Permanent life insurance contract finance essay

Finance

" In a Permanent Life Insurance contract, a segment of the money paid as premiums is invested in that type of fund which earns interest on a tax-deferred basis. Thus, over a period of time, these investments are supposed to accumulate increased cash values which the policyholder will be able to get back either during the period of the policy or at the end of the policy or at intervals, depending on the nature and design of policies". The need for life insurance can change over different stages of life. Therefore, a person should evaluate the circumstances and the standard of living he/ she wishes to maintain for his/ her dependents. The life insurance premium is based on the type of insurance bought by the policyholder and the chances of death while the policy is in effect. This type of policy not only provides security to the dependents (payment of death benefits upon policyholder’s death), but also, enables the policyholder to use some part of the money when he/ she is alive or at the end of the policy. The premiums of such policies can, not only be expensive but also if not paid on time can lapse the policy. Hence, in order to take full advantage of the policy, it is important to pay the premiums on time and designate the nominee. These policies can also help in fetching some tax saving benefits. This policy demands regular payment of premiums till the time the policyholder desires to terminate the policy, irrespective of the fact that, the premium amount exceeds the amount to be distributed to the dependents in case of death. This surplus will be deposited in a separate account by the company and at times will yield higher return if the company performs well, out of which a share of the profits is periodically dispatched to the policyholder. Now, it is at the discretion of the policyholder whether to raise loans out of those funds or accumulate them back in the account. If the holder of the policy decides to end the policy, he/ she will be

paid back the surrender value but, if he/ she decides to retain the profits made from the investments, then he/ she holder is not required to pay the income tax for that amount. There can be a possibility like, when a certain amount of money is withdrawn within the given limit he/ she need not pay income tax for that amount. But when the money is deposited in the bank he/ she has to pay the income tax irrespective of the fact that the money is utilized or not. Some examples of such policies are : whole life, universal life and variable-universal life. However, it is advised not to choose permanent insurance if the motive is solely investment and tax exemption. In that case, it is always advisable to invest in some form of cheap investments and make use of other financial instruments for saving tax because the basic objective of insurance is neither investment nor tax exemption. The various types of permanent life insurance are as follows : Whole Life - As the name implies, this insurance policy is taken for the life term of an individual and the policy holder has to pay the premium for whole life till his death. These policies have no fixed end date; only the death benefit exists and is paid to the named beneficiary. The policy holder is not entitled to any money during his or her own lifetime. This plan is ideal in the case of leaving behind an estate.

Primary advantages of whole life insurance are guaranteed death benefits, guaranteed cash values, fixed and known annual premiums, mortality and expense charges that will not reduce the cash value of the policy. Second, this policy helps the insured to make a substantial investment; however, the returns are not that high, but, earn a higher interest than commercial banks. Third, the insured is eligible to earn tax exemptions. Fourth, the insured continues to be a beneficiary till the end of his life once he successfully completes paying premiums.

The major disadvantages of whole life are inflexibility of premiums and the fact that the internal rate of return in the policy may not be competitive with other savings alternatives. Second, this policy, however, fails to address the increasing needs of the insured and the additional needs during his post-retirement years. While the insured buys the policy at a young age, his requirements increase over a period of time. By the time he dies, the value of the sum assured is too low to meet his family's needs. As a result of these drawbacks, insurance firms now offer either a modified whole life policy or combine it with another type of policy. This kind of policy is neither very popular nor is suggested by the insurance companies.

Universal Life - The insured is required to pay a limited sum of money for a fixed period. The amount of premium paid is constant, like that of a term life insurance policy. Similarly, the benefits reaped resemble a 'whole life insurance' policy.

Variable Life Insurance - The insurance company invests the premiums in multiple options. These policies are said to be risky as the returns are based on the performance of stocks in the share market. These policies yield great returns when the financial markets perform exceedingly well.

Variable Universal Life Insurance - Variable Universal Life Insurance is a combination of universal life insurance and variable life insurance. The insurer pays the premiums as in a universal life insurance. Similarly, the coverage falls in line with a universal life insurance. The insurance company uses the funds of policyholder for investing them in the stock market. The terms of investment in a variable universal life insurance policy are the same as variable life insurance.

Premium Life Insurance - This policy enables the policyholder to obtain insurance on payment of premium at one stroke. However the amount is quiet expensive and also decided on the basis of your age. This policy is highly recommended for people intending to invest in insurance for the purpose of wealth creation. This policy does not involve any risks because the payments are made at a stretch and the likelihood of not paying the future premiums does not arise.

Survivorship Life Insurance – It is also called as " second-to-die" or " survivor insurance". This policy provides one policy that insures the lives of two people, usually spouses. No proceeds are paid on the death of first spouse but the policy remains in force but, the premiums may need to be paid. The death benefit is not paid to the beneficiary until the death of the second insured.

