk of not being able to meet financial needs during such old age, the savings and pension plans are effective tools.

These plans should be looked at two parts:

Savings or accumulation stage – Deferred Annuity Plans. Under the deferred annuity plan, the policyholder contributes a small amount on a monthly/quarterly/ annual basis and on maturity, the sum assured is used to buy a pension plan (immediate annuities) that will provide a monthly income throughout retirement. These plans are best when bought at a young age as the corpus depends upon the period of accumulation.

The term of the policy is called deferment period. During this period, the insurance company will invest the lump sum amount on behalf of the policyholder and earn returns on it. The maturity of the policy is called vesting where the accumulated corpus will be used to pay a regular annuity to the policyholder.

At the time of vesting the policyholder can decide whether to buy the immediate annuity plan from the same insurance company or some other life insurer of his choice. This option to choose the pension provider is known as the open market option.

At the time of vesting the policyholder will also have the choice of selecting the type of annuity plan that he would like from the annuity options available to him. The annuity payout will depend on the type of annuity chosen and the rates prevailing at the time of vesting.

The deferred annuity plans are available both in traditional and ULIP forms. In India the deferred annuity plans are largely driven by tax benefits.

Payout or annuity stage – Immediate Annuity Plans.

An annuity is a series of regular payments from an annuity provider (insurance company) to an individual (called the annuitant) in return for a lump sum (purchase price) or installment premiums for a specified number of years. Annuities are usually sold by life insurance companies. They may be purchased by a single lump sum payment or under a deferred annuity plan. The premium (purchase price) may be made by the person who is to be the annuitant or another annuity purchaser such as the annuitant's employer, other personal benefactor or a pension scheme.

The tax laws in India stipulate that upon vesting of a deferred annuity plan, only 1/3rd of the vested amount can be paid out as a lumpsum and the balance should be necessarily paid out only as annuities.

Some of the types of immediate annuities available in the market are:

- Life Annuity
- Life Annuity with returns
- Joint Life Annuity
- Guaranteed Annuity
- Increasing Annuity

PROPOSAL FORM

The Insurance policy is a legal contract between the Insurer and the Policyholder. As is required for any contract there is a proposal and an acceptance. The application document that is used for making the proposal is commonly known as the 'Proposal Form'. All the facts stated in the Proposal form becomes binding on both the parties and failure to appreciate its contents can lead to adverse consequences in the event of claim settlement. The Proposal form has been defined under IRDA (Protection of Policyholders' Interests) Regulations, 2002 as "it means a form to be filled in by the proposer for insurance for furnishing all material information required by the insurer in respect of a risk, in order to enable the insurer to decide whether to accept or decline, to undertake the risk, and in the

event of acceptance of the risk, to determine the rates, terms and conditions of a cover to be granted.

Explanation: “Material” for the purpose of these regulations shall mean and include all important, essential and relevant information in the context of underwriting the risk to be covered by the insurer.”

While the IRDA had defined the Proposal form, the design and content was left open to the discretion of the Insurance company. However based on the feedback received from policyholders, intermediaries, Ombudsmen and Insurance companies, the IRDA felt it necessary to standardise the form and content of the Proposal Form. Thus the IRDA has issued the IRDA (Standard Proposal form for Life Insurance) Regulations, 2013. While the IRDA has prescribed the design and content, it has provided the flexibility to the Insurance companies for seeking additional information. The Proposal form carries detailed instructions not only for the Proposer and the Proposed Life Insured but also to the Intermediary who solicits the policy and assists in filling up the form.

It also requires the Proposer and the Proposed Insured to declare the correctness and authenticity of the information provided in the form. In addition, the Intermediary is required to certify that he has explained the features of the policy, including terms and conditions, premium requirements, exclusions and applicable charges to the Proposer. It is pertinent to mention here that the Proposal form gains utmost importance in any insurance contract, as the insurance company offers a cover on the basis of information provided in the Proposal form. Through the Proposal form, the Insurer seeks to elicit all material information of the Proposer and the Proposed Insured, which includes name, age, address, education, income and employment details of the Proposer, medical history of the Proposed Insured and his family members, income details, any existing life insurance cover on the Proposer as well as Proposed Insured. The Information sought in the Proposal form is important for an insurance company to assess the risk that can be underwritten and also to comply with other regulatory requirements such as the ‘Know Your Customer’ norms.

The IRDA regulations divide the Proposal form into the following broad sections:

Section A – contains details of the Proposer;

Section B – contains specialised/additional information which may vary based on the product;

Section C – contains suitability analysis which is highly recommended;

Section D – contains details of the product proposed.

Some of the Insurers also have online versions of the Proposal form, through which an Insurance policy can be proposed online by the Proposer on the website of the Insurance Company.

The Intermediary plays a very vital role in executing the Proposal form. It is the responsibility of the intermediary to not only explain the features and benefits of the

product but also explain the significance of the information sought in the Proposal form and thus help the Proposer appreciate the essence of material information.

This is where the doctrine of “Uberrima fides” becomes very important. The Insurance Company relies on the information provided in the Proposal form for taking a decision on acceptance of the risk and issuing the Insurance policy. In the event it is discovered later that the information provided was incorrect or any material fact was concealed in the Proposal form, the Insurance Company may deny paying benefits under the Policy. Insurance litigations in the country are predominantly on the premise of rejection of claim due to nondisclosure of material facts and there are numerous cases which have reinforced the principle of “Uberrima fides”.

POLICY CONTRACT AND DOCUMENTATION

An Insurance Contract is known as a contract of 'Uberrimate Fides' or a contract based on 'utmost good faith', which means both the parties must disclose all material facts.

