Module 2

Risk Management and Insurance

This session will help you understand

- Risks and risk management
- Insurance
- Life Insurance Need and Analysis
- Analysis of an Insurance Policy
- Agent Regulation
- Claims handling

What is a Risk?

- An uncertain event or condition, which if occurs, would have an undefined or unknown impact on achievement of objective.

Causal Forces

- Natural Perils: Fire, wind, hail, explosion.
- Human Perils: Theft, riot, vandalism, negligence.
- Economic Perils: Stock market declines, inflation, technological advances.

Classification of Risks

Pure

No Prospect of gain, only Loss. Eg- Fire
Types:

- **Property Damage Risk-** Risk of loss to personal belongings due to theft, accident, fire & Natural disasters
- **Liability Risk-** Risk of economic loss resulting from your being held responsible for harming others or their property
- **Personal Risk-** Risk of death, poor health or outliving savings

Speculative

Offers the possibility of gain or loss.

These are generally not Insurable

Fundamental

Tend to affect large sections of society or even the world, rather than an individual.

Particular

Restricted Consequences

Most insurable risks are particular risk

Financial

Possibility of Financial Risks

Methods of handling risks

Avoiding	Controlling	Accepting	Transferring
To avoid the risk altogether. For Eg: Not Investing in the stock market, to avoid financial loss	Take steps to prevent losses. For Eg: Controlling the risk of fire in a cotton godown by banning smoking in godown.	To accept or retain the risk and to assume all financial responsibility for that risk.	Transferring the risk to another party and shifting the financial responsibility to that party, Generally for a fee Eg. Insurance

Basic Characteristics of Insurance

- Risk pooling:
  - Risk transfer from individual to a pool of the insurance company's policyholders.
  - The company charges premium for accepting risk
  - It 'pools' premiums from a group of policyholders into a general fund to fund the death benefits under contract.
- Law of large numbers:
  - Larger the pool, more predictable the amount of losses in a given period.
  - Since not all members of the pool are the same age or in the same health condition, we can assume not all of them will be making a claim at the same time.

Requirements of Insurable Risks

- Sufficient number of homogeneous exposure
- The loss must occur by chance
- The loss must be definite
- The loss must be significant
- The loss rate must be predictable
- The loss must not be catastrophic to the insurer

Advantages and Disadvantages of insurance in handling risks

Advantages

- Indemnification:
  - Rupee benefits paid or services rendered to insured who suffer covered losses
  - Continuity in operations at or close to the same rate as before the accident.
- Reduction of uncertainty
  - Permits lengthening planning horizons
  - Allows the firm to accept more uncertainties in other areas
  - May contribute to improved performance

Disadvantages

- Less incentive for loss control:
  - Insurer's expected loss estimate will rise, causing premiums to rise.
  - Insurance does not cover all the financial consequences of insured events.
  - Lax attitude toward loss control of insured events is likely to increase the incidence of non-insured events.
- Exaggeration or false reporting of insured claims:
  - Subsequently premiums may rise or there may be difficulty retaining insurance coverage.
  - Insured may benefit, but society does not

Personal Risk Management

What is Risk Management?

- Process that uses physical & human resources to accomplish certain objectives concerning most pure loss exposures.
- Concerned with recognizing risks, severity and controlling of risks.
- The identification, analysis and economic control of risks which can threaten the life, assets or earning capacity of an individual/enterprise.

Objectives of Risk Management- Post Loss

Survival

- Most important & Basic Post loss objective.
- Aim is to ensure atleast partial resumption of operations within reasonable time frame

Continuity of operations

- Important for the entity to continue to serve clients and customers.
- They may otherwise turn to competitors and not return

Earnings Stability

- Continue operations at no increase in cost.
- Funds to replace lost earnings resulting from loss of operation.
- A combination of the above.
- Perfect stability is not the goal

Continued Growth

- Product & Market Development.
- Acquisitions & Mergers

Social Responsibility

- Good citizenship resulting in a good image

Objectives of Risk Management- Pre Loss

Economy

- Firms seek to prepare for possible happenings in economical ways consistent with post loss goals.

Reduce Anxiety

- Reduce fear created because of uncertainty and costs.

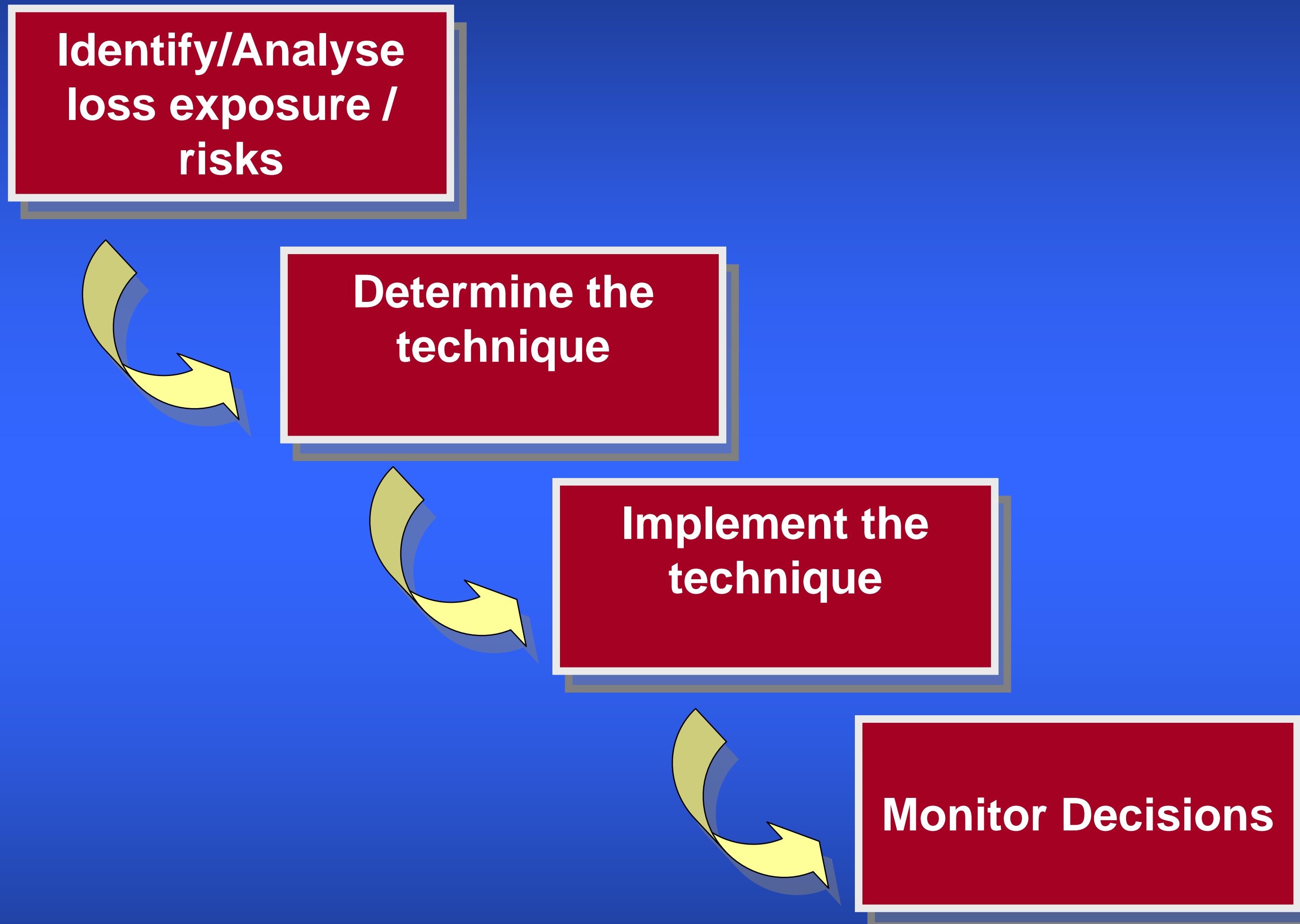
Meeting External Obligations

- Satisfies responsibilities imposed by others.
- Requirement of insured property as collateral

Social Responsibility

- Measures taken prior to loss contributes to the reduction of fear of loss.

Steps in Personal Risk Management



Insurance Market Dynamics and Underwriting Cycle

Insurance Market Dynamics & Underwriting Cycle

Demand Pattern:

- Relatively fixed
- pricing not very important
- demand curve relatively flat.
- price is mainly determined by supply.

Commodity Nature

- Generally price and features in a particular segment are more or less same.
- Price cannot be a differentiating proposition so they tend to create brand names for their products.

Insurance Market Dynamics

- **Attributes creating brand:**

  Scheme coverage, financial strength of company, flexibility in customizing insurance program to meet customer needs and claims-handling setup.

  This may cause different insurers to have different demand curves. This somewhat **de-commoditize** insurance products.

- Different insurance companies have different supply curves because of the following:
  - **Underwriting selection** -Less claims, less cost, more profit, more supply
  - **Cost of company expenses, taxes, commission** - Different companies have different degrees of success at controlling expenses.
- Commodity-type nature of the insurance market place gives it a business cycle.