Endowment Policies

" These policies provide periodic payment of premiums by the insured and a lump sum amount (claim) is received in return either in the event of death within the policy's term or on the date of expiry of the policy in an event of the assured surviving the policy's term, whichever occurs earlier". These are the most popular life insurance plans among other types of policies. These policies combine risk cover with the savings and investment. In case of endowment assurance, the term of the policy is defined for a specified period say 15, 20, 25 or 30 years known as ‘ endowment period’. Combining risk cover with financial savings, endowment policies are the most popular policies in the world of life insurance. The advantages of these policies are; if the policy holder survives after the completion of policy tenure, he receives assured amount plus additional benefits like bonus from the insurance company. Second, in addition to the basic policy, some insurance companies also offer various benefits like double endowment and marriage/ education endowment plans. Thus, the costs of such policies are comparatively higher but worth the value. Third, the policies are ideal if the person has short career path and further he/ she hopes to enjoy the benefits of the plan (the original sum and the accumulated bonus) in his/ her life time. Fourth, the policy holder receives huge amount while completing the tenure. Fifth, endowment plans are especially useful when a person retires; by buying an annuity policy with the sum received; it generates a monthly pension for the rest of his/ her life.

Money Back Policy

" In a money-back plan, the insured keep getting a percentage of the sum assured during lifetime of the policy. In case the insurer outlives the term, he/ she get the remaining corpus with accrued options like bonus. In the event of his/ her death before the full term of the policy, his/ her nominee or legal heirs get the sum assured irrespective of the number of instalments received, with accrued benefits". A unique feature which is associated with this type of policy is that in the event of death of the insured during the policy term, the designated beneficiary will get the full sum assured without deducting any of the survival benefit amounts, which have already been paid as money-back components. Moreover, the bonus on such policies is also calculated on the full sum assured but will be paid only till the period for which premium was paid. Money back life insurance policies are very popular among traditional investors who seek financial instruments that provide insurance and investment, with a low risk element and guaranteed returns. This type of policy is perfect for individuals who are in their late 30s or early 40s and are looking at significant payouts after 10-15 years to fund their children's higher education, marriage and other expenses. Money back policies create a long-term savings opportunity with a reasonable rate of return, especially since the payout is considered exempt from tax, except under specified situations. This is the costliest life insurance available in the market, mainly because there is a pay-back component built into it. It differs from the endowment policy in the sense that in the later, the survival benefits are payable only at the end of the endowment period and cannot be used as collateral in case of loan (as the money is withdrawn intermittently). You can choose to receive parts of your sum assured as ‘ pay backs’ at

certain points in time in your insurance plan tenure. Insurers are bound to pay these sums no matter what happens; they need to make sure that the money is available with them during those periods, so, they invest a portion of the premiums received in such instruments that earns them a good return. Since such investments come with risk attached, this is passed on to you in terms of higher premiums. The primary advantages of money back insurance policies are; that they help us to plan our finances in a very systematic way by guaranteeing a regular flow of income at fixed stages in our lives and are best for those who are looking for a product that provides both - insurance cover and savings. Second, other than providing an insurance cover, it provides regular income, tax benefits and bonuses; thus the plans serve as a secure and safe investment decision. Third, these plans are very good for conservative investors who are looking for good returns but with an element of guarantee and above mentioned benefits. Fourth, a money back insurance policy can be used effectively to plan for your child's higher education or marriage, purchase a car or even to pay the down-payment for your dream house or perhaps you can re-invest the amount. Fifth, by investing small amounts every year, you can be rest assured that you will receive a large sum of money after every 5 years (defers company to company). Sixth, it works like your small piggy bank in which you keep making small investments. Seventh, inflation becoming a matter of concern, companies have realized that sometimes the money value of the policy is eroded. That is why with-profit policies are also being introduced to offset some of the losses incurred on account of inflation. It carries one disadvantage that they have higher premium as compared to other insurance policies.

To consider before buying money back policy

It is advisable to read the terms and conditions thoroughly. You should carefully check out the actual allocation of amount towards the premium (bifurcation of amount which is going to be accumulated and amount towards insurance company's charges). Make sure that the periodic payouts are sound enough to meet your anticipated needs. You can analyze the past performance in terms of declared bonuses. Though the past is not necessarily an indication of future performance, still it gives a fair idea of the insurance company's commitment to its policy holders.

Annuities and Pension

" Annuities are just opposite to life insurance. The function of an annuity is to protect against risks as well as provide money in the form of pension at regular intervals".

Basics differences of Annuity and Pension

Annuity and pension, both are funding schemes after retirement. Though major chunk of the population do not consider any difference between the two, however, they have some basic differences that include funding schemes. If considered in totality, pension scheme is more popular and known. Pension is the financial benefit received by the individuals after they have retired from service, whereas; annuity is also a pension scheme but for availing it there is no need for a person to get retirement. A difference that can be seen between pension and annuity is majorly in the payment amount. Pension is determined by the sum that one has earned during his service and adjusted for the duration of his career, whereas; annuity is a system that is determined by the amount of investment made by a person towards the

scheme. The differentiation is also between the sum paid. Lump sums are generally included in pension scheme but they are given on a monthly basis, whereas; a person can get lump sum amounts if he has enrolled in annuity scheme. Though the sum given in pension and annuity is fixed with variation calculated on the basis of cost of living standards, some annuities pay more or less of the amount depending upon the investments the persons have made. Pension given to a person is normally converted into a family pension after his demise, whereas; annuity is paid in three categories — single life annuity, joint annuity and survivor annuity. Annuity can be bought from any insurance company but pension is one that cannot be bought. Pensions are generally given for government jobs.