Insurance contract is regulated by guidelines, rules, regulations, notifications and circulars of IRDA though not defined anywhere. It is an Intangible product. In return for the price (premium), the insurance companies issue the policies which are stamped and legally enforceable document. This insurance document is basically a promise to pay for covered loss according to its terms and conditions.

Policy contract has the same meaning as stated u/s. 10 of Indian Contract Act, 1872, “All agreements are contracts if they are made by the free consent of parties competent to contract, for a lawful consideration and with a lawful object, and are not hereby expressly declared to be void. Nothing herein contained shall affect any law in force in, and not hereby expressly repealed, by which any contract is required to be made in writing or in the presence of witnesses, or any law relating to the registration of documents”.

A Policy Contract needs to necessarily have all the ingredients as mentioned under Indian Contract Act, the prominent amongst them are communication, acceptance, consideration etc. However, unlike any other contract, an Insurance Contract commences only on communication of acceptance. Mere silence to the proposal doesn't complete the contract. There has to be an acceptance to the proposal which should be communicated.

In a contract of insurance the insurer undertakes to protect the insured from a specified loss and the insurer receives a premium for running the risk of such loss. Insurance Contract entered into by mis-representation of facts, coercion or fraud, will not hold good in Law and the party in default will not enjoy the benefits under the same.

IRDA (Protection of Policy holders' Interest) Regulations, 2002, under clause 6 stipulates the matters to be included in a Life Insurance Policy Contract.

As per Regulation 6, A Life insurance policy shall clearly state:

- (a) the name of the plan governing the policy, its terms and conditions;
- (b) whether it is participating in profits or not;
- (c) the basis of participation in profits such as cash bonus, deferred bonus, simple or compound reversionary bonus;

- (d) the benefits payable and the contingencies upon which these are payable and the other terms and conditions of the insurance contract;
- (e) the details of the riders attaching to the main policy;
- (f) the date of commencement of risk and the date of maturity or date(s) on which the benefits are payable;
- (g) the premiums payable, periodicity of payment, grace period allowed for payment of the premium, the date the last instalment of premium, the implication of discontinuing the payment of an instalment(s) of premium and also the provisions of a guaranteed surrender value.
- (h) the age at entry and whether the same has been admitted;
- (i) the policy requirements for (a) conversion of the policy into paid-up policy, (b) surrender, (c) nonforfeiture and (d) revival of lapsed policies;
- (j) contingencies excluded from the scope of the cover, both in respect of the main policy and the riders;
- (k) the provisions for nomination, assignment, and loans on security of the policy and a statement that the rate of interest payable on such loan amount shall be as prescribed by the insurer at the time of taking the loan;
- (l) any special clauses or conditions, such as, first pregnancy clause, suicide clause etc.; and
- (m) the address of the insurer to which all communications in respect of the policy shall be sent;
- (n) the documents that are normally required to be submitted by a claimant in support of a claim under the policy.

The Policy contract is approved by the IRDA. The IRDA has advised that the language of the policy contract should be simple, unambiguous, clear and consistent for better understanding of common man.

Guidelines on Insurance Repositories and Electronic Issuance of Policy contract, 2011 is a major breakthrough in Insurance arena, where procedures have been laid down for appointment of Insurance repositories and electronic issuance of policy contract. Despite the regulation, most of the Insurance Companies are yet to fully avail the fruitfully benefit of such advanced technology, which would not only benefit the Insurance company but also the Insured from operational and servicing view point.

Though the Insurance Contract is of utmost significance in the life of an Insured who avails the same to cover his life, health, old age and investment, it is given least importance and is not even being perused

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completely to know its features and benefits, thus resulting into various issues of mis-selling, which causing hindrance to the growth of Insurance Industry.

LESSON ROUND-UP

- In order to effectively regulate the sector, the IRDA has issued various regulations for different types of life insurance products.
- A pure protection plan is a simple risk cover insurance product where the sum assured becomes payable upon the happening of the risk event during the term of the policy.
- A term insurance plan provides a pure risk cover where the sum assured becomes payable upon death of the life assured during the term of the policy.
- A health insurance plan provides a pure risk cover where the sum assured becomes payable upon the life assured being diagnosed of certain identified illness during the term of the policy.
- In Protection cum Savings insurance products, in addition to getting a pure term insurance cover, the policyholder is also able to leverage long term savings.
- An endowment insurance offers death cover if the life insured dies during the term of the policy and also offers a Survival benefit if the life insured survives until the maturity of the policy
- A term insurance plan with an unspecified period is called a whole life plan. A Unit Linked Insurance Plan or 'ULIP' as it is popularly known is basically a combination of insurance as well as investments, similar to a protection cum savings plan.
- Variable life insurance is a permanent life insurance policy with an investment component.
- Pure savings and Pension plans address the risk of living too long. In the age of medical advancement where the mortality rates have declined and life span has increased significantly, it is important that the individual saves enough to meet his financial needs during the age when his earning capacity diminishes.
- The Insurance policy is a legal contract between the Insurer and the Policyholder. As is required for any contract there is a proposal and an acceptance.
- The application document that is used for making the proposal is commonly known as the 'Proposal Form'.
- Policy contract has the same meaning as stated u/s. 10 of Indian Contract Act, 1872.
- A Policy Contract needs to necessarily have all the ingredients as mentioned under Indian Contract Act, the prominent amongst them are communication, acceptance, consideration etc.

SELF-TEST QUESTIONS

(These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation)

1. Explain the broad features of Pure protection plans of life insurance.
2. What are the characteristics of endowment insurance?
3. What are ULIPS? Explain its features and importance.
4. What are the matters to be included in a Life Insurance Policy Contract under IRDA (Protection of Policy holders' Interest) Regulations, 2002
5. Write a short note on the Proposal form under IRDA (Protection of Policyholders'.