Insurance Market Dynamics

- The business cycle begins with low supply. The low supply may be due to insurers losing money.

Legal Principles of Insurance

Legal Principles of Insurance

- Insurance - contractual agreement between the insurer and the insured.

- Should also meet all the requirements of a valid contract:
  - Offer and acceptance
  - Consideration
  - Legal capacity of parties and
  - Purpose of contract should be legal and not contrary to public interest

Legal Principles of insurance

Offer and Acceptance

- Should be a definite and unqualified offer by one party , accepted by another party in the exact terms.
- Free Consent
- Need not be in writing, verbal contracts are also valid.
- The offer is made by the prospect and the insurer may accept the same or make a counter offer with some modifications

Consideration

- The binding force in any contract.
- Consideration made by insurer- promise to pay/ compensate in case of insured event occurring.
- Consideration made by the Insured- payment of premium or the promise to pay future premiums
- In life insurance, only the first premium constitutes consideration.
- Subsequent premiums are conditions for continuation of contract.

Legal Capacity

- Parties to the contract must be capable of entering into a contractual agreement.
- Minor, insane or intoxicated persons are not competent to make or enter into contracts.

Legal Purpose

- A contract, the purpose of which is illegal or against public interest in unenforceable.
- Presence of insurable interest is a must.

Legal Principles of Insurance

Insurance contracts are special type of contracts which have certain additional distinguishing features associated with it.

- Indemnity
- Insurable interest
- Subrogation
- Utmost good faith
- Adhesion
- Waiver & estoppels

Indemnity

- Insurer will make good the loss / damage in such a manner that financially, the insured is neither better off nor worse off as a result of the loss.

- Principle is generally applied in insurance where the loss suffered by the insured is measurable in terms of money.

- *It does not apply to insurance of persons where it is not possible to measure the financial loss caused by death of the insured or bodily injury sustained.*

- Any loss or damage under an insurance contract is settled based on the sum insured under the policy.

Indemnity

- The insured cannot gain by over-insuring his property. But he will lose by under-insurance.
- Principle of indemnity states that the insured cannot claim more than what he has lost, although he has insured the property for a higher value.
- He cannot get full indemnity under the policy if he has insured property for a lower value.
- Fire Insurance: provision can be made to cover the building, plant and machinery on reinstatement value basis- *the cost of replacing or reinstating the destroyed property by new property which is neither superior to, nor more extensive than the insured property when new*

Indemnity

- Wholesale merchants: in respect of goods only, by effecting contract price insurance, if due to operation of an insured peril any loss occurs, the settlement of losses is allowed on the basis of the contract price and not on market value.
- Marine policies are construed to be Agreed Value policies, i.e. when the basis of valuation of the consignment is agreed in advance and incorporated in the policy, settlement of claim is made accordingly.
- In other words, even incidentals and profit to a reasonable extent can be included in the marine cover.
- As regards the customs duty element, it is one of pure indemnity and when a claim arises, claim settlement is made on the basis of either the insured customs duty or actual customs duty, whichever is less.

Insurable Interest

- The insured must
  - bear a legal relationship to the subject matter of the concerned insurance cover.
  - He should stand to benefit by the safety of the property, rights, and interest and lose by any loss, damage, injury or creation of liability
- Insurable interest is required throughout the period of contract in all classes of property insurance except Marine Insurance, where such existence is necessary only at the time of a claim.

Insurable Interest- Life Insurance

- Insurable interest in life insurance contracts requires somewhat different relationship to exist.
- The family relationship of husband and wife is universally accepted to satisfy the requirement of insurable interest.
- Acceptance of other relationships depends.
- Insurable interest has to be established to exist at the time of entering into the contract only.

Subrogation

- The transfer of rights and remedies of the insured to the insurer who has indemnified the insured.
- Applicable only to indemnity contracts… not to life insurance.
- If subrogation rights are not given to the insurer, the insured can recover the losses from the insurer as well as the person responsible for the loss, viz., carrier, bailee etc.
- This defeats the very principle of indemnity
- The insurer gets the right only after indemnifying the insured. But by an express condition under fire insurance contracts the position is altered. The insurer gets the subrogation rights even before indemnifying the insured.

Subrogation

- Subrogation applicable only to the extent of indemnification by the insurer. He cannot recover more than what he has paid.
- In cases where the insured has not been indemnified fully, any amount recovered from any third party in excess of the claim payment made by the insurer has to go insured
- The insurer, after making good the loss, tries to recover the same from the person who was responsible for the loss.
- Therefore, insurance contracts are subjected by law to a higher duty, that is, of utmost good faith.

Utmost good faith

- The law requires all contracts, to be made in good faith- in absence of fraud or deceit.
- Commercial contracts will be a nullity if one of the parties has committed breach of trust, resulting in fraud or deceit.
- In Insurance, the insurer, in a majority of cases has no knowledge or no opportunity to inspect the risk , as the proposer only has this information.
- Insurance Contracts are therefore subject to the Principle of Utmost Good faith.
- States that the proposer must, in utmost good faith, declare all material facts that would influence the insurers decision to accept the risk.

Utmost Good Faith

- This principle is more applicable to the insured, who will do well to scrutinize the document issued to him with care and satisfy himself that what he has received is really what he wanted
- The principle of utmost good faith can cause harassment to the insured if a proposal form is vaguely filled in and does not give the details, which the insurer wants.
- As far as possible it is advisable to get the insurance companies' representative / surveyor to inspect the risk and satisfy himself that what the proposer wants is acceptable to him.
- The policy should be issued to the extent possible on the basis of an inspection by the insurer. He will then not be able to contest that there was any misrepresentation or concealment of facts.

Average

- If the sum insured is less than the sum to be insured the principle of average will be applied and the claim settlement will be less than the loss actually suffered.

- The market value of the insured at the time of a loss will be taken by the insurer as the sum to be insured.

- Exceptions to this rule are as follows:
  - In cases of wholesale merchants, by effecting contract price insurance, if any loss occurs to goods due to insured peril, loss settlement is allowed on the basis of the contract price and not market value.
  - Under Marine insurance, even incidentals and profit to a reasonable extent be included can be included in the marine cover.
  - As regards the customs duty element, it is one of pure indemnity and when a claim arises, claim settlement is made on the basis of either the insured customs duty or actual custom

Contribution

- Defined as the right of an insurer, who has paid a loss under a policy to recover a proportionate amount from other insurers, who are also liable for the loss.

- If two insurances are affected on the same property, the insured cannot claim from both the insurers. By the contribution principle, each insurer will pay the loss to the extent of his ratable proportion.

Proximate Cause

- This principle serves to define the scope of coverage under the insurance contract and also to protect the rights of the parties to the contract.
- *"The active efficient cause that sets in motion a chain of events which brings about a result, without the intervention of any new force started and working actively from a new independent source."*
- Effect of this principle is to keep scope of the insurance within the limits intended by both the parties when the contract was made.
- In the absence of this rule, every loss could be claimed by the insured and every loss could be rejected by the insurer

Consideration

- In case of Insurance - Amount of premium paid to the Insurance company.
- The Insurance Act stipulates that payment of premium for any general insurance policy should be effected before assumption of the risk (either by cheque or in cash).
- The obligation is on the part of the proposer and the insurance company to account for the premium before the date of commencement of insurance.
- It is advisable to submit the proposal and effect payment of the bill, well in advance to ensure that there is no gap as between the time at which a policy is decided to be taken or renewed.

Adhesion

- The terms and conditions of the contract are fixed by one party (insurer) and with minor exceptions, must be accepted or rejected in total by the other party (the proposer or the prospective policy owner).

- It is not drawn up by negotiation between the two parties.

- Any ambiguity or unclear elements in the contract will be construed in favour of the party not participating in the design of the wording of the contract- insured.

Waiver and Estoppel

- Directly related to the responsibilities of insurance agents.
- Waiver is defined as the intentional and voluntary giving up of a known right. An insurance company may waive its right to cancel a policy for nonpayment by accepting late payments.
- *Estoppel* means that a party may be precluded by his or her acts of conduct from asserting a right that would act to the detriment of the other party, when the other party has relied upon the conduct of the first party and has acted upon it. An insurer may waive a right, and then after the policyholder has relied upon the waiver and acted upon it, the insurer will be estopped from asserting the right.

Co-insurance

- Sharing of insurance by two or more insurers (or even by the insured himself) in some agreed proportion.

- The co-insurance where there is a sharing of risk between the insurer and the insured (also called copay) is called under-insurance in India.

- In a co-insurance, claims under a policy are shared by all insurers in the same proportion as their shares bear to the total value insured.

- Co-insurance is generally observed in large commercial insurance, where one insurer does want to retain the whole risk.

Co-insurance – operates in 3 ways

- Each insurer issues a separate policy for his share of the insurance and will attach a co-insurance clause limiting his liability in accordance with the share of premium held by him.

