

Research paper on life insurance

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Life Insurance

Introduction

Insurance is a means to manage the risk of financial losses incurred due to unforeseen events and contingencies. Unforeseen events can be in the form of accident, illness, fire outbreak or loss of life. These incidents are not only emotionally stressfully, but also financially draining. Insurance is critical for protection of the latter. Primarily, there are three components of an insurance agreement, the insurer, the insured and the policy holder. In case of a life insurance policy, the insured and the policy holder are usually the same person. For a home insurance policy, home is insured and the policy holder is its legal owner.

Insurance is an integral part of a person's life. The objective of this paper is to discuss certain key aspects of insurance like the variability in the need for insurance, how does the mechanism of insurance work and its recent industry trends. The paper is divided into five sections. The first section explains variability in the need of importance. The second section discusses the mechanism of life insurance taking the example of life insurance. The third section describes the key challenges in the life insurance industry. The fourth section is an application of the concept of insurance to real life. The fifth section concludes the paper.

Variability in the Need for Insurance

It is important for people to get insured against various financial risks they foresee. The insurance need of a person may differ from other person. It may

depend up on a person's demographics, socioeconomic conditions, one's risk taking ability and upbringing. Upbringing plays an important role in the physical and mental well-being of a person. A research conducted by Zlotnick, Tam and Soman (2012) concludes that adults with a history of foster care in childhood were more than twice more prone to receiving a Social Security Disability Insurance. Similarly, risk of life can be more for people with chronic medical conditions, with dangerous jobs and a surrounding of political unrest. Some medical conditions that may entail higher threat to life are high cholesterol, high blood pressure and high sugar levels in a person. High risk jobs include instructing adventure sports like mountain climbing and scuba diving, mining and working in a manufacturing unit. Political unrest is a geography specific issue and applicable to people of a particular locality. Apart from this, higher probability of occurrence of natural calamities also increases the threat to life for a person.

Mechanism of Life Insurance

The insurance business is beneficial for both, the insurer and the policy holder. For the policy holder, the financial risk is transferred to the insurer with payment of a premium that is relatively insignificant in comparison to the financial losses foreseen. Insurance companies earn from the premium paid by their customers.

The mechanism of functioning of an insurance business can be explained with the help of life insurance scheme. In life insurance, people are insured against threat to life. If a bread earner dies, his or her family will be financially compensated to the extent of sum insured. However, life risk depends on the mortality rate in a given location and the age of the insured.

Insurance is built on the premise that probability of a mishap is quite low. An unforeseen event may occur to a few in a large pool of policy holders, whereas, each policy holder has to pay a premium for availing this facility. The premium is charged taking into account the mortality rate and age of a person. The premium is invested in equity and other markets to earn profits. For the insurer, the incident risk of an individual's death is spread over a large population minimising its impact. The insurer acts merely as a facilitator, a pool generator and a portfolio manager. The insurer often transfers the incident risk to a reinsurer, who settles claims raised by the insurer. The insurer is compensated for its effort through premium and profits. The premium collected plus income from investment minus life insurance claims and overhead costs is the profit of a life insurance company.

It is, however, important to understand that life insurance is an instrument to minimise financial losses for people, rather than a means to gain financially. Thus, the amount of insurance cover a person is entitled to will depend up on the extent of financial losses to family due to the person's death.

Life Insurance Industry

As the life insurance industry is maturing, revenue growth is become really challenging for insurance providers. According to Deloitte (2007), growth of premiums written in life insurance has been quite slow in the last decade. The Financial Services Authority (2010) of the United Kingdom mentions that demand for insurance products is likely to be low given the high level of household indebtedness, lesser investment income and low consumer confidence. This, in turn, affects the return on equity for the investors.

Challenges for Insurers

The key challenges being faced by life insurance providers are lower premium rates, uncertain equity markets, upsurge of economic crisis in Europe and increasing involvement of the regulators. The increasing competition in the industry has adversely affected the growth in premium rates. In addition to this, fluctuations in equity market and global economic crisis have impacted the investment income. The profitability is decreasing on both these accounts. Decreasing profits result into increasing pressure from investors for performance improvement. According to Deloitte (2007), increasing involvement of regulator is making it difficult for insurers to manage the complexity of compliance.

Key Customer Issues

The key issues faced by policy holders with respect to life insurance policy are product complexity, delay in claim settlement and lack of transparency on calculation of insurance premium.

Insurance policy contracts are very complex. It is difficult for a common man to comprehend the insurance policy contracts given their length and heavy use of technical words. At times, the policy documents are not available in the local language making it all the more difficult for customers. Given the competitive scenario and increasing pressure on insurance providers to improve their revenues, its employees may misuse customer's innocence and provide misleading information.

The claim settlement process is complicated and the nominees of the deceased have to face incidences of delayed or no claim settlement. Given

the increase in fraud cases, the insurers have tightening their claim processing norms that increase inconvenience for the nominees. The fine prints of the policy document also act as a hindrance in getting the claim payments.

Calculation of life insurance premium is done by the insurer depending upon mortality rate, age and demographic factors. The underwriting team of insurer is involved in risk assessment and premium calculation. However, there is no transparency in this process and customers are unable to comprehend the wide variations.

Application of Concept of Life Insurance

Life insurance, or transfer of threat to life to the insurer, is an important part of our lives. The paper and associated research has improved by understanding of the subject. The subject is quite useful in our everyday life. Life insurance will serve as an important protection for my family in future. However, I will take care of a number of things before taking an insurance policy. First, insurance need varies across people. So, I will calculate my insurance need based on my net disposable income, loan obligations and future commitments. Second, I will strive to comprehend the terms of insurance in detail so that I do not miss any fine prints. Third, I will provide all details with respect to my insurance to my family. This will help them claim insurance amount, if such situation arises. Last, it is comforting to know that regulators are making more efforts to safeguard customer's interest. I will file my complaint with the regulator, if need be. I will advise my family to do the same.

Conclusion

Insurance is a protection against unforeseen events. Depending upon the need, insurance can be of various types. Different factors affecting an individual create a need for a different type of insurance. People usually take insurance for life, health, auto and house. Life insurance is of prime importance as it helps one protect his or her family's financial condition. The recent financial crisis has impacted the insurance industry. The insurers are facing the challenges of stagnant revenues, increasing compliance complexity and uncertainty in equity markets. The key issues faced by customers are delay or no claim payment, complexity of documentation and lack of transparency. In spite of the issues, need of insurance protection cannot be undermined and growing maturing in the industry will stabilise it from short term crisis situations.

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