equaliFi | ACADEMY

FPA

CERTIFICATE IN FINANCIAL PLANNING & ADVISORY

Session 5- Insurance Planning

Content

Sr. No.	Coverage	Duration
1	Insurance Principles	
2	Insurance Types	
3	Insurance Planning	
4	Customers & Tax Benefits	

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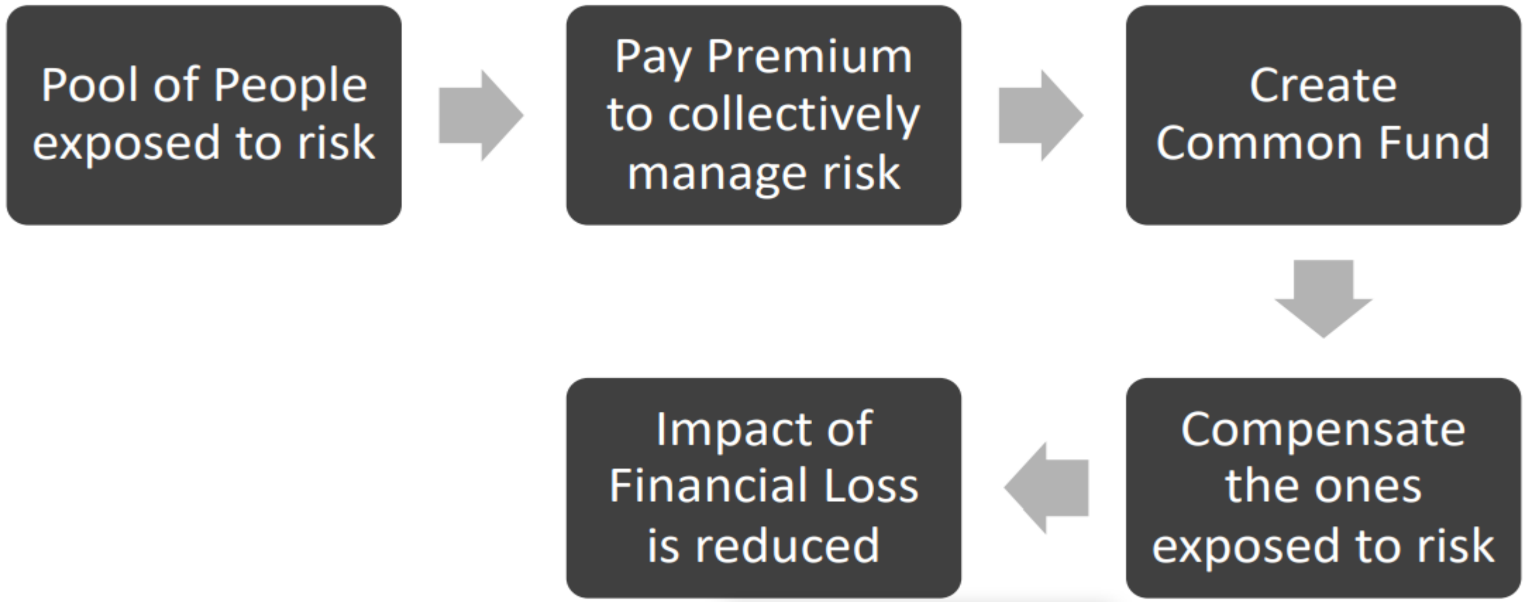
Section

1. Principles of Insurance

Purpose of Insurance



Purpose - Risk Management

- Risk Avoidance
- Risk retention
- Risk transfer
- Risk reduction
- Risk sharing

What is Insurance?

Insurance can be defined as a device which – an individual/business uses – to substitute a large uncertain financial loss (i.e. the contingency insured against) – for a small certain cost (i.e. the premium).