- One insurer acts as a leader and is responsible for risk survey, rating, and collection of premium and completion of insurance contract.
- The leading company prepares a specification showing the shares of all insurers and attaches to it, the policy.
- Each insurer then puts his signature on the specification for its share in the policy.
- This is called collective policy.

- The third method is very common.
- Involves leading office to issue the policy and sign on behalf of the participating insurers.
- A clause called collective insurance clause is incorporated in the policy, which sets out the liability of each insurer in case of a claim under the policy.

Some problems of Co-insurance

- Insurers, particularly lead insurers do not prefer it. They have to provide services to the insured without enjoying the full premium.
- Recovery of claims from co-insurers is also a problem.
- The insured usually does not prefer co-insurance, particularly the first type of co-insurance where each co-insurer issues a separate policy.
- Liaising with all co-insurers in case of a claim, may be a tedious job.

Endorsement/riders

- An endorsement usually changes a provision in the contract to which it is attached.
- It may add or delete exclusion, for example, or define or redefine a term used in the contract.
- Policyholders often assume that endorsements improve the coverage provided by the contract (as in "my contract was endorsed to cover theft losses").
- However, endorsements can remove coverage just as well as they provide it. Some endorsements, for example, may serve to define perils in ways that eliminate coverage courts have found the standard contract to provide.

Legal Liability

Legal Liability Insurance

- Protects individuals and organizations against financial implications due to lawsuits.
- The concept of legal liability has developed from the English common law principle of 'Duty of care'.
- Means that every individual owes a duty of care, which means not causing any injury or suffering to fellow citizens. When this duty is breached, the person is legally liable to compensate the affected parties.
- There are three areas of law under which legal liability risks may arise:
  - *under statute,*
  - *under contract and*
  - *at common law.*

Torts

Involves a breach of civil duty and the person who commits the tort is known as the tortfeasor.

Torts can be classified as under:

- Intentional torts
- Absolute liability/strict liability.
- Negligence

Types of Torts

Intentional Torts

- Result in injury or suffering to others.
- Acts are committed intentionally and are within the control if the insured- can be generally avoidable and are not insurable.
- Some examples
  1. **Libel**: It is the publication of a false statement in a permanent form designed to damage the reputation of another person.
  2. **Slander**: It is similar to libel but in verbal form
  3. **Assault**: It is touching another person unlawfully

Absolute Liability

- Absolute Liability: Sometimes liabilities arise because a law dictates it- arises because of a statute.
- In this case, the negligence or fault need not be established by the affected party. It is also known as 'No Fault Liability'.
- Eg- Employer is legally liable for injury to employee even if there is no negligence on part of the employer.

Strict Liability

- If land is used unnaturally by bringing or collecting or keeping some thing for one's own purposes which can cause mischief to others if it escapes, the person is prima facie answerable for all the damage which is the natural consequence of its escape.
- In case of strict liability certain defenses are allowed..
- For example, if an employee has sustained injuries resulting from his direct disobedience or drunkenness then the employer is not liable. But in case of absolute liability, such defenses are not allowed.

Types of Torts…

Other Liabilities

- **Law of negligence:**
  - Simply put it means- negligence means not doing something, which a reasonable man would do, and doing something, which a reasonable man would not do.
- **Duty of care:**
  - Lord Atkins', 'Neighbour principle' comes to some help in deciding if duty or care exists.
  - States that a general duty of care exists towards all legal neighbours - those closely and directly affected by our act or omission at the time the tort is committed.
- **Vicarious Liability:**
  - Follows the legal doctrine '*respondent superior*'. The word 'vicarious' means 'in place of others'.
  - Vicarious liability arises in case of employer - employee relationship.
  - Employers are vicariously liable to others for the actions of their employees committed while performing their duty.
  - Based on the principle that the employer is financially stronger than the employee and is better able to bear the damage.

Indian Civil Justice System…….

Supreme Court of India

- This apex court is the final court of permissible appeal.
- It also deals with:
- Inter-state matters
- Matters involving more than one State
- Matters between the Union Government and any one or more States

High Courts

- Next in hierarchy after Supreme Court.
- Every state in India has a high court that works under direct guidance and supervision of the Supreme Court.
- The uppermost court in the state & generally the last court of regular appeal.
- Can be approached in writs for violation of fundamental rights under articles 32 and 226 of the Indian Constitution.
- When apparently there is no effective remedy available to a person in equity, he can always move the High Court in an appropriate writ.

Subordinate Courts

- District Courts- hear appeals from districts
- Appellate Labour Courts- hear appeals from the judgments and orders of the subordinate original Labour Courts and officers, under the provisions of various labour and related laws.
- Accident Claims Tribunals- try the claims of road and rail accidents
- City Civil Courts- only present in presidency towns- Mumbai, Chennai & Kolkata.
- Special Courts- setup from time to time to try particular matters deemed to be Important to public life
- Sub-subordinate courts- Litigation mostly begins in these courts
- Labour Courts

Identification of Risk Exposures

Collection of Information

- An appropriate advice to the client on insurance requires sound understanding of the client's current position and future plans.

- This requires collection of information about the client, which may generally include:
  - Banks statements
  - Tax returns
  - Last annual statement for insurance policies
  - Superannuation details
  - Credit card statement, current and previous cheque book

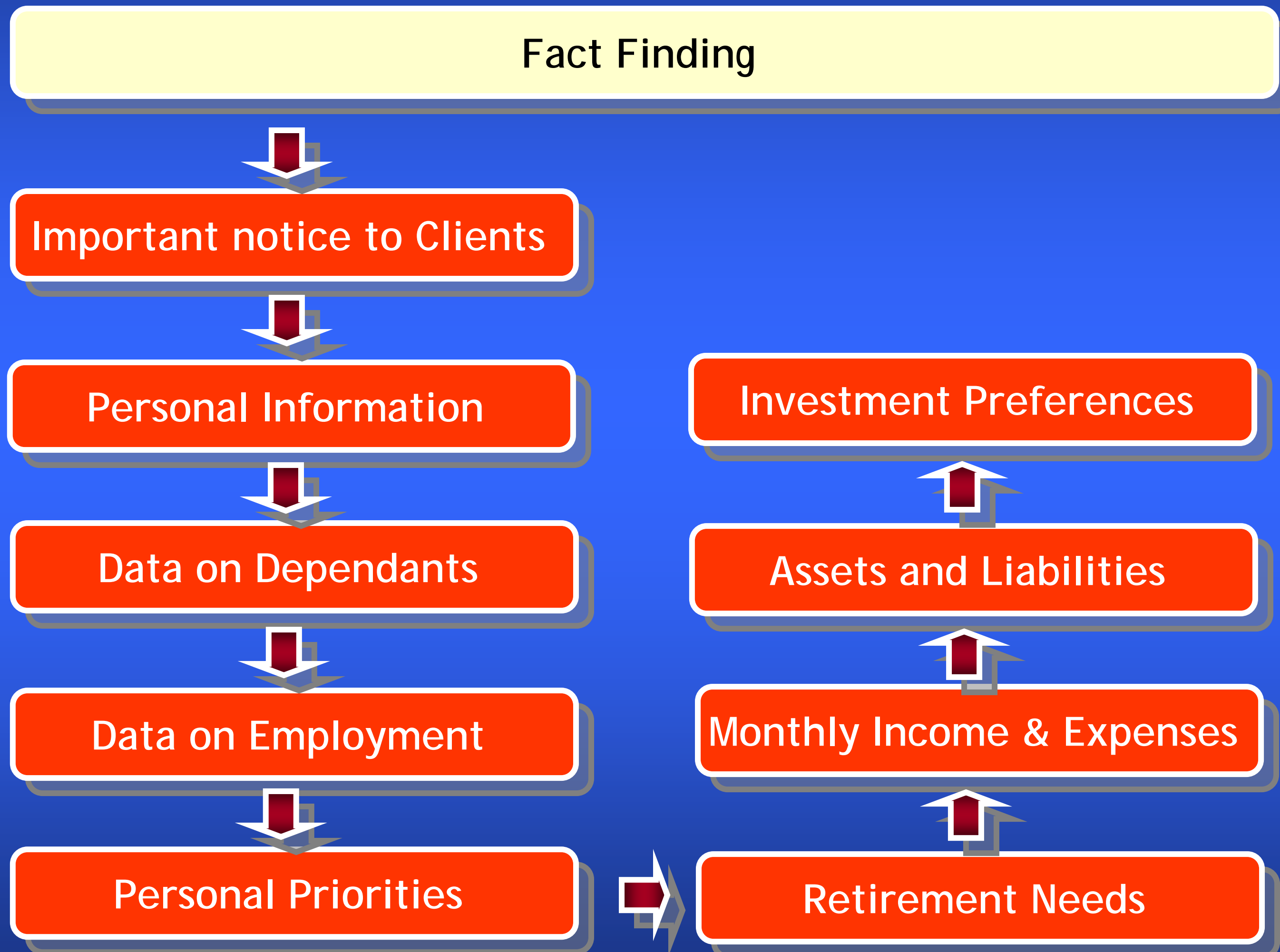
Types of Financial Needs

- Financially providing for the individual and his family during unpredictable events such as the death or disability of the breadwinner.
- The types of needs a person normally has are:

Need	Description
Emergency Fund	Reserved for use during crises or emergencies
Educational Fund	Keeping aside a sum of money for child's higher education needs.
Final Expenses	Fund to be used for payment of liabilities/ expenses immediately after an individuals death.
Fund to redeem mortgage	Keep aside a sufficient sum of money for paying off loans in case of death.
Income Needs	Income to family in case the breadwinner passes away. Required for essentials, non-essentials and expense payments.
Retirement Income	For helping the client live out his retirement comfortably
Accumulation needs	Accumulation of money for purchase of an asset, starting a business, charity and so on.
Other needs	Any other need not discussed above.