What is an annuity?

An annuity provides you with guarantee of lifetime payments. You buy an annuity using a lump sum from your pension or, perhaps, some savings. Annuities remove the worry of having to budget for an unknown period of time. It is actually the contract or the deal between the investor and the insurance company. The insurance company is involved in promising something good with the money of the investor. It either helps to grow the money or pays the money out after a certain period of time. You must always remember that insurance is an essential part of your investment. Pros and cons of the pattern must be known if you are interested in annuity insurance. The annuities provide guaranteed rates for the return on the dollar you invest and are very useful to those who desire to provide a regular income for themselves and their dependents after the expiry of a specific period. A person entering into an annuity contract agrees to pay a specified

sum of capital (lump sum or by installments) to the insurer. The insurer in return promises to pay the insured a series of payments not in one lump-sum but by monthly, quarterly, half-yearly or annual installments which are paid either until insured’s death or for a specified number of years. Generally, life annuity is preferred by a person having surplus wealth and wants to use this money after his retirement. Insurance companies majorly offer two types of pension plans : Endowment Plans – the money is invested in fixed income products which are supposed to be less risky in nature, so, the rates of return are comparatively lower, as return is directly proportional to risk. Unit Linked Plans (ULIPs) - more flexible in nature; even if the policyholder stops contributing may be after 10 years, the fund will keep compounding and creates corpus till the vesting date. These plans were introduced by the private players and are widely accepted because they combine the benefits of life insurance policies with mutual funds. Though a certain part of the premium is invested in listed equities/ debt funds/ bonds and the balance is used to provide for life insurance and fund management expenses. As per the risk appetite of a person, one can also opt for higher exposures in the stock market. However, lower risk options like balanced funds are also available. Annuities can prove to be beneficial in terms of your investment like they offer the tax deferred growth of your money. But, at the same time there are certain features of the annuities which might prove to be unhealthy for your investments, like; some of the deals might have surrender period which may tie up the money for a longer period of time or some might be overused in the banks. For this reason, it is always suggested to find out the details about the company rules regarding the annuities, before you make an

investment. Majorly, there are three annuity insurances available; fixed, variable and indexed which have some common characteristics in them.

Fixed Annuity

Annuities that make payments in fixed amounts or in amounts that increase by a fixed percentage are called fixed annuities. During the time when your account is growing, the insurance company agrees to pay no less than a specified rate of interest. The company also agrees towards the periodic payments of specified amount in your account which may last for a definite period, such as 20 years, or an indefinite period, such as your lifetime or the lifetime of you and your spouse. The investments are usually made in government securities and corporate bonds, they do offer a certain rate of return over a defined period. Fixed annuities are interest-based vehicles similar to bank-issued CDs, but geared specifically towards retirement savings. They have very low risk, have more liquidity than CDs, are tax-deferred and typically offer higher yields than bonds, CDs, treasuries or money market accounts. Fixed annuities are not securities and are not regulated by the SEC (Securities and Exchange Commission). One of the advantages of this investment is that the money is free from any kind of risks because of the fluctuations in the market.

Variable Annuity

Variable annuities, by contrast, pay amounts that vary according to the investment performance of a specified set of investments, typically bond and equity mutual funds. Variable annuities allow you to invest is different kinds of portfolios that are tied to the performance of the market. You can choose the type of investments that you have with variable annuities from

conservative to aggressive investments. You can switch between your investments during the time that you have the annuity and you can make more investment choices than you can with a fixed annuity. Investors who have a good understanding of the market and investing can choose to work with the variable annuity if they want to try to build up their investments and make more money, but those who are not as familiar with the market and want to have a secure retirement account often choose the fixed annuity. Variable annuities offer an opportunity for the market growth with the help of fund investing and are securities regulated by the SEC. This kind of insurance is for long term. The longer you keep your money the more it will grow. Finally when you receive the money you will be the gainer. On the other hand the variable annuities also have an effect on the principle because of the market fluctuations. Here, you can choose to invest your purchase payments from among a range of different investment options, typically mutual funds. The rate of return will vary depending on the performance of the investment options you have selected, on your purchase payments and the amount of the periodic payments you eventually receive. The longer you let your money build, the more you are likely to gain from it. However, unlike a fixed annuity (where your money sits in an account from which you are paid a fixed income throughout a fixed period), a variable annuity gives you more control over your investment–but also gives you the burden of risk. Variable annuities are used for many different objectives. One common objective is deferral of the recognition of taxable gains. Money deposited in a variable annuity grows on a tax-deferred basis, so that taxes on investment gains are not due until a withdrawal is made. Variable annuities offer a variety of funds (" subaccounts") from various money

managers. This gives investors the ability to move between subaccounts without incurring additional fees or sales charges.

