What you should know about Insurance – appeared in Sunday Times on 01st April 2007

The Insurance Board of Sri Lanka, the independent body set up by the Government to regulate the insurance sector, will be initiating a series of articles to provide information to the consumers to promote consumer understanding of the insurance system. This is its second article in the series.

In our previous article we gave a general overview of the Insurance Industry in Sri Lanka, understanding life assurance, types of life assurance products offered to consumers, importance of having a life insurance policy and how to choose a life insurance policy.
This article will deal with other aspects of Life Assurance such as rights to insure, disclosure of facts, assignment & beneficiary designation of life policies, rights of policyholders in cancellation and lapsing of life policies.

Insurable Interest:

The Insurable Interest is the "legal right to insure arising out of a financial relationship recognized in law between the insured and the subject matter of insurance". It means that the person obtaining Insurance has some legally recognized financial relationship to the subject matter of insurance. A contract of insurance formed without insurable interest is void. It means that the insured must have an actual pecuniary interest and not a mere anxiety or sentimental interest in the subject matter of insurance. In Life Insurance, the subject matter of insurance is the life of a person. Generally, an insurable interest must be demonstrated when a policy is issued.

Insurable Interest is a Common Law concept that has been applied for centuries whereby if one has no legal relationship with a given person, he does not have the right to insure another and profit from his/her death. When a person takes a Life Insurance Policy on behalf of another person he/she should have an insurable interest in that other person. Further, a person has a legal right to insure his/her own life and his/her spouse, theoretically for an unlimited amount.

Utmost Good Faith:

This is something very important in entering into an insurance contract with an insurance company. "Utmost Good Faith" ('Uberrima fides' in Latin) is the name of a legal doctrine, which governs insurance contracts. It means that all parties to an insurance contract must deal in utmost good faith, making a full declaration of all material facts.

In Life Insurance, the person taking out the policy knows all the facts relating to the life to be insured. That person is the one proposing the insurance and it is his duty to disclose all the facts material to the contract when completing the proposal form to the best of his/her knowledge. Material facts are all facts that would influence the judgement of an insurer in fixing the premium or deciding whether or not he will accept the risk.

If any material facts are not disclosed or inaccurately disclosed or misrepresented and if the insurance company finds out about non-disclosure of any facts or inaccuracy of the facts, the policyholder or his/her beneficiaries may encounter problems in getting the claim at the time of maturity or in the event of the death of a policyholder. A material fact goes to the root of the contract of insurance and has a bearing on the risk involved. It is for this reason that the proposal form is the basis of contract between the insurer and the insured. Therefore, if there is any material misrepresentation or non-disclosure, the contract is null and void from the inception. It is only when the insurer knows the whole truth that he is in a position to judge

(a) whether he should accept the risk and
(b) what premium he should charge.

The duty of disclosure of facts applies from the start of negotiations for the insurance cover and terminates when the contract is formed. In life insurance, during the period of contract, there is no

need to disclose any changes in the insured's life while the contract is running, except in the case where the policy condition may require disclosure of only certain types of facts during the period of contract such as periodic medical reports. Since insurance shifts risk from one party to another (from the insured to the insurer), it is essential that there must be utmost good faith and mutual confidence between the insured and the insurer.

Premium:

The premium is the amount that the insurance company charges for the benefits payable under the policy. The premium may be payable in one sum when the contract is made (a single premium policy) or spread over a defined period such as a term or the lifetime of the life assured. Life premiums should be adequate and equitable.

1. Adequate: to ensure the Insurer will be able to pay the benefit and meet future obligations under the contract of insurance, and
2. Equitable (Fair): to ensure each policyholder is paying an amount in line with the risks and contracted benefits involved.

The Actuary of the Insurer determines the Premium rates for any Life Insurance policy taking into account the Mortality Rates, Interest Rates, Expenses and the benefits payable. Further the actuary is required to certify that the Premium rates, Terms and conditions of the policies are sound and workable for both the insurer and the policyholder. The Premium collected by the Insurers, are utilized for claims, reinsurance protection, operational expenses and investments.

Death due to Suicide:

Death due to suicide is excluded for an initial period from the date of purchase of the policy. If a policyholder commits suicide during this period, the sum assured under the policy is not payable. The said period may vary with the insurers, which is often one year. If the suicide occur after that period, the sum assured under the policy is payable.

