

Insurance Intermediaries Quality Assurance Scheme

Life Insurance Examination

Study Notes

PREFACE

These Study Notes have been designed to prepare candidates for the Insurance Intermediary Qualifying Examination in the subject of “Life Insurance”. They are intended to give candidates a general introduction to the subject and reference materials, where identified in these Notes, serves to provide candidates with a wider coverage of the syllabus and can be used selectively by candidates who wish to investigate a topic in particular detail. The examination, however, will be based on these Notes.

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It should be noted that new editions or amendments of the Notes will be published from time to time where necessary. Although we have exercised diligence in the preparation of these Notes, errors or omissions may still be inevitable. We would appreciate your feedback on these Notes, in order that improvements can be made in the next edition or amendments of these Study Notes.

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NOTE

*If you are taking this Subject in the Insurance Intermediaries Qualifying Examination, you will also be required, unless exempted, to take the Subject "**Principles and Practice of Insurance**". Whilst the examination regulations do not require you to take that Subject first, it obviously makes sense to do so. That Subject lays a foundation for further studies and many of the terms and concepts found in that Subject will be assumed knowledge with this Subject.*

For your study purposes, it is important to be aware of the relative "Weight" of the various Chapters in relation to the Examination. All Chapters should be studied carefully, but the following table indicates areas of particular importance:

Chapter	Relative Weight
1	15%
2	15%
3	25%
4	25%
5	15%
6	5%
<u>Total</u>	100%

1 INTRODUCTION TO LIFE INSURANCE

1.1 DEFINITION OF LIFE INSURANCE

In the first of an excellent series of textbooks produced by the U.S. Life Office Management Association Inc. (**LOMA**), life insurance is defined as follows:

"Life insurance provides a sum of money if the person who is insured dies whilst the policy is in effect."

Anybody who has some knowledge about life insurance will be tempted to say "Yes, **BUT**.....". In other words, surely this is too brief an explanation for a financial service that provides a very sophisticated range of savings and investment products, as well as mere compensation for death. "Yes, **but**" let us remember the objectives of these Study Notes, and this Quality Assurance Scheme. The more we think about this, the more appropriate the above definition becomes, as a starting point.

The definition captures the original, basic, intention of life insurance: i.e. to provide for one's family and perhaps others in the event of death, especially premature death. Originally, policies were for short periods of time, covering temporary risk situations, such as sea voyages. As life insurance became more established, it was realized what a useful tool it was for a number of situations, which would include:

- (a) *Temporary needs/threats*: the original purpose of life insurance remains an important element in life insurance and estate planning, as things like children's education etc. occupy responsible people's thoughts.
- (b) *Savings*: providing for one's family and oneself, as a long-term exercise, becomes more and more relevant as society evolves from a tribal, clan, family orientated community to relatively affluent individual independence.
- (c) *Investment*: the accumulation of wealth and safeguarding it from the ravages of inflation become realistic goals as living standards rise.
- (d) *Retirement*: provision for one's own later years becomes increasingly necessary, especially in a changing cultural and social environment.

So our purpose, as we begin this study, is not so much to remember certain facts, but rather to *understand* something of the fundamentals of long term (life) insurance, and to appreciate its role in a modern society.

1.1.1 Needs for Life Insurance

Whilst **1.1** above outlines the developing appreciation of the many uses of life insurance, the modern scene tends to look upon available life insurance products from the perspective of meeting various needs. These we may think of as:

- (a) *Personal needs:*
 - (i) dependants living expenses;
 - (ii) final (end of life) expenses;
 - (iii) educational funds;
 - (iv) retirement income;
 - (v) mortgage repayment fund;
 - (vi) emergencies fund;
 - (vii) disability income.
- (b) *Business needs:*
 - (i) key persons;
 - (ii) business owners;
 - (iii) partnerships;
 - (iv) employee benefits.

1.2 PRINCIPLES OF LIFE INSURANCE

In the Core Subject for this Quality Assurance Scheme "**Principles and Practice of Insurance**", the principles of insurance were studied in detail. By way of reminder, but not detailed comment at this stage, these principles are:

- (a) *Insurable Interest:* the legal right to insure;
- (b) *Utmost Good Faith:* the requirement to reveal material information;
- (c) *Proximate Cause:* determining the effective reason for a loss;

- (d) *Indemnity*: providing an exact financial compensation;
- (e) *Contribution*: insurers sharing an indemnity payment;
- (f) *Subrogation*: the insurer taking over rights against third parties.

1.2.1 Insurable Interest

In simple terms, insurable interest is that relationship with the subject matter (a person, in the case of life insurance) which is recognized at law and gives rise to a legal right to insure that person. This is a general law concept that has applied for centuries and is obviously based on common sense. If you have no relationship with a given person, why should you have the right to insure him and thus profit from his death? Some particular points to be noted with this principle are:

- (a) **Insurable interest in oneself**: we all have an insurable interest in our own lives. From the law concept that husband and wife are one person, it follows that there is also an insurable interest in one's spouse.
- (b) **Insurable interest in others**: to have an insurable interest in other people, the law requires some financial involvement which could be at risk by the other person dying. Some examples which may be reasonably common are:
 - (i) *debtors*: if a person owes you money, you may insure him for the amount of the loan, plus reasonable interest;
 - (ii) *business partners*: especially where personal services are involved, such as musicians, lawyers, medical practitioners etc;
 - (iii) *contract relationships*: if another person's services have been engaged under contract (booking a singer for a concert, professional sportsperson etc.), that person's death may cause the other contract party to suffer financially. That potential loss is insurable.