Equity Indexed Annuity

Indexed annuities are hybrid between fixed and variable. An equity indexed annuity is an insurance contract which is linked to a common market index, such as the S&P 500. These annuities are popular amongst the people those who want growth potential of a variable annuity, but with less risk. Unlike fixed annuities, rates of index annuity varies, based on market performance and unlike variable annuities, losses are typically covered. This type of annuity gives you a win-win situation whereby, if the index grows you are entitled to a majority of the earnings and if the index declines, your account is protected against losses with a modest baseline rate. The annuity insurance can be chosen according to the personal requirements. It is advisable that you should always try to consult an expert before investing in it. Market Value–Adjusted AnnuitiesA market value–adjusted annuity spreads your premiums over different contract periods. The total value when withdrawn is linked to interest rates. If the market rates fall, the value could be higher, but, if rates rise, expect the opposite. These annuities have a greater potential to provide higher interest rates than the traditional fixed annuities.

Choosing the best annuity - Shop around for the best deal

The secret to feeling good about your retirement is being certain that you will have money for as long as you live. It is very essential that before you plan your retirement you need to understand how the money is built up in your pension plan which is used to provide you with an income when you

retire. You should choose good investment patterns and schemes so that you can invest your financial assets in a proper way and that is why before choosing an investment you must perform a good amount of research. One of the options people can choose is to invest the majority of their pension in an annuity which pays them a regular income throughout their retirement period. There is not a right or wrong way to invest when you choose annuities; it is up to each person to decide which type is best for them. With any kind of investment, the more that you know about how the market works, the better investment choices you can make. It is a good idea to learn about each type of product that is available to invest in, so that you make sure you are choosing the best products for your retirement. Annuities can offer you security in your retirement accounts and offer you different options to choose which one is the best. If you are looking for a secure investment, choosing the best annuity can help you invest for your retirement.

Benefits of Annuity Insurance

All annuities, fixed or variable, share several common benefits. Here is a summary of what annuities can bring to your retirement portfolio : Ideal for Estate Planning - Proceeds from annuities pass directly to your beneficiaries without the delay, expense and publicity of probate in most states. The Power of Tax Deferral - Tax-deferred is not the same as " tax-free" where there is no income tax on gains, but, tax deferral refers to instances when the taxpayer can delay paying taxes to some future period. An annuity grows tax-deferred during the accumulation phase whether it is fixed or variable. Annuity gains will be taxed only when you withdraw, the advantage is at least you can decide when that happens. No Contribution Limits -

Contributions to other retirement savings vehicles, like 401(k) and IRAs (see chapter 11 for further details), are strictly limited. Annuities, however, offer tremendous flexibility. You can contribute as much as you want, up to the limits imposed by the insurer, to take advantage of tax-deferral or variable accounts inside the annuity, plus, you can add to your annuity contract at any time. Flexible Payment Options - Unlike 401(k)s and IRAs, which require that you begin making withdrawals at age 70 1/2, you may be able to wait much longer with annuities. When you decide and wish to begin receiving payments, you can usually select one of the following methods : Lump sum distribution (a one-time payment)Periodic distributions (you can take money only when you need it)Systematic distributions (a fixed or variable amount is sent to you at regular intervals)Annuitization (fixed or variable payments, guaranteed for the rest of your life)Tax Control - the money inside your annuity is made up of two components – ‘ principal’ and ‘ earnings’. Assuming your annuity was opened with after-tax amount, you're only taxed on your earnings. Different distribution methods behave differently when it comes to taxes; for instance, lump sum, periodic, and systematic distributions exhaust all earnings (which are taxable) before tapping principal. Under annuitization, each payment consists of both principal and interest, spreading your tax liability evenly among payments. Through these distribution options, you have complete control over when you will pay taxes on your earnings. Annuities are not perfect when it comes to tax control. If you should pass away while your annuity is accumulating, all deferred taxes on your growth will become due, reducing your annuity's value. Easy To Start and Maintain - Usually, a simple application, a check, and your signature begins your annuity. Other Features - Annuities also do not offset Social

Security benefits like bond, CD and other investment income does. Annuities are easy to establish and often come with a " free look period." Your state of residence or the annuity contract will define a length of time (usually 30 days) where you can cancel your contract if you decide it's not right for you. You can even exchange older, non-performing annuities into a newer fixed annuity with no tax consequences, thanks to Section 1035 of the Internal Revenue Code.