1. Principle of Utmost Good Faith

- Applies to all types of insurance
- True and complete information
- Disclose clearly and accurately all material facts
- Consequences – Claim rejection

2. Principle of Insurable Interest

- Life Insurance - Family, Employees, Lender, Self (exceptions)
- Financial loss to person buying insurance
- Assets – Home, Vehicle, Gold, Furniture, Stock, Transport

3. Principle of Indemnity

- Insurance is not for profit making
- Compensate for losses only i.e. restore financial position
- Doesn’t apply to Life Insurance & Accident Policy

4. Principle of Contribution

- Applies when insured has policy from more than one insurer
- Insurer has the right to recover contribution from another
- Example – Insurance Cover from Company A & Company B = INR 10 Lakhs each – Insurance claimed by insured from Company A = INR 6 Lakhs – Company A has the right to recover INR 3 Lakhs from Company B

5. Principle of Subrogation

- Insurer benefits from the remains of a fully damaged asset
- Just like indemnity, doesn’t apply to Life & Accident Insurance
- Example: – Insured’s Bike fully damaged in an accident – Insured claims money from the Insurer, Insurer settles the claim – Insurer benefits from selling the remains of the bike, not the insured – Insurer can claim the losses from third party (if at fault)

6. Principle of Loss Minimization

- Attempt to minimize losses
- Insurance should not be an excuse for inaction
- Additional info: – Peril – Something that can cause a loss (Covered) – Hazard – Something that increases the chances of loss (Not covered)

7. Principle of Causa Proxima

- Knowing the actual reason of loss
- Nearest cause should be insured
- No liability for farthest cause
- Example: – Met an accident with a Car (Nearest) – Bike fell of the hill (Farthest)

Section

2. Insurance Types

Life Insurance - Term Plan

- Cheapest available insurance
- Biggest life cover among all types of insurance
- Premium not refunded
- Premium = Risk Cover & Admin Charges

Life Insurance - Traditional Policies

ULIPs	Money Back Policy	Whole Life Policy
Insurance & Investment in Equity and/or Debt	Insurance & Investment in Debt	Insurance & Investment in Debt
Low Insurance Cover	Low Insurance Cover	Low Insurance Cover
Good returns, potential	Low Returns	Low returns
Good product for Asset Allocation	Partial maturity after predefined years	Maturity proceeds for life
Premium = Risk Cover + Investments + Admin Charges	Premium = Risk Cover + Investments + Admin Charges	Premium = Risk Cover + Investments + Admin Charges

Life Insurance - Key Man Policy

- Premium Payer - Employer
- Insured – Employee with special skill set & substantial responsibilities
- Company gets the claim amount
- Tax benefit – Company can claim premium amount as business expense

Health Insurance

- Individual Health Cover
- Family Floater
- Group Health Insurance
- Critical Illness
- Personal Accident & Physical Disability

Health Insurance

Health Insurance	Critical Illness
Hospitalization Costs – Pre & Post	Specific illnesses covered
Day Care Costs	Number of illnesses predefined
Domicile treatment	Treatment abroad covered
Free Health Check up	Free of indemnity clause
Top Up Policies & Bonus	

Health Cover for Multiple People

Family Floater	Group Insurance
Family members cover	Company buys for employees
Covers most requirements	Cover ceases with employment
Affordable premiums	Family member cover possible
Sufficient cover	Premium deducted from Salary
	Low Cover

Personal Accident, Physical Disability

- Partial & Permanent Disability
- Temporary Disability (as per income)
- Post mortem expenses cover

General Insurance

- Vehicle Insurance
- Home Insurance
- Fire Insurance
- Marine Insurance
- Travel Insurance
- Commercial Insurance

Vehicle Insurance

- Own Vehicle – Insured's Declared Value
- Third Party Insurance (Mandatory by law)
- Deductible – if higher, premium lower

Home Insurance

- Market Value Basis
- Reinstatement Basis
- Furniture & Jewelry Cover possible
- Affordable premiums

Other Insurances

Fire Insurance	Marine Insurance	Travel Insurance
Movable or immovable property	Cargo Vessels	Trip cancellation due to sickness, injury or death
Fire, lightning, explosion	Ships	Medical expenses while travelling
Natural calamity	Only Hull	Luggage lost or stolen
Water tank burst	Hull & Goods	
Overflown pipeline		