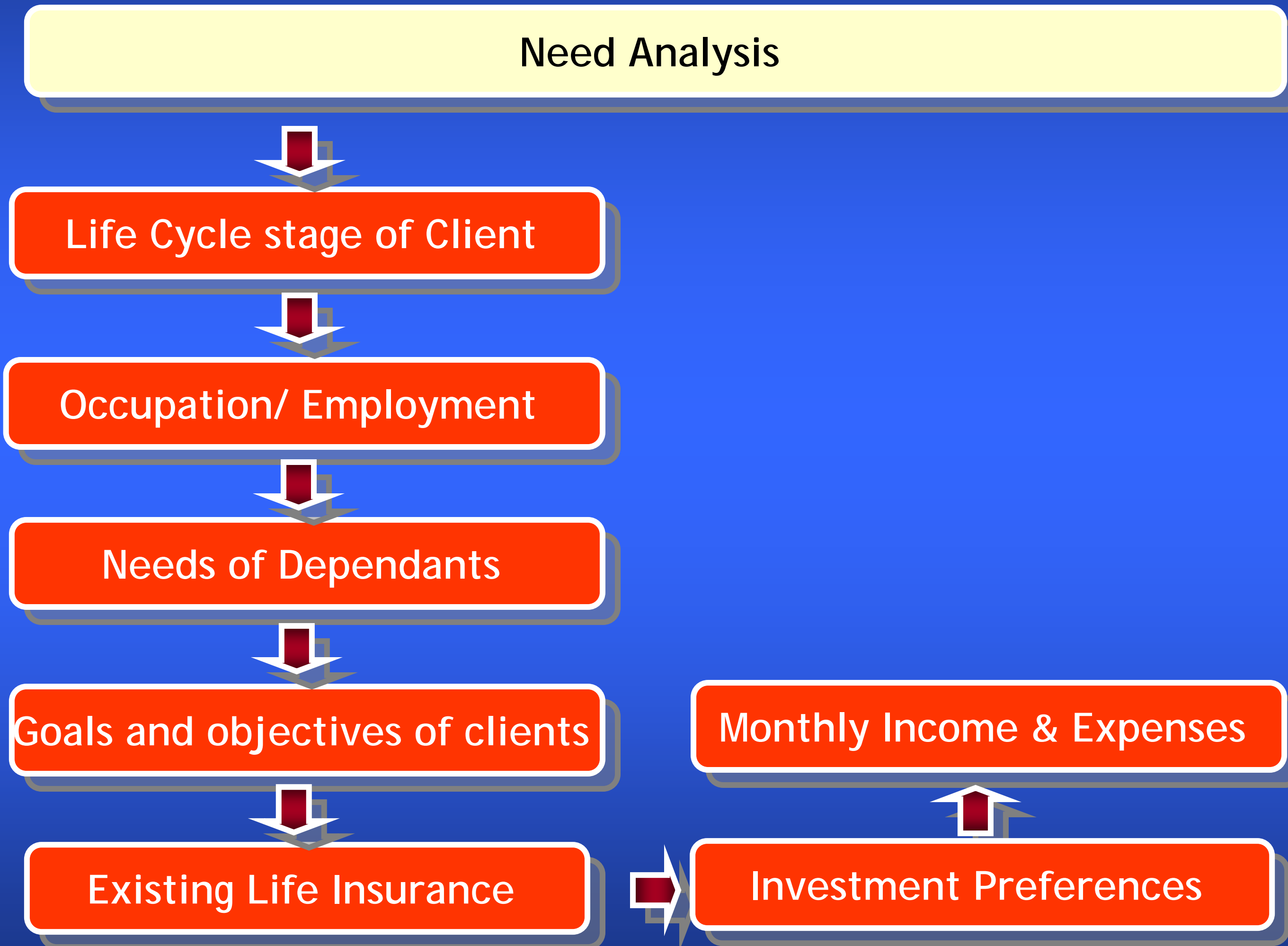
Need Based Analysis- Steps

- First step is to find out all the relevant facts



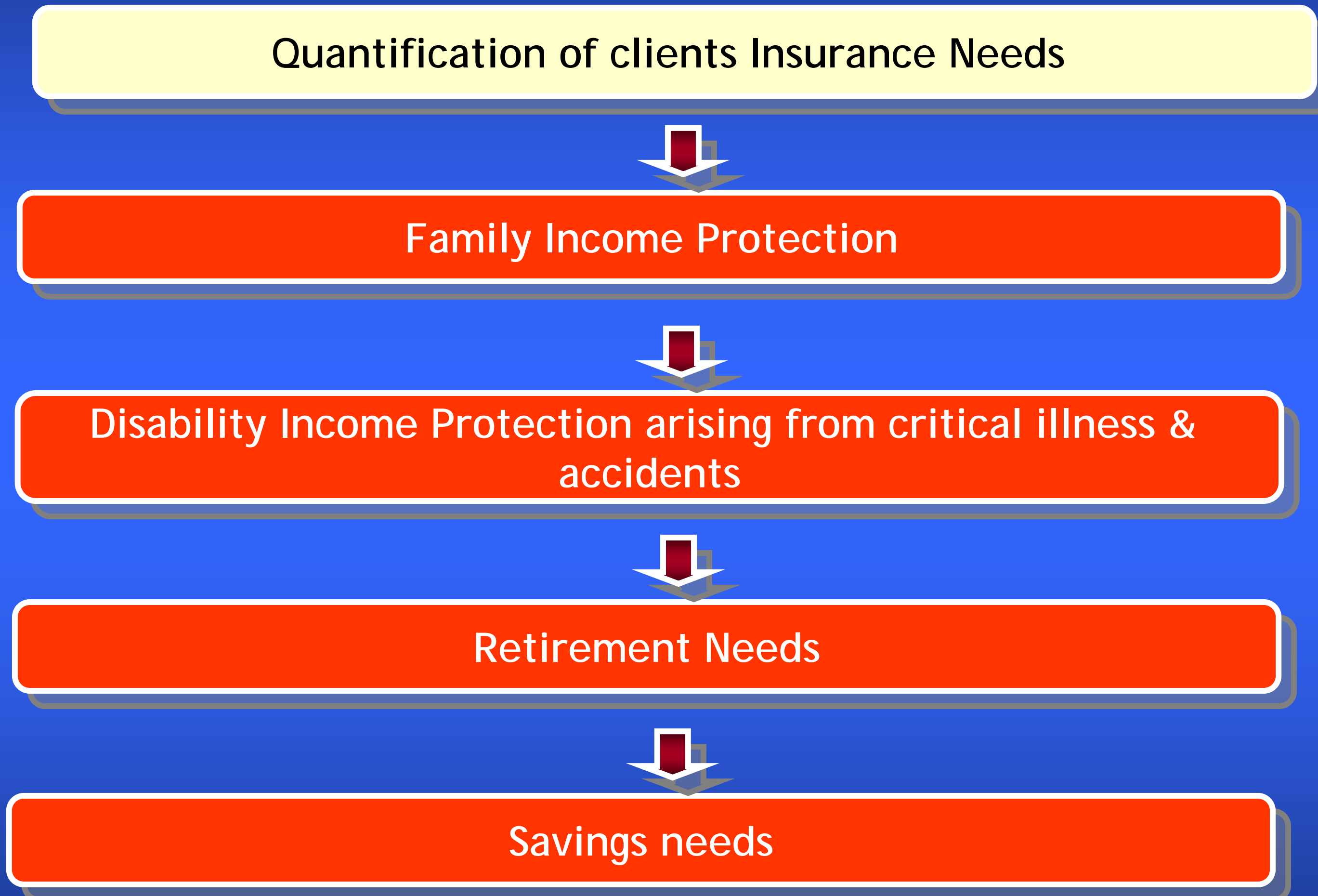
Need Based Analysis- Steps

- Second Step is to analyse the needs



Need Based Analysis- Steps

- Step 3 is to quantify the Insurance needs of the client.