Children Plans

An Overview - As a parent, your priority is your children's future and being able to meet your children's dreams and aspirations. Cost of education is sky-rocketing and with each passing year we are witnessing increase in the fee structure of various academic institutions. Today providing a good education and establishing a professional career is expensive and will further increase as the time goes. The good old days of government support is practically over. Marriages are also no longer a simple affair when it comes to finance. The event has become more expensive over the years and making it important for everyone to sit down and work out the budget well in advance. Does the parent dream to give his/ her child the freedom and choice to : acquire an education of his/her choice ? opt for even a new-age career which demands a longer time to gain ground (or which take a longer time to get established) ? make a key career or personal decisions without worrying about the money factor ? have a fairytale wedding ? fulfil all his/her wishes during childhood and teenage years ? Irrespective of the type of dream, you will surely agree that all dreams come with a price tag unless finances planned thoughtfully or else parent will not be able to provide

adequate economic support to the child when he/ she needs the most. Add to it inflation and other financial commitments and you will realise that you need nothing less than a fortune to ensure your child's bright future. So, how one can cope with these increasing costs ? The possible answer can be ‘ Children's Plans’ which helps a person to save gradually over the long term by creating a financial corpus so that the child’s future needs can met easily. Regular small sums invested can help in building a decent corpus over a period of time and it goes a long way in providing the child, a secured financial future. These plans are also accompanied with the riders like ‘ Accidental Death Benefit Rider’ or ‘ Accidental Disability/ Dismemberment Benefit Rider’ (explained later in this chapter). Hence, children's plans are immensely popular as parents are looking at so many non-traditional avenues for their kids. This means insurers are also in the game, offering a host of children's policies. This list of insurers offering children's plans as well as details of all the plans they offer will help you make that informed decision regarding your child's future. Chances are that it might take some time before you know what your kid is good at, but you can always provide for his/ her future by salting away a children's plan that will give you the funds at the right time to take his/ her dreams forward. Children plans are available both in traditional as well as ULIP platform. Insurance companies offer policies such as children's money back or endowment, which give a defined payout at a defined period. Besides, if something unfortunate happens to you as a parent, not only does the child still get the sum assured on maturity, but the interim premiums are also waived off. However, the return from such policies is relatively quite low, barely covering the inflation. As a parent, your priority is your children's future and being able to meet

your children's dreams and aspirations. The graph is indicating the infant mortality rate in India which is showing the number of deaths of infants under one year old in a given year per 1, 000 live births in the same year. It includes total death rate and deaths by sex, male and female. This rate is often used as an indicator of the level of health in a country. It is always advisable to compare child plans to see what are the services being offered, the respective premiums and which offer is most suitable according to your requirement.

LIFE INSURANCE POLICY PROVISIONS

" Stipulations of the rights and obligations of an insured and an insurer under a policy". The insurance policy has two most important sections to locate, which are; Clauses and Exclusions.‘ Clauses’ establish the rules you and your insurance company must follow. ‘ Exclusions’ reduce the insurance company's responsibility. Since these two sections outline the protection you can expect to receive, it is important to pay special attention to what these provisions imply. The provisions are those, which the insurance policies are required to follow. These are regulated by the state. Some of the following are standard provisions, which are evident in all life insurance policies. The policies normally contain seemingly countless provisions, clauses and options that determine the type and scope of coverage as well as what will happen if premium payments lag or a claim is made. It is important to understand the provisions of the policy you have or any one you're considering. But, most of us tend, not to pay sufficient attention to the details of a life insurance policy until someone dies or until we are in dire need of some cash. Normally, the thinking goes something like this : " My

husband is dead, he did mention that he had some life insurance, I wonder how much ? I do need some cash, how does the insurance company pay out the policy proceeds ? Was I named as beneficiary or were our children named ?". These are just a few of the questions that may come to mind. No policy of life insurance shall be issued or delivered in this state or be issued by a life insurance company organized under the laws of this state unless such policy contains the following provisions :

Definitions

Age - means age at last birthday unless specifically otherwise mentioned. Base Plan - means the coverage which provides benefits mentioned in clause 3 on benefits. Base Plan Premium - is the instalment premium payable by you for the base plan and is mentioned in the policy schedule. Company, Insurer, We, Us - mean XYZ Life Insurance Company Limited. Due Dates - means the dates on which the policy premiums are due and payable by the policyholder. First Premium - is the premium received along with the proposal form for issuance of the policy. Grace Period - is a period of 30 days starting from the due date of policy premium and ending at the midnight of 30th day from the due date of policy premium irrespective of whether the 30th day is a holiday, public or otherwise. IRDA - means the Insurance Regulatory and Development Authority. Life Assured - as specified in the schedule means the person on whose life the base plan insurance cover is granted by us. Maturity Date - is the date of expiry of the base plan by efflux of the policy term and is mentioned in the policy schedule. Policy - means the contract of insurance entered into between the policyholder and the company as evidenced by this document which sets down the benefits

available to the policyholder and the terms and conditions for availing of such benefit/s. policy means the base plan. Policyholder, You or Your/s - mean the policyholder named in the policy schedule. Policy Anniversary - is the date corresponding to the policy date occurring after the completion of every policy year. Policy Date - is the date of commencement of the base plan and is mentioned in the policy schedule. Policy Premium - is the base plan premium. Policy Term - means the period commencing on the policy date and ending on the date of maturity as mentioned in the policy schedule. Policy Year - is measured from the policy date and is a period of twelve calendar months from the policy date. Proposal Form - is the application form you have submitted to us for purchasing this policy.