Section

3. Insurance Planning

Life Insurance Need

- Human Life Value Approach
- Need Based Method
- Capital Retention Method

I. Human Life Value

- Present value of the total income of the individual
- Financial loss to the family in the event of untimely death
- Reasonably estimated cover required for an earning individual
- Family’s day to day maintenance
- Future financial security in case of his premature death

HLV Computation

Formula:

HLV = PVn of an annuity x (E-M) – Where, – HLV = Human Life Value – E = Earnings per annum – M = Annual self Maintenance Charges + Taxes + Life Insurance Premium – PV n= Present value of an annuity at a given rate of discount – n = the working span (Retirement age - Present age)

HLV Example

- Mr. Sharma, aged 30 years, is an employee of Praj Industries Ltd. He is planning to retire at the age of 60 years.

- His monthly salary is Rs. 55,000. He pays professional tax of Rs. 3,000 and income tax of Rs. 1,32,000. His self maintenance expenditure is estimated to be at Rs. 45,000 p.a.

- Currently he holds life assurance cover of Rs. 12,00,000 for which he pays Rs. 18,000 p.a. For his wife and child he pays insurance premiums of Rs. 10,500 and Rs. 6,500 respectively pa. Rate of interest assumed for capitalization of future income is at 8%.

- Is his cover sufficient for him? Calculate

HLV Example - Answer

Gross total income	6,60,000
Less: Self maintenance expenses	45,000
Taxes payable	1,35,000
Life insurance premium	18,000
Balance	4,62,000

- Set = Begin;
- N = (60 -30) 30 years;
- I = 8%;
- PMT = 4,62,000;
- PV = solve = 56,17,184

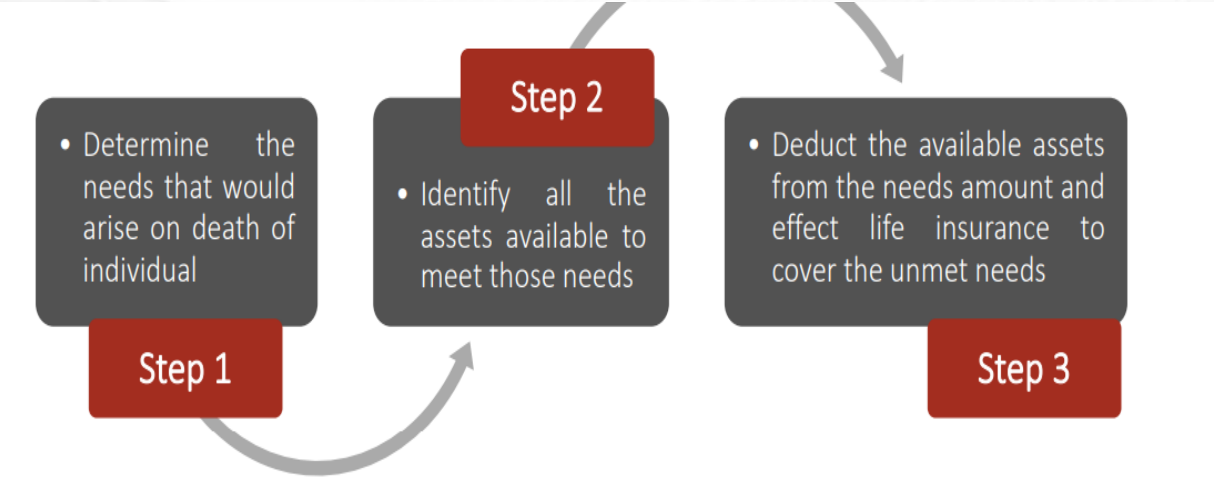
Mr. Sharma needs insurance cover of Rs. 56 lakh

Out of this, he already has a policy of Rs. 12 lakh

Additional cover of Rs. 44 lakh is required

II. Need Based Approach

The needs based approach tries to calculate the amount of life cover required based on an analysis of the needs of the dependents. Needs analysis has three basic steps.