Family income protection

- This need normally arises when client has dependants who could be left without any financial support in case of clients death.
- Adequate insurance coverage should be available to provide for their needs until a time when such needs are no longer necessary.
- The amount of needs normally constitute the total of the following:
  - The amount of the client's liabilities such as loans, credit card debts, etc
  - The immediate expenses that will be incurred at the time of death
  - The funds required to support the dependants for the desired period

Family income protection

- The computation of the amount can be based on three of the following methods:

Needs Based Approach

- Annual income needed by family after clients death- subtract clients personal expenses from current living expenses- (C)
- Identify dependant with longest dependency period and ascertain the duration- (D)
- Identify inflation rate and rate of return
- Based on the above, calculate PV- (E)
- List and quantify fair market value of family assets that can be used by dependants in case of client's death. Obtain total amount- (F)
- Calculate shortfall- Subtract (F) from (E). This will give you (G)

Multiple Approach

- Ascertain the following:
  - The current annual gross income of the client (J)
  - A suitable rate of return is derived (K)
  - The number of years to retirement (L)
- In time value calculation, the following inputs are used:
  - pmt: J
  - i: K
  - n: L
- Calculate PV (AD) to get family income protection needs.

Capital Preservation Approach

- The insurance proceeds are used as a principal sum to generate interest and only the interest is used to provide for the dependants needs.
- Upon the dependants needs being fully satisfied, the principal sum can be distributed to the designated beneficiaries.
- To calculate the life insurance needs, divide real income by rate of return less inflation rate and add the amount derived by the first year income required.

Disability Income Protection

- If the client is disabled or critically ill, further protection will be required. Disability income would fall under:

  - Medical expenses- The medical costs involved. Can be estimates at best, due to the number of uncertainties involved.

    The amount is derived by subtracting the insurance proceeds.

  - Ancillary Expenses- Client may require ongoing treatment to combat the disability/ illness.

    After subtracting the amount of insurance proceeds from existing policies that can cater to this need (like disability income insurance) from the total amount, the shortfall is derived.

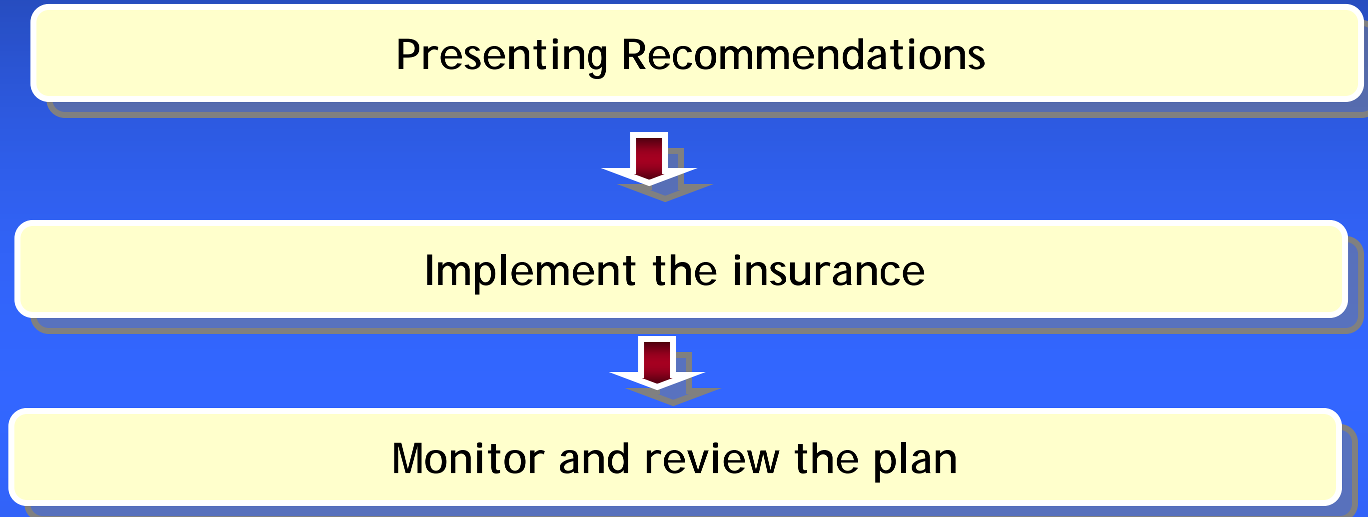
Disability Income Protection

How to calculate maintenance amount

- PMT- The annual income required for the whole family including the client.
- I- The inflation adjusted rate of return.
- N- The period when payments will be required.
- Calculate PV(AD) to get the monthly expenses.

Need Based Approach- Steps

- The final steps are as follows:



Presenting, Implementing and monitoring

- The planner will present the recommendations to the client, who may accept them or wish to make modifications.
- After study and analysis, an insurance plan suitable and acceptable to the client will be finalized.
- The planner will then implement the plan with the services of Life Insurance Agents or Brokers if required.
- Once implemented regular monitoring and review of the plan has to be done to ensure relevance to the client's needs.
- Certain events may also trigger off the need for review. For instance, instead of sending his child to a local university, the client may want to send him overseas.

Frequency of Review

- There is no set frequency for conducting of the review.
- However it is recommended that a review be held periodically.
- Reviews can be held when required by the client or when the planner is of the opinion that certain circumstances warrant the need for a review of the plan.

Establishing and implementing changes

- The periodic reviews will highlight if any changes are required to be made.
- Once a change is identified, the Planner will once again create a new plan with the changes incorporated.
- The new plan will be presented to the client and the client will be given the opportunity to peruse through it.
- The changes will then be implemented after such discussions with the client.

Personal Property and Liability Insurance

The sphere of general insurance

- The sphere of general insurance can be divided into five categories.
  - Property Insurance
  - Motor Insurance
  - Liability Insurance
  - Marine Insurance
  - Pecuniary Insurance

Benefits of General Insurance

- Property, motor and liability insurance can offer useful and economical solutions to various key problems in the risk management process of financial planning.

- Some of them are
  - Financial planning also involves preserving wealth like house (property), a car and jewellery.
  - The extent of losses arising from risk concerning property can be huge.
  - Clients may be exposed to the risk of claims by third parties due to loss arising from their acts or omission. For example, negligent driving resulting in a road accident will be liable for the damages.

Property Insurance- Householders' and Houseowners' Insurance

- Protects your home from unpredictable events.
- The typical home insurance, in addition, covers your valuable personal property as well-The contents inside your home like furniture, clothing, stereo, computer equipment, jewelry etc.
- There are lots of schemes available in home insurance. Under the House Holders insurance policy, coverage is available for 10 sections.

Medical Insurance

The risks generally considered under the health insurance include

- Medical Expenses
- Personal Accident/ Loss of Income Due to a Disability
- Long Term Care Expenses

Mediclaim policy

- The Company will pay the Insured the amount of expenses reasonably and necessarily incurred by or on behalf of such Insured Person, not exceeding the Sum Insured in aggregate mentioned in the schedule :

- **Age limit**: 5 years to 80 years. Children between the age of 3 months and 5 years of age can be covered provided one or both parents are covered concurrently.

- **Family discount**: 10%in the total premium will be allowed comprising the insured and any one or more of the following:
  - Spouse
  - Dependent children (i.e. legitimate or legally adopted children)
  - Dependent parents

Mediclaim policy

- **Payment of claim:** All medical treatments will have to be taken in India only.
- **Cumulative bonus:** For each claim free year of insurance, the Sum Insured shall be progressively increased by 5% upto a maximum accumulation of 10 claim free years.
- In case of a claim by Insured, who has earned such cumulative bonus, the increased percentage will be reduced by 10% of Sum Insured at the next renewal, however basic Sum Insured will be maintained and will not be reduced.
- For existing policy holders (as date of implementation) the accrued amount of benefit of cumulative bonus, the bonus will be added to the Sum Insured, subject to the maximum 10 claim free years.
- Cumulative bonus will be lost if policy is not renewed on the date of expiry.
- Waiver: In exceptional circumstances the seven days exception in period of renewal is permissible to be entitled for Cumulative bonus although the policy is renewed only subject to Medical Examination and exclusion of diseases.

Insurance of Business Risk

- **Key person Insurance**: is insurance that a business purchases on the life of a person whose continued participation in the business is necessary to its success and whose death would cause financial loss to the business.

- **Business assets and liabilities Insurance**: These insurance policies are designed to cover the insured against various types of legal liabilities which may arise in anyone of the following ways:

Liability policies:

- Workmen's compensation insurance: Designed to provide indemnity to the insured arising out of injuries and/or loss or damage to a third party due to defective goods that may be sold, repaired, serviced, tested or supplied by the insured

- Product liability insurance: Designed to provide indemnity to the insured arising out of injuries and/or loss or damage to a third party due to defective goods.

- Public liability insurance: Designed to protect the insured against liabilities to third parties arising out of their business activities

Liability policies:

- Directors' and officers' liability insurance: Directors and officers of a company if they breach any of their duties and the company sustains losses, are liable to parties like shareholders. This cover offers them protection from these losses

- Professional indemnity insurance: Designed to cover people who provide professional services in the course of their work & provides indemnity to the insured against legal liability to third party arising from negligence, omissions and mistakes committed by the insured in the course of carrying out their duties to that third party.