Ownership

The ownership clause states that the policyholder owns all contractual rights in the policy as long as he/ she is alive. These privileges can include the right to appoint beneficiaries, to receive the benefits of the policy and the right to make decisions concerning the cash value account in such policies. The applicant of the policy is usually the owner and the insured and has all rights to the policy. There are certain circumstances when the applicant is not the insured like a parent may purchase a policy on a minor child, a spouse may own a policy on his or her partner, a business may own insurance on a partner, shareholder or employee, business partners may purchase policies on the lives of other partners, stockholders may purchase policies on other key stockholders, a corporation may purchase life insurance on key employees. Whenever the insured is a major, he/she must approve of the

policy being purchased on his or her life. This insured must complete the medical part of the application and sign it.

Entire-Contract Clause

This statement establishes the life insurance policy and your application as the entire contract. Therefore, the statements you have made in your application are part of the contract and if these statements are false, can be used as a basis to terminate the entire contract. This is one of the most important provisions of the life insurance policy, which is the ‘ contract’, in itself. The complete policy in written form and the application attached thereto represents the entire contract between the insurer and the policy owner. Due to this written contract provision, agents or the insurance company cannot change or waive any terms and conditions of the contract. Statements in the application are considered representations*, rather than warranties**. It means that only those statements which are material and that would have caused the insurer to make a different decision than the current, about the issuance of the policy and the amount of premium charged to the policyholder, will be considered valid on the grounds, to void the contract.* Representations - Statements made by the applicant for insurance. Insurance contract is voidable at the insurer’s option if the representation is : material, false or relied on by the insurer. Innocent/ unintentional misrepresentation of material facts, if relied on by the insurer also makes the contract voidable.** Warranties - A statement that becomes a part of the insurance contract and is guaranteed by the maker to be true in all respects. For example; a shop owner warrants that burglary alarm is operational all the times or a bank warrants that 24*7 guard is operational or

a building owner warrants that sprinkler system is working throughout. Without the knowledge of the policyholder, the contract cannot make any references to other documents like the corporate bylaws or charter that can change the terms of the contract or any conditions of the contract cannot be changed without the consent of the insured. This clause is desirable for the protection of the insured and the beneficiary because without the clause it might be possible to affect the rights of the respective parties through changes in the bylaws or in the charter of the insurer.

Incontestable Clause

The incontestability clause makes a contract unarguable and protects the policyholder from having any of their benefits contested by the insurance company after it has been in force for two years during the lifetime of the insured and the company cannot void it because of misrepresentation or concealment by the insured in obtaining the policy. This provision is stated in most life insurance policies and is applicable in most of the states which limits the time your insurer is allowed to dispute the validity of the statements you have made on your application. In other words, the clause states that, if the policy has been in force for a given period, usually two years and if the insured has not died during that time, the insurer may not afterwards refuse to pay the proceeds, nor may it cancel or contest the contract, even due to fraud. Thus, if an insured is found to have lied about his or her physical condition at the time, application was made for life insurance, but this misrepresentation is not discovered until after the expiration of incontestability clause, the insurer may neither cancel the policy nor refuse to pay the face amount if the insured has died from the

cause not excluded under the basic terms of the policy. For example; if the insured have had an angina but did not disclose it while taking the policy but later the company discovered it, after a certain amount of time has passed, usually two years, they cannot change the benefits or the premium amount. This is why they are usually very stringent about health exams and medical history. However, if the age of the applicant had been understated, with the objective to obtain a lower premium, the company will recalculate the benefit according to the correct age but, if the insured dies before the end of the two years, the policy is contestable on the basis of material misrepresentations, concealment and fraud in the application. Of course, this is not a license to the policyholder to commit any fraud but, it should be noted that the discovery of fraud will lead the company to contest any claims and possibly pursue criminal charges. Exceptions to the rule (situations under which an insurer is allowed to deny the payment of a claim or to cancel the policy during the incontestable period) : when the insurance applicant had no insurable interest in the life of the insuredif the insured committed a major fraud like medical/ physical examination was conducted on some other person other than the insuredthe beneficiary murders the insuredif the policy is purchased with the express intent of committing suicide and the suicide is committed within the contestability period, then the amount paid by the insurance company will be limited premiums paid plus interest. Hence, it is suggested that, as the incontestable clause forces the insurer to do considerably more investigations (which is a part of the underwriting process) before the insurance policy is issued than would otherwise be the case, perhaps does result in some claims being paid that should not have been, it is important for the policy owner to be honest while

communicating the details if he/ she wants to be confident that he insurance proceeds will be paid upon death. This clause finally ensures that the death benefit is paid promptly without the insurance company hassling the family of the deceased.

Suicide Clause

If the life assured under the policy, whether medically sane or insane, commits suicide, within a specific year of the policy date or the effective date of reinstatement of the policy, the company will not pay any benefit but, only return of premiums plus interest and the policy shall become void. After that period, a claim on a death due to suicide will lead to a full payout. Commonly insurance companies offer coverage for suicide only after you have owned the policy for a certain period of time, which is most often two years. The inclusion of this clause means that if you commit suicide within two years (or less, depending) of purchasing the policy, the insurance company is not required to pay the death benefit, but is obligated to reimburse your family for all the premium payments you previously made. This clause protects the company against adverse selection i. e. purchase of a policy in contemplation of planned death in order for a beneficiary to collect the proceeds. It is argued that if the payment was provided immediately, someone determined to commit suicide could purchase a life insurance policy and then commit suicide. The presumption is that most people who really want to commit suicide are not going to wait till 2 years and give full benefits to the beneficiary, who is authorized to collect the death payment.