Phases in Need Based Approach

Readjustment Period - The readjustment period is a one- or two-year period following the breadwinner’s death. The purpose of the readjustment period is to give the family time to adjust its living standard to a different level. Child Dependency Period – The period until the youngest child reaches maturity age. Surviving Spouse Life Period – Remaining life expectancy for the surviving spouse

Example – Need Based Approach

Mukesh is aged 35 years, his spouse is aged 30 years. Life expectancy for both is assumed to be 65 years. Mukesh plans to retire at age 55 .While working with the financial planner, Mukesh lists the following needs = Rs 20,000 as final expenses at death Rs 30,000 as emergency fund Rs 80,000 as mortgage clearance fund Rs 1,60,000 as education fund for children Apart from these the family needs will be Rs 3400 per month for 2 years during readjustment period, Rs 2920 per month for the next 14 years during the dependency period and Rs. 1942 per month for the rest of life for surviving spouse. Calculate how much should be the insurance cover for Mukesh? Interest rate is 4% p.a.

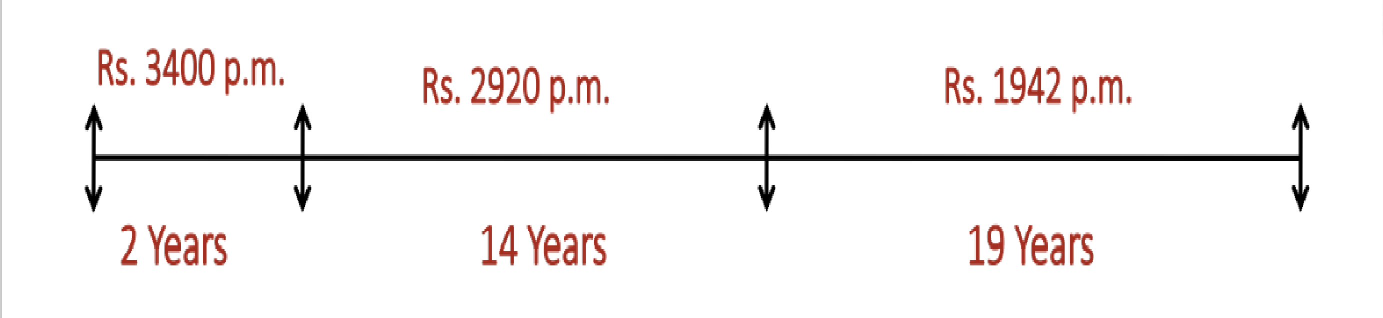
Answer – Need Based Approach

Immediate Needs = (20,000 + 30,000 + 80,000 + 1,60,000) = 2,90,000 • PV of Ongoing Needs 5,95,122 • Readjustment Period 78,610

• Dependency Period

3,49,578

• Spouse Life 1,66,934 Total Insurance Required = 8.85 Lacs



III. Capital Retention Approach

- The capital retention approach assumes that the income is derived from earnings only, leaving the principal intact.

- Under this method, a larger amount of insurance cover is required to provide an adequate amount of income.

Example - Capital Retention

Suppose a family need is estimated as Rs. 1,20,000 per year after the earning member’s death and prevailing interest rate is assumed to be at 8% p.a., what will be the insurance requirement?

Answer - Capital Retention

Required Insurance cover will be: Annual Requirement / Rate of Interest Answer: 1,20,000 / 8% INR 15,00,000

Section

4. Check Needs & Taxation

Check Needs

- Check for must have insurances – Life, Health, Vehicle, Home • Understand customer profile – personal and professional

- Check for under insurance

Tax Benefits – Life Insurance

- Premium paid can be availed as deduction under section 80C
- Premium amount should not be more than 10% of life cover*
- Subject to ceiling amount of INR 150,000 of section 80C
- Claim amount is Tax Free, subject to #2 • Maturity amount is Tax free, subject to #2

Tax Benefits - Health Insurance

Scenario	Premium paid (Rs)		Deduction under 80D (Rs)
	Self, family, children	Parents	
Individual and parents below 60 years	25,000	25,000	50,000
Individual and family below 60 years but parents above 60 years	25,000	50,000	75,000
Both individual, family and parents above 60 years	50,000	50,000	1,00,000
Members of HUF	25,000	25,000	25,000
Non-resident individual	25,000	25,000	25,000

Thank You