Life Insurance Need Analysis

Life Insurance Needs

Two questions need to be answered:

- How much income would be needed for specific purposes if the person should die now: and
- When would it be needed?

Life Insurance Needs

- The amount of needs normally constitute the total of the following
  - The amount of the client's liabilities such as loans, credit card debts etc
  - The immediate expenses that will be incurred at the time of death
  - The funds required to support the dependants for the desired period

Human Life Approach

Involves a capitalization of the part of a wage earner's income devoted directly to the support of his/her family.

- **Human Life Value**
  - Used by most insurance agents/planners and at most financial-planning Web sites.
  - Chartered Life Underwriters (CLUs) know the method as Human Life Value Concept or the Human Capitalization Method.
  - According to this concept, an individual's net worth is the present value of that person's future income stream that will be allocated to others.
- **Needs Approach**: Arguably the best way to pinpoint a smart life insurance figure is through a needs analysis, which can be broken down into a simple formula:
- **Short-term needs + long-term needs - resources = how much life insurance you need**
- Experts advise an analysis at least once every three years, or whenever you have had a major life change.

Human Life Approach

- **Capital Need Analysis Approach:** The assumption is that all income needs will be met from earnings on an investment fund that will be kept intact and available to the younger generation when the surviving spouse dies.
- **Steps:**
  1. First step is valuing the estate - construct a personal balance sheet.
  2. Second step is to estimate the amount of capital available to meet the income needs of the family.
  3. Third step is to examine the income position of the family - income analysis

Insurance Policy Analysis

Type of Life Insurance Policies

There are three basic classes of life insurance contracts. They are:

- Term Insurance
- Whole Life Insurance
- Pure Endowment

Type of Life Insurance Policies

Term Insurance

- Provide coverage for a specified period of time.
- In case of death of the policyholder during the term, the sum assured is paid to the nominee of the policy holder.
- In case of survival for the specified period, nothing is payable

Whole Life Insurance

- Cover the insured for their entire life subject to renewal premiums being paid.
- Contains a savings element.
- In case of death of the insured, the sum assured is paid to nominee.
- On maturity, the sum assured is paid to the insured.

Endowment

- Carries a specified benefit amount, regardless of whether the insured survives till the maturity date or not
- Maturity date is reached either:
  - At the end of a stated term or
  - On the insured reaching a particular age.
- On maturity- amount paid either to the insured or to nominee in case of death while the policy is in force.

The new generation products include

- Universal Life
- Adjustable Life
- Variable Life
- Variable Universal Life
- Interest-Sensitive Whole life
- Indeterminate Premium Products

Life Insurance Policy Riders

- Riders are add-on benefits that could be attached with the basic policy.
- They enhances the coverage of the basic policy & are relatively inexpensive.
- The following are the various types or riders available
  - Critical illness rider
  - Payor Benefit
  - Term rider
  - Surgical rider
  - Spouse rider
  - Waiver of Premium rider
  - Accidental Death rider
  - Disability rider
  - Guaranteed insurability rider
  - Disability Income benefit

Life Insurance Policy Riders

Critical Illness Rider

- The insurer agrees to pay a specific sum of money to the insured if he contracts a critical illness covered under the policy.

Waiver of premium

- The company waives off its right to collect renewal premiums that become due when the insured becomes totally disabled

Payor Benefit Rider

- Waives off the balance premiums if the premium payor dies or is disabled during the premium payment term

Term Rider

- Under this policy in the event of death during the term of this benefit, the beneficiary would receive an additional death benefit amount, which is over and above the sum assured.

Accidental Death Rider

- If the insured dies due to accident, the insurer pays the beneficiary an amount in addition to the death benefit provided by the insurance company

Spouse Rider

- Insured can cover his/ her spouse without taking a fresh policy.
- In case of death of spouse, insured gets the spouse benefit sum assured
- If the insured dies before the spouse, he/ she may convert the rider into a contract with the insurance company.

Life Insurance Policy Riders

Surgical Rider	Guaranteed Insurability Rider	Payor Benefit Rider
• This rider added to a life insurance policy provides financial support in case of medical emergencies	• Guarantees the insured the right to purchase additional life insurance at different stages in his/her life without having to undergo any further medical examination.	• This rider provides a monthly income benefit to the insured if he/she becomes totally disabled while the policy is in force.

Life Insurance Policy Selection

- Choice of a life insurance policy depends on age and needs of the person, life cycle stages, attitudes, expectations and financial well being of an individual.
- The choice of a life insurance plan by an individual, actually depends on a number of factors:

Factor	Description
Needs	Extent and the period of time over which the protection is required
Special Needs	Depend upon status and occupation. In some occupations, risk of disability/ mortality is more
Risk bearing Capacity and Wealth of Individual	The amount of risk that the individual may be willing to take and the wealth he has
Premium	Affordability of premium outgo in relation to disposable income
Returns on Life Insurance Plans	In case of early death, returns on Life insurance would be high, but in case held till maturity, returns would be comparable to return on Savings deposits.
Tax Features of Life Insurance Policy	Premiums paid are eligible for tax rebates under the Income tax Act.

Calculation of costs

- Belth Method:

$$\frac{(P + CVP) \times (I + i) - (CSV + D)}{(F - CSV) \times 0.001}$$

- 0.001 = Policy cost per thousand conversion
- i = Interest rate selected equivalent to the after-tax rate of return that could have been generated from investing an amount equivalent to the premium and the cash surrender value (P+CVP) in an alternative investment vehicle having similar investment risk characteristics
- D = Dividend or bonus
- F = Death benefit
- P = Annual premium
- CSV = Cash surrender value at the end of current policy year
- CVP = Cash surrender value at the end of the previous year

What are Annuities?

- An annuity is any series of payments made or received at regular intervals.
- Annuity benefits protect against the risk of outliving one's financial resources.
- Life annuity- Insurance company GUARANTEES that the individual will receive the same payments each year no matter how long they live. Purchased the same way as life insurance.
- A person can either purchase the annuity with a one-time large payment or with smaller yearly premiums before the annuity's payments begin.

Annuities- Features

- Usually the person who buys the annuity determines the amount per month they wish to receive.
- If the insured dies before payments begin, the premiums paid are returned to the beneficiary.
- The size of the payments, in relation to the total amount of the contract, depends on the annuitant's (the owner of the annuity) age when the payments begin and the sex of the annuitant.
- *Annuities* start where life insurance ends. It is called the 'reverse' of life insurance.

Annuity benefits: Relevant Factors

- The amount of principal invested
- The time over which the principal accumulates at interest
- The interest rate earned on investment
- The number & timing of periodic annuity payments

Annuities- Types

Can be classified in many ways. The most common being…

Number of lives covered

- Single
- Joint

Period of payment

- Annuity Certain
- Pure life Annuity
- Life and period certain
- Refund Annuity

Method of paying premium

- Single Premium
- Regular Premium Payments

Beginning of payment of annuity

- Immediate
- Deferred

Quantum of annuity installment

- Fixed
- Variable
- Index Linked

Business Liability Insurance

- Designed to cover the insured against various types of legal liabilities which may arise in anyone of the following ways:
- **Pursuant to contract**: An example - a contract where A promises to indemnify B (the other contracting party) against any liability to third parties.
- **Pursuant to the Common law**: A typical example- the tort of negligence where a person could be liable for damage sustained by a third party due to his negligence.
- **Pursuant to legislation**: A typical example - strict liability imposed on an employer for injuries or death sustained by the employees under the Workmen's Compensation Act.

Liability Policies

Workmen's Compensation Insurance

- The Workmen's Compensation Act imposes legal liability on the employer to pay specific compensation to a workman in the event that he is stricken with a specified occupational' disease or is injured or dies from accidents that occur out of and during the course of employment.

- Under the Act, a workman is defined as all manual labourers and non-manual workers, whose monthly income does not exceed Rs 3,500.

What does this cover?

- In the event of death 40% of monthly wages of the deceased workman multiplied by the relevant factor.
- In the event of permanent incapacity of the worker, 50% of the monthly wages of the deceased workman multiplied by the relevant factor or an amount of Rs 24,000 whichever is more.
- In the event of temporary disablement, a half-monthly payment of the sum whether total or partial results from the injury equivalent to 25% of the monthly wages of the workman to be paid in accordance with the provisions.

What does this cover?

- Half monthly payment shall be payable on the 16th day:
  - From the date of disablement where such disablement lasts for a period of 28 days or more
  - After expiry of the waiting period of 3 days from the date of disablement where such disablement lasts for a period of less than 28 days and thereafter half monthly during the disablement or during a period of 5 years, whichever is shorter.
- Medical expenses subject to limits imposed in the act.

Product Liability Insurance

- Designed to provide indemnity to the insured arising out of injuries and/or loss or damage to a third party due to defective goods that may be sold, repaired, serviced, tested or supplied by the insured.

- The indemnity normally includes legal costs and expenses, and the scope of coverage may be extended to include product recall and/or product guarantee.