Grace Period

Period of time provided in most loan contracts and insurance policies during which default or cancellation will not occur even though payment is due. Grace period is common in a lot of other financial products also such as consumer loans, mortgages, credit card payments etc. The grace period in a life insurance policy is meant to protect the insured. The policy stipulates that the premium has to be paid in the insurer's office on the dates specified therein. These dates are called ' due dates'. Premium may be paid by any of the normal modes of making payments, which includes cash, cheque, demand draft, postal order, money order, banker's order etc. Now-a-days electronic means of payment as well credit and debit cards are also acceptable. The insurer has the option to decide whether the collection charges should be collected from the policyholder. Premiums are required to be paid on the due dates mentioned in the policy. Insurers however allow a ' grace period' for the payment of premium. Payment within the grace period is considered to be payment on time. The grace period would be one month, but not less than 30 days for yearly, half-yearly or quarterly modes of premium and 15 days for monthly modes of premium. Some insurers allow 30 days even for monthly modes. Strictly, the premium is deemed to have been paid only when the cash is received in the insurer's office. That means the cheque or demand draft must be cleared and the proceeds credited into the insurer's account. In practice however, the premium is deemed to be paid when the cheque or demand draft is received. The RPR (renewal premium receipt) is issued " subject to clearance". Sometimes, the insurer may consider that the premium has been paid, if there is proof that the policyholder had sent the money, even if it had not been received in the

office. This may be necessary in the case of death claims, where the death has occurred before the premium reached the office. Such proof may be available in the case of money orders or bank drafts. The benefit is given to the policyholder because the money towards payment of premium had left his hand and was in transit. Not long ago, the RPRs were printed in advance and kept at the servicing Branch office of the LIC to be issued when premium was paid. With the advent of computers and the advanced information technology, it is now possible for any office (not only the servicing office) to verify the status of the policy and accept premium and issue receipts. Very soon more modern methods will be available, enabling remittance from the policyholder's premises itself. In India, where the area is vast and the numbers of offices of the insurer are not too many, arrangements are made with the banks for collection of premium. Such collecting branches send cheque for the consolidated amount collected, along with the list of policies, to the specified office of the insurer at specified intervals. Date of collection by the collecting bank is considered to be the actual date of payment of premium. If the premium is not paid within the days of grace, it is considered a default and the policy is said to be lapsed and the ' reinstatement clause' comes in (see next provision). If the insured happens to die within the days of grace and the premium has not been paid, the claim will be admitted in full and the premium for the current year will be deducted from the claim amount. If the insurance contracts lapse in the 1st couple of years and the lapsed policy is a cash-value policy, then the insured will lose immense amount of money because most of the initial premiums go into paying sales commissions and other expenses of acquiring a policy.

Reinstatement Clause

If premiums are not paid within the stipulated time as mentioned in the policy (indicated in the previous provision) and the policy lapses, it may be reinstated within a specific period of time if the policy holder remains insurable. In the event of your policy's termination because of nonpayment or other noncompliance with the insurance company's rules, you may still be able to reinstate your policy. However, to get it reinstated, you will have to fulfill the stipulations listed in the policy. The reinstatement clause lists the conditions that must be met in order for a delinquent policy holder to reactivate his/ her policy. However, this option must be weighed against the potential benefits and downsides associated with purchasing a new policy. These might include changes in premium costs, payment of all overdue premiums on the policy, other indebtedness to the insurer plus interest on these items is required along with payment of the current premium. It also includes resetting of provisions for contestability, suicide, satisfactory evidence of insurability of the life assured insurability (the insurer may be interested in health, occupation, hobbies and any other factors that may affect the probability of early death). For recently lapsed policies, most insurers require only a personal health statement from the insured. The policyholder can apply for reinstatement of the lapsed policy within three to five years (depends from company to company) from the due date of the first unpaid premium (" reinstatement period"). However, the insurance company is allowed to use their own discretion and therefore, can even deny a request to reactivate a policy cancelled because of delinquent payments or noncompliance. Note : In case the lapsed policy is reinstated; acquisition expenses will be avoided)