Assignment of Life Policies:

Life Insurance is an asset to the policyholder. Therefore the policy owner has the legal right to assign or transfer that asset to another. In the assignment process, a policy owner is the 'assigner' and the third party is the 'assignee'. Change of assignment should be informed to the Insurer in writing. The assignment must not be for any illegal purpose. The amount payable to the assignee will be the sum assured along with bonus accrued, if any, at the time of death of the assigner or at maturity if it is an endowment type policy. The proceeds of the policy may be restricted to payment of only a lump sum to the assignee. If the policyholder had more than one assignment to his policy, the benefit on the policy after the death of the policyholder or at maturity, will accrue to the last assignee in the event the proceeds are not accrued on a percentage basis among the assignees.

Beneficiary Designation for Life policies:

Nomination of a beneficiary is a right conferred on the life assured, to appoint a person/s to receive policy proceeds in the event of a claim arising out of death of the life assured or at maturity of the policy if the policy has a maturity value. A Beneficiary is the proposed recipient of the proceeds of a Life Insurance Policy. The Beneficiary does not get any other benefit except to receive the policy proceeds on the death of the Life Assured or at maturity. The beneficiary is usually named in the Life policy. It is the life assured's responsibility to ensure a beneficiary is nominated in the policy for easy settlement of death claims or maturity proceeds. The Life Insured may nominate anybody as Beneficiary and change this at a later occasion as he/she wishes.

Surrender value:

The surrender value of a policy is the amount that an insurance company is prepared to pay at a particular point in time if the policyholder wishes to terminate the policy prior to maturity date. According to the Regulation of Insurance Industry Act. No. 43 of 2000, if a policyholder maintains a life insurance policy for a minimum period of three years continuously, it acquires a cash value, known as a surrender value. This is the cash entitlement available for the policyholder if he/she

decides to cancel his/her life policy before the maturity date. The amount one person obtains, as surrender value is a portion of the premiums paid and not a portion of the sum assured less expenses, i.e. part of the premium that provided the life cover and premium paid in respect of rider benefits and not a portion of the sum assured. In addition to the surrender value, depending on the policy terms and conditions, bonus accrued up to the time of surrender date will also be paid to the policyholder. Surrender value is available under Endowment or Whole Life type of policies, which have a savings element. The Actuary of the Insurer determines the surrender value for any life policy. It is the policyholder's responsibility to get to know the surrender value of his life policy that he will be entitled in case of cancellation of the policy, from the insurance company.

When a policyholder stops payment of premium for a life policy, it becomes a 'lapsed policy'. Whilst this sort of an action is discouraged, due to various circumstances a policyholder may not be in a position to continue payment of Premium. To avoid lapsing of the policy, the policyholders should take a long-term view of his ability to maintain the policy, prior to purchase of such policy. When a policy lapses, the policyholder will not be in a position to obtain the amount he has already paid as the company has taken risk to itself during the period prior to lapsing of the policy.

If Premiums are not paid after the policy has acquired a surrender value, it becomes a 'Paid Up Policy'. The Policy will continue to remain in force for a reduced sum assured, which is determined on the basis of the premium paid. It is proportionate to the premium already paid on a policy as against the total sum assured. The 'Paid Up' amount is payable either at maturity to the life assured or to the beneficiaries at an early death of the life assured. Paid Up value is available for Endowment or Whole Life type of policies only, which have maturity value.

Reinstatement/Revival of the Life Policy:

Reinstatement/Revival is a process by which an insurer puts back into force a life insurance policy that has been lapsed due to non-payment of premiums. Revival/Reinstatement is considered as a fresh contract with the insured, wherein the insurer can impose fresh terms and conditions. According to the reinstatement/revival concept, a lapsed policy can be made active under the circumstances given below:

A Policy can be reinstated under the following provisions:

1. There is a time limit within which a Reinstatement may be demanded. The period is normally accepted as five years but it may vary depending on the policy conditions.
2. This right normally applies to policies, which were lapsed due to non-payment of premium.
3. The Reinstatement is subject to any of the following conditions.
    - Evidence of continued Insurability i.e. good Health
    - Payment of arrears of premiums, plus interest
    - Payment of Reinstatement/Revival fee.
    - Inclusion of further 'suicide exclusion period' from the date of reinstatement
4. Special Revival – The period of policy-lapse is added to the term of the policy. If it is mentioned in the policy conditions, the 'Declaration of Good Health' and medical tests are necessary for the special revival. This scheme can be availed only once during a policy term.

The mutual consent of the Insurer and the Policyholder is essential for reinstatement of a Life policy. Reinstatement normally implies the right of the policyholder to have a lapsed Policy brought back into force.

Next article will explain Rider benefits, Policy Loan, Loss of policy Document and Claims & Settlement options of life policies.

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