- The following are the normal exceptions
  - War-related risks
  - Radioactive-related risks
  - Natural perils
  - Risks, which should be insured under other types of policies like Workmen's compensation policy and product liability policy

Director’s and Officer’s Liability Insurance

- Indemnifies the director for any damages payable by him.
- Indemnifies the company for any cost reimbursed to the director to enable him to legally defend any action.
- Is made on a “claims made" basis, which means that, irrespective of when the act incurring liability occurs, the claim against the insurer must be made during the currency of the policy.

- The following are typical exclusions of the policy:
  - Criminal fines and penalties
  - Breach of professional duty
  - Fraudulent and/or dishonest acts of the director

Professional Indemnity Insurance

- This type of insurance is designed to cover people who provide professional services in the course of their work.
- It provides indemnity to the insured against legal liability to third party arising from negligence, omissions and mistakes committed by the insured in the course of carrying out their duties to that third party.
- Typical examples of such professionals are engineers, doctors, architects, lawyers and financial planners.
- It usually covers legal expenses and costs reasonably incurred and carried out with the consent of the insurer.
- They are usually issued on a "claims made" basis.

Normal Exceptions

- The following are typical exclusions of the policy:
  - Loss resulting from lack of fidelity of employees or partners
  - Claims arising from libel or slander unless committed during the course of discharge of professional duties
  - Claims arising from war-related or radioactive related risks
  - Claims already known or arising from known circumstances
  - Risks that should be insured under other types of policies

Insurance Regulatory & Development Authority (IRDA)

- The Insurance Act, 1938 - provided for setting up of the Controller of Insurance to supervise and regulate the insurance sector.
- The need for a strong, independent and autonomous Insurance Regulatory Authority was felt after the opening up of the insurance Industry .
- The IRDA Act, 1999 is an act to provide for the establishment of 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 or incidental thereto and further,
- To amend the Insurance Act, 1938, the Life Insurance Corporation Act, 1956 and the General insurance Business (Nationalisation) Act, 1972 to end the monopoly of the Life Insurance Corporation of India (for life insurance business) and General Insurance Corporation and its subsidiaries (for general insurance business).

Provisions of the IRDA Act

- **Composition of Authority:** Authority shall consist of a chairperson, not more than 5 full time members and not more than 4 part time members,
- **Tenure of service:** A period of 5 years and eligible for re-election till the age of 65 years.
- **Removal from office:** If adjudged insolvent, mentally or physically incapable to perform duties, convicted of any moral offence, abuse of authority, has a vested financial or other interest which is likely to affect functioning.
- **Bar on future employment of members:** The Chairperson and the whole-time members shall not, for a period of two years from the date of having held such post, take up employment in the Central or State Government or in any company in the insurance sector.

Provisions of the IRDA Act

- **Administrative powers of Chairperson**: Powers of general superintendence and direction in respect of all administrative matters of the Authority.

- **Vacancies, etc., not to invalidate proceedings of Authority** : No Act or proceeding of the Authority shall be invalid merely by reason of any vacancy in, or any defect in the constitution of, the Authority, any defect in the appointment of a person acting as a member of the Authority, any irregularity in the procedure of the Authority not affecting the merits of the case.

Provisions of the IRDA Act

- **Officers and employees of Authority:** The Authority may appoint officers and such other employees as it considers necessary for the efficient discharge of its functions under this Act.

- The terms and other conditions of service of officers and other employees of the Authority shall be governed by regulations made under this Act.

Duties, Powers and Functions

- To issue to the applicant a certificate of registration, to renew, modify, withdraw, suspend or cancel such registration
- Protection of the interests of the policy-holders
- Specifying requisite qualifications code of conduct and practical training for intermediary or insurance intermediaries and agents surveyors and loss assessors
- Promoting efficiency in the conduct of Insurance Business.
- Promoting and regulating professional organizations connected with the insurance and reinsurance business
- Levying fees and other charges for carrying out the purposes of this Act.

Duties, Powers and Functions

- Conducting Audit of Insurance companies and intermediaries.
- Control & regulation of the rates, advantages, terms and conditions that may be offered by insurers for general insurance business not controlled & regulated by the TAC* under section 64U of the Insurance Act, 1938
- Prescribing the form & manner in which books of account shall be maintained & statements will be rendered by insurers and other intermediaries
- Regulating investment of funds by insurance companies, maintenance of margin of solvency, adjudication of disputes between insurers and intermediaries or insurance intermediaries

**Tariff Advisory Committee*

Provisions of the IRDA Act

- Specifying the percentage of premium income of the insurer to finance schemes for promoting and regulating professional organizations
- Specifying the percentage of life insurance business and general insurance business to be undertaken by the insurer in the rural or social sector
- Supervising the functioning of the Tariff Advisory Committee
- Exercising such other powers as may be prescribed.

Provisions of the IRDA Act

- **Grants by Central Government:** The Central Government may, make to the Authority grants of such sums of money as the Government may think fit for being utilised for the purposes of this Act.
- **Fund:** A Fund to be called **"The Insurance Regulatory and Development Authority Fund"** is to be established and the following sums will be credited thereto :-
  - All Government grants, fees and charges received by the Authority
  - All sums received by the Authority from such other source as may be decided upon by the Central Government
  - The percentage of prescribed income received from the insurer.
- **The Fund shall be applied for meeting the following expenses :-**
  - the salaries, allowances and other remuneration of the members, officers and other employees of the Authority
  - the other expenses of the Authority in connection with the discharge of its functions and for the purposes of this Act.

Provisions of the IRDA Act

- **Accounts and audit:** The Authority shall maintain proper accounts and other relevant records and prepare an annual statement of accounts in the form prescribed by the Central Government in consultation with the Comptroller and Auditor General of India.

- The accounts of the Authority shall be audited by the Comptroller and Auditor General of India at intervals specified by him and any expenditure incurred in connection with such audit shall be payable by the Authority to the Comptroller and Auditor General of India.

Provisions of the IRDA Act

- The Authority shall, in exercise of its powers or the performance of its functions under this Act, be bound by such directions on questions of policy, other than those relating to technical and administrative matters, as the Central Government may give in writing to it from time to time

- However, Authority must, as far as practicable, be given an opportunity to express its views before any such direction is given. The decision of the Central Government, whether a question is one of policy or not, shall be final.

Agent

- According to Section 182 of the Indian Contracts Act, an 'agent' is a person' employed to do any act for another or to represent another in dealing with a third person. The person for whom such act is done or who is so represented is called the 'principal'.

- The lawyer is the agent of the client, when he argues the case in court. An ambassador is an agent of his country. It is the function, which determines the relationship of agency, not the designation.

- The Insurance Act defines an insurance agent *as one who is licensed under Section 42 of that Act and is paid by way of commission or otherwise, in consideration of his soliciting or procuring insurance business, including business relating to the continuance, renewal or revival of policies of insurance. He is, for all purposes, an authorized salesman for insurance.*

Agents Regulations

- The Insurance Regulatory and Development Authority (IRDA), constituted by the IRDA Act of 1999, issued the IRDA (Licensing of Insurance Agents) Regulations, 2000.
- Deal with the issue of licences under Section 42 of the Insurance Act, 1938 and other matters relating to agents.
- By another notification in October 2002, these Regulations were made ineffective for corporate agents and the new IRDA (Licensing of Corporate Agents) Regulations, 2002 were issued.
- These Regulations deal with the issue of licences and other matters relating to corporate agents.

Agents Regulations

- License will not be given if the person is
  (a) a minor,
  (b) found to be of unsound mind
  (c) found guilty of criminal misappropriation or criminal breach of trust or cheating or forgery or an abetment of or attempt of commit any such offence
  (d) found guilty of or knowingly participating in or conniving at any fraud, dishonesty or misrepresentation against an insurer or an insured
  (e) not possessing the requisite qualifications and specified training
  (f) not passed such examinations as are specified by the Regulations
  (g) found violating the code of conduct as specified by the Regulations.

- Besides Individuals, collectives like companies, firms, banks, cooperative societies, etc., can also become agents after designating one or more persons as 'Corporate Insurance Executives', who will be required to obtain licences.

- The fee for grant of a licence is Rs.250 for individual as well as corporate agents. A licence is granted for 3 years & may be renewed after 3 years. It can be cancelled, if the agent acquires any of the disqualifications. The fees for the certification of the specified person is Rs.500. This is also valid for 3 years.

Remuneration of Agents

- A life insurance agent is paid a stated percentage of the premium collected through his agency as commission.

- Section 40 A (1) of the Insurance Act stipulates the maximum amount of commission or remuneration which can be paid to a life insurance agent:
  - 35% of the first year's premium,
  - 7.5 % of the second and
  - Third year's renewal premium and
  - 5% of subsequent renewal premium.

Remuneration of Agents- Exceptions

- During the first ten years of the insurer's business, he may be paid 40% first year's premium.
- Under certain circumstances, commission of 6% can be paid on the renewal premium even beyond the third year.
- Within these limits, the manner of remunerating the agent will be determined by the insurer.
- Normally, under terms assurance plans, commission rates are less.
- Similarly, for shorter duration policies, commission rates are lesser than under longer duration plans.