Misstatement of Age or Sex Clause

Without prejudice to the company’s other rights and remedies including those under the insurance act, 1938, if the age or gender of the life assured has been misstated or incorrectly mentioned, the company will adjust the sum assured under the base plan accordingly. The insurance company bases decisions about your insurability and the cost of your premiums on your health, habits and age. Providing false information about any of these statistics is grounds for termination of your policy or decreasing the policy's worth or increasing the policy's premiums. The policy conditions provide that, if the age of the life assured is found to be higher than the age as stated in the proposal, apart from any other rights and remedies available to the insurer, premium at the higher rate will have to be paid from the commencement with interest. This is largely redundant now-a-days, as the proof of age is provided with the proposal itself. Even then, there could be an odd case of the proof of age being found to be false. In such cases, the insurer’s rights and remedies would include also the right to declare the policy ab initio void, on the ground of suppression of material facts. Age is important not only for the calculation of premium (as age and sex have a direct bearing on the cost of life insurance) but also for underwriting of risk. Therefore, they are material facts. Thus, the misstatement of age or sex would ordinarily provide grounds, within the contestable period, to void the contract. (Refer Exhibit 3 of chapter 14 for a table of standard and non-standard age proofs). In situations in which a person’s sex has been misstated, the policy may also provided that the proceeds will be adjusted in a similar manner through the misstatement of sex clause. This provision is relevant only when premiums differ on the basis of sex. When such sex-

based rates are used in life insurance, which are very common, females pay lower premiums than do males of the same age.

Beneficiary Designation

This is customary to most policies and allows you to name the recipient of your death benefit. Generally the recipient is either an individual or your estate. It is a wise decision to make an individual the beneficiary to insure prompt payment of the death benefit. As stated earlier, beneficiary of a life insurance policy generally must have an insurable interest in the insured's life at the time the policy is issued. Although technically the insured can specify anyone as the beneficiary regardless of insurable interest considerations, insurers, out of concern for moral hazard, generally reject applications for coverage if an insurable interest does not exist. As a safety net you also can name what is commonly referred to as ' further payees'. As per the provision in a life insurance policy, the policy owner is permitted to name anyone as primary and secondary beneficiaries. The policy owner is also authorized to change the beneficiaries at any time by communicating the insurance company in writing and sending the policy for endorsement. There are 3 levels of beneficiaries in the life insurance policy : Primary Beneficiaries - This is the person who has first right to inherit the asset. This beneficiary is sometimes referred to as the direct beneficiary. If more than one primary beneficiary is named on a policy, the other beneficiaries will equally share the portion. Contingent Beneficiaries - If the primary beneficiary dies before the insured and if the insured has not named someone else as beneficiary before his or her death the benefits will be paid to a named contingent beneficiary. If there are more than one contingent

beneficiary, the proceeds will be distributed in equal shares. Further Payees – If the primary as well as the contingent beneficiary dies, the proceeds would go to further payees, as per the contract.

Change of Plan Provision

In order to provide for changing conditions and different desires, most life insurance contracts allow the policy holder to change the type of life insurance. In any policy change increases the pure insurance component (net amount at risk for the insurer), the policy owner must provide evidence of insurability and if the change is requiring greater reserves; policyholder pays the difference, but, if the reserve is less; insurer refunds the difference. The owner of a term life insurance policy may change, or convert, it to any permanent type policy. This has to be agreed to by the owner and the company. There are set time periods within which a policy may be converted without evidence of insurability. Evidence of insurability would include a medical examination and possibly an inspection report. Exclusions and RestrictionsExclusion is a statement within the life insurance policy that will outline conditions or type of loss that is not covered. These exclusions will be within the policy and they will be clearly marked. You need to know what these exclusions are, because this is a key part of becoming familiar with all aspects of your coverage. Your beneficiary must also know what exclusions surround your policy, because they will be the ones making the claim. There are different types of exclusions and they vary among life insurance companies, but the following are some of the major ones : War Clause - The insurance company includes this stipulation to limit their obligations in times of war. An act of war, on either foreign or domestic soil, is typically not

covered by most life insurance companies. This is a big exclusion that you need to pay attention to if you are in the military, but it often goes unnoticed by many people. This may seem unfair, but to life insurance companies that's more risk than they can safely take. The amount of money that a life insurance company would have to pay out as the result of war time deaths would bankrupt most of them but there can be other options for people in these situations like life insurance through the military. For example; after the blasts in J&K on 6th Aug 2012, victims were hit by insurance bombshell where the TPAs for medical insurance companies had not cleared their bills stating that " war and war-like perils are not covered under the policies". The victims were explaining the insurance companies that there was no war, nor any war like peril that led to the blasts. Moreover, J&K police had yet to ascertain the exact cause of the explosion. If you are in a casualty of war, your insurance company is not responsible for paying the death benefit under this clause. Instead, the insurance company is only responsible for reimbursing your family the money you have paid in premiums i. e. return of premiums plus interest or a refund equal to the reserve portion (cash value) of the policy and also this clause cannot be added to a policy that had none originally. If it is included in a policy bought in time of war, it is typically removed by life insurance companies at the end of the war and once removed, can never be restored. Aviation Exclusion - This exclusion usually states that the policy will refuse to pay death benefit proceeds if the policyholder dies in a private plane crash and not as a passenger on a commercial flight. For this exclusion it doesn't matter if you are the pilot or passenger. The reason behind this exclusion is the guidelines that private planes have to follow are not regulated as strictly as the ones for commercial

airlines. Life insurance companies are very cautious when it comes to private plane crashes and the circumstances surrounding them. These days, a policy with aviation exclusion is rare, but, some do still require you to pay a higher premium to cover the risk, especially in the case of you being employed by an airline.