Note: This heading would include a common life insurance product known as *Key Person Insurance*, where an employer insures an important employee, in case of loss to the company from the employee's death.

- (c) A parent or guardian of a minor (person aged under 18) is given an insurable interest in that young person. Apart from one's spouse, only the relationships mentioned (parent/guardian of a minor) constitute insurable interest arising from blood or family connection.

- (d) **When is the interest needed?** : this is a key question, and very important consequences flow from its answer. The answer is that insurable interest is **only** needed when the contract **begins**, and becomes irrelevant thereafter. What could be the (quite legal) consequences of this? Some examples are:
- (i) *Divorce*: a spouse, who insures his/her spouse and then becomes divorced, can keep the policy in force and be perfectly entitled to collect the benefit in due time.
 - (ii) *Debts*: it is legally possible to insure your debtor, have the debt repaid, keep the policy in force, and be "paid again" in due time.
 - (iii) *Assignment*: it is quite legal to transfer a properly arranged life insurance to a third party, provided this was not intended at the outset.

1.2.1a Beneficiary Designation

This will be discussed in rather more detail in **4.4**, but in the context of insurable interest we may say that:

- (a) in most cases the beneficiary, as one nominated by the policyowner to receive the benefit under the policy, does **not** need an insurable interest;
- (b) the **exception** is where the insurance is being arranged on the life of someone other than the applicant. This relates to what becomes known as a *third party policy*. In such cases the beneficiary **does** need insurable interest.

1.2.2 Duty of Disclosure

This concerns another important insurance principle, that of **utmost good faith**. Simply expressed, utmost good faith requires the disclosure of all *material facts*, whether they are requested by the insurer or not. A **material fact** is one that would influence the judgement of a prudent underwriter in deciding whether to

insure a particular risk, or the terms on which to insure it. Some points to note:

- (a) **What to disclose:** clearly, the insurer wishes to know all important facts, but you **cannot** be expected to disclose what you reasonably cannot be expected to know. Some medical conditions, for example, may be easily recognizable to qualified doctors, but the average layman cannot be expected to self-diagnose and reveal such things.
- (b) **Non-medical application:** if the insurance is arranged without a physical examination of the applicant, the insurer will normally have great difficulty in alleging that anything not covered by questions on the application or personal physician's form is material.
- (c) **Medical application:** if the insurance is arranged with a physical examination of the applicant, the insurer cannot hold against the applicant any omissions or mis-diagnosing by the medically qualified person concerned.
- (d) **Medical tests:** the insurer is entitled to supplement information supplied verbally with reasonable medical examinations or tests.
- (e) **Breach of the duty:** technically, this constitutes a breach of utmost good faith, which normally renders the contract voidable by the insurer. If fraud is involved, this situation remains true in Macau and the insurer might well void the contract. But with most policies in Macau regard has to be taken of the **Incontestability Clause** (see 4.2), which means that the policy cannot be contested after it has been in force for a specified period (unless there is proof of fraud).

1.2.3 Other Insurance Principles

- (a) **Indemnity:** this means an exact financial compensation for the loss sustained and is very important in most Non-life insurance policies. As far as life insurance is concerned, however,
 - (i) it is immediately obvious that the policy proceeds in no way pretend to (or can) represent an exact financial compensation. That is why life insurances are called benefit policies, not indemnities;

Note: Every life insurance claim is a “total loss”, in the sense that the full sum insured is payable. The actual payment, however, may be more than the sum insured in some cases, e.g. where policy dividends (or bonuses) apply, or where death is from an accident and accidental death benefits have been

added to the policy.

(b) **Indemnity corollaries:** a corollary is a sub-principle and indemnity has two corollaries, *Contribution and Subrogation*. To remind or inform you:

(i) **Contribution:** in most Non-life Insurance classes, if by some chance a person has more than one policy covering the loss (called, helpfully, *double insurance* in marine insurance) he does not get paid twice. Each policy *contributes* to (shares) the loss rateably. If he has more than one policy **not** by chance, it could well be an indication of intended fraud!

In life insurance, the policies do not represent indemnities, so it is quite normal for a person to have more than one life policy and each must pay in full upon the insured event happening.

(ii) **Subrogation:** this relates to the right of the insurer who provides an indemnity to take over any remedies the insured possesses against third parties, to seek to recover his payment to the insured. This does not apply to life insurances.

If, for example, a third party negligently smashes a person's car (which has comprehensive cover), the person's motor insurer must pay but can attempt to recover his payment from the third party. In that same accident if an innocent victim in the car is killed, his life insurer must pay, but the life insurer has no right of recovery from the third party.