Procedure for becoming an agent

- The Insurance Act, 1938 lays down that an insurance agent must possess a licence issued by the IRDA, under Section 42 of that Act.
- The IRDA has authorized designated persons, in each insurance company, to issue the licences on their behalf.
- The fee for the licence, the manner of making application, etc., have been described in the IRDA Regulations.
- The license will be valid for three years and may be to act as an agent for a life insurer, for a general insurer or as a "composite insurance agent", working for a life insurer as well as a general insurer.
- No agent is allowed to work for more than one life insurer or more than one general insurer.

Qualifications for becoming an agent

- The person (individual or corporate insurance executive) must:
  - Be at least 18 years old
  - Have passed at least the 12th standard or equivalent examinations, if he is to be appointed in a place with a population of 5000 or more, or 10th standard otherwise
  - Have undergone at least 100 hours practical training in life or general insurance business, from an institute approved and notified by the IRDA.
  - For a composite insurance agent, the applicant should have completed at least 150 hours of practical training in life and general insurance business, which may be spread over six to eight weeks.
  - Have passed the pre-recruitment examination conducted by the Insurance Institute of India or any other IRDA recognized examination body.

Qualifications for becoming an agent

- Applications for renewal have to be made at least thirty days before the expiry of the licence, along with the renewal fee of Rs.250.
- If the application is not made before the date of expiry of licence, an additional fee of Rs.100 is payable.
- If the application is made after the date of expiry, it would normally be refused.
- Prior to renewal of the licence, the agent should have completed at least 25 hours of practical training in life or general insurance business or at least 50 hours practical training in life and general insurance business in the case of a composite insurance agent.

Disqualifications

- A person with the following disqualifications is debarred from holding a licence:
  - He has been found to be of unsound mind by a court of competent jurisdiction
  - He has been found guilty of criminal breach of trust, misappropriation, cheating, forgery or abetment or attempt to commit any such offence.

- The licence once issued, can be cancelled whenever the person acquires a disqualification.

Insurance Pricing

- Pricing generally refers to methods used to determine general rate levels, and the phrase rating procedure recognizes special characteristics of an exposure for which coverage is sought. Most insurance prices rely on claim data.

- Loading process adjusts estimated (or actual) claim costs to account for the cost of administering the insurance claim and providing other services associated with insurance. Loading also may include an allowance for uncertainty and profit.

- Rate is the price per unit of exposure.
  - Net premium= rate needed to pay losses and loss adjustment expenses (cost of expected loss)
  - Loading= other expenses (allowance for profit, contingencies, commission, taxes and fee) (cost of doing business)
  - Office premium=net premium + loading

Objectives of Rate Making

- **Regulatory Objective:**
  - Regulations require reasonable, adequate and not unfairly discriminatory rates for property and liability insurance . Insurance rates are adequate if, they are high enough to maintain the solvency of insurers.
  - The fairness requirement requires that rate differentials among insured should reflect differences in expected losses and expenses for these insured
- **Strategy in competitive market**:
  - When there is a competition among insurers, pricing helps them understand the expected outcome of their pricing strategy.
  - An insurer whose rates are unreasonably high will be underbid by competing insurers, forcing the insurer to lower rates or lose business.
  - At the other extreme, an insurer whose rates are inadequate, ultimately becomes insolvent and is withdrawn from the market

Basic Rating Methods

Individual/ Judgement Rating

- Each exposure is individually evaluated. Rating is based largely by underwriter's judgement.
- Each Insured is charged a unique premium based on the judgement of the person setting the rate supplemented by knowledge of premium charged to similar insured and stats.
- Reliance on this method alone is not common in the industry today.

Class/ Manual rating

- Insureds are classified on the basis of few observable characteristics and all in one class are charged the same premium.
- The person has to be put in the correct class.
- Widely used for individual life insurance and health insurance rates, automobile insurance rates, homeowner's insurance rates on dwellings, and general liability and workers' compensation rates for small organizations.

Modification/ Merit Rating

- The rate distinguishes among insureds in the same rating class on the basis of difference in expected losses or expense per exposure unit.
- The distinctions may be based on past experiences, size of exposures, or detailed analysis of the quality of the exposure.
- For types are:
- Schedule rating
- Experience rating
- Retrospective rating
- Premium discount plans

Types of Merit Ratings

- **Schedule Rating:** Modification based on a comparison between some specified characteristics of a standard insured and the corresponding characteristics of the proposed insured.
- **Experience and retrospective ratings:** Claim-sensitive rating methods. Both the methods recognize the claim activity of the insured organization in setting the rate for insurance coverage. Available only to large organizations.
- **Premium Discount Plans:** Reduce rates for large-premium insureds on the ground that economies of Large scale arise. The most important premium-discount plans are those recognizing that not all the expenses of servicing an insured increase proportionately with the size of the premium. Premium-discount plans usually apply a table of discounts to the premiums otherwise charged.

Underwriting

- The process of selection and classification of risk exposures to determine the extent of premium payable by a particular individual.
- The goal of underwriting is to avoid a disproportionate amount of bad risks.
- In addition, an underwriter has to gain a sufficient number of exposure units in each class.
- For the insurance concept to be viable, the main class should be those in the standard category, namely, the category consisting of those exposed to an average level of risk.

Factors Influencing Underwriting

- Age
- Build
- Physical condition
- Personal history
- Family history
- Residence
- Habits
- Occupation
- Morals
- Sex
- The nature of the insurance plan
- Economic status

The Underwriter gets information from

- **Agent:** The insurance agent or broker is normally appointed the field underwriter as he usually gets precise information as to what types of risks are deemed acceptable to the insurer. He is required to submit a report containing relevant information about the insured. As he is the only representative from the insurer to see and speak to the prospect, he is expected to report any instances of false representations.

- **The Applicant:** A substantial amount of information is supplied by the applicant, by way of completion of an application form.

- **Medical Sources:** The insurer may also send the applicant for the relevant medical examinations and tests or apply for attending physician's report to ascertain the health of the applicant.

Underwriting Methods

Life insurers resort to two methods of underwriting, namely:

- **The Judgement method**; and
- **The Numerical rating system**

Underwriting Methods

- **Judgment method:**
  - Regular and routine applications are managed by the clerical staff.
  - The more difficult or borderline cases will be referred to senior supervisors for their assessment.
  - Suitable in cases where there is only one unfavourable factor or the only decision applicable is either to accept or reject the case.

- **Numerical Rating system:**
  - Based on the premise that a large number of factors determine the nature of the risk.
  - An insured with an average risk is given a 100% rating.
  - Adverse factors will increase the rating by an amount relative to the seriousness, while a favourable factor will reduce the rating by an amount related to the extent of favourability of the factor involved.

Reinsurance

- A reinsurance policy is a contract where an insurer of a risk or several risks transfers part of such risks to a party or parties who are known as reinsurers.
- The transfer can be-made individually or by way of pre-arrangement. In such cases, the insurer is known as the cedant. Usually under such arrangements, the original insured is not a party to the reinsurance contract.
- The cedant is still totally and primarily liable to the original insured under the original insurance policy where the reinsurer is liable only to the cedant under the reinsurance contract.
- In turn, the reinsurer, if it so wishes can transfer part or all of the risk that it bears to another party who is called the retrocessionaire

Why Reinsurance?

- **Security** - Enables the insurer to transfer a portion of a risk to a reinsurer, thereby decreasing its risk exposure and reducing its losses in the event a claim is made.

- **Capacity** - If an applicant applies for coverage beyond the maximum capacity, rather than rejecting the application, the direct insurer can cede part of the risk to a reinsurer to an extent that allows it to accept the risk. This ensures that it does not lose valuable business without having to sacrifice underwriting limits.

- **Stability -** Reinsurance allows the direct insurer to "smoothen" the fluctuations in losses and tamper it, making the business more stable.

- **Protection against catastrophes**: By spreading its risks through reinsurance, it can protect itself from risks of catastrophes.

Types of Re-insurance

- Facultative reinsurance
- Treaty reinsurance.

Facultative Re-insurance

- Each risk is transferred on an individual basis.
- The terms of the reinsurance contract are negotiated.
- The reinsurer has the discretion to decline or accept the risk or make counter offers or accept a smaller portion of the risk.
- **Advantages :**
  - It accords flexibility to the cedant and reinsurer as the term for every risk to be ceded can be negotiated on an individual basis.
- **Disadvantages:**
  - The duty imposed on the cedant under the law is onerous.
  - It is time consuming.
  - It can be costly in view of the extra work that needs to be done.

Treaty Re-insurance

- Risks of a specified class or classes of business are reinsured. For example:-Liability or property insurance.

- Usually renewable every year.

- **Advantages :**
  - Easy to administer
  - Less costly
  - Less onerous for the cedant in fulfilling his obligations

- **Disadvantage:**
  - The treaty reinsurance contract is binding on both the parties . It becomes an automatic process and is less flexible.

Thank You