(c) **Proximate cause:** this principle is concerned with the discovery of the dominant effective cause that produced the loss being claimed for under the insurance. The principle **does** apply to every class of business, but it is likely to have rather less significance with life insurance. The application of proximate cause is very much concerned with different kinds of **perils** (causes of loss):

(i) *Insured Perils:* are those which **are** covered by the policy. Non-life policies may *specify* the perils which are covered, and one of those must be the **proximate cause** of the loss. In life insurance, the cause of death is probably not critical.

(ii) *Excepted (or Excluded) Perils:* in non-life insurances all policies will carry some exclusions. If one of these is involved with a claim, the

insurer is not liable. Life insurance policies will seldom have exclusions (but see **Note 1** below).

- (iii) *Uninsured Perils*: these are causes of loss which are not included but are also not excluded, for example water damage with a fire insurance. If property is damaged by water (e.g. by rain) with no other cause involved, the damage is **not** covered. But if the water damage is **proximately** caused by an insured peril (say fireman fighting a fire with water hoses), the water damage **is** covered. Such complexities are unlikely to arise with life insurance claims.

- Note:**
- 1 *Suicide* is an exception to the general statement that life policies seldom have *exclusions*, so proximate cause will be important in determining whether death arose from suicide or not. **However**, even here the principle does not have full impact, because suicide is only excluded for a limited time period with life policies (see **4.12**).
 - 2 We may conclude that the principles of insurance, **especially** those concerned with **claims**, have less application in life insurance.

1.3 CALCULATION OF LIFE INSURANCE PREMIUM

The individual premium to insure a given life may have to take into account *individual* features which make the risk better or worse than the average for a person of that age and sex. That, however, is essentially a matter of underwriting, which we shall consider in more detail in **5.3**. Life insurance **rates**, which may be thought of as the normal or standard premiums applicable according to age and sex, are subject to certain common features considered below.

1.3.1 Premium

The classic criteria usually applied to life insurance premiums is that they should be:

- (a) *adequate*: so that the insurer will be able to pay the benefit and meet other obligations under the contract; and
- (b) *equitable (fair)*: so that each policyowner is paying an amount in line with the risk and contracted benefit involved.

To achieve these criteria, a number of factors must be taken into account.

1.3.1a Mortality, Interest and Expenses

- (a) **Mortality:** perhaps more accurately phrased as the *Rate of Mortality*, this indicates the rate at which insured lives are expected to die. Whilst this sounds very morbid, it will be immediately obvious that this is absolutely at the heart of life insurance premium calculation. To know, on average, when your insured may be expected to die is a crucial factor in determining the correct premium to charge.

Of course, individual lives may live much longer or shorter than the average, but following the "*law of averages*" (which is sometimes called the "law of large numbers") reasonable predictions and calculations can be made. These are greatly facilitated by the use of **mortality tables**, which are published tables showing the expected rate of mortality at any given age.

As mentioned above, individual risks may call for special terms and consideration, but that is an *underwriting* matter. Premium rating, as a concept, deals with *normal* risks and normal expectations.

- (b) **Interest:** in very simple terms, life insurance involves collecting money now, and at specified intervals, to provide for a benefit at some time or upon some event in the *future*. This, by definition, means we have some **time**, and as the old saying goes "time is money"!

How much time we have, on average, largely concerns (a) above. The fact that we have some time means we have an opportunity for **investment**. The interest earned on invested premiums and previous interest earnings is another crucial factor in determining premium rates. If the anticipated returns of investment are good, we can charge lower premium rates than our competitors, and/or make more profit for our shareholders.

Note: The above two factors combined will produce what is called the *net premium* (sometimes called the **pure premium**), i.e. the money necessary to meet death claims arising under normal statistical expectations. But there is more to consider.

- (c) **Expenses:** the **net premium** has to be subject to a *loading* (surcharge or additional sum) to take care of all expected and possible expenses. These will include all internal operating costs, commissions, tax and overheads to which any business is subject. With life insurance there is also the possibility (however remote) of unusual mortality rates from some new disease or other disaster - and existing premiums

cannot be increased later to deal with changed circumstances. Loading the net premium will include an amount to cover that kind of contingency.

Note: The **loading** added to the **net premium** produces the *gross premium*, which takes into account all three basic factors mentioned above.

1.3.1b Other Factors

As mentioned, premiums (other than Term policies) for existing policies cannot be changed. Life insurance is long term business, and this implies that the contract not only is likely to last several years, but also it cannot be cancelled or amended by the insurer without the consent of the policyowner. Therefore, other factors which may arise from time to time can only affect new policy premiums. Some of the influences which might have an effect on life premium rating are mentioned below:

- (a) **PAR or NON-PAR:** this is extremely important. One unique feature of life insurance is that the insured has the choice to select whether to effect a "*participating*" or "*non-participating*" (**PAR** or **NON-PAR**) policy. Policies which are "participating" are entitled to receive a share of ("participate" in) the divisible surplus (profits) of the insurer. These are in the form of *dividends*. Participating policies, naturally, are subject to higher premium rates than Non-Participating policies.

Note: 1 Insurers using U.K. style practice call such policies **With Profits** or **Without-Profits**. The concept is the same, although there are differences. *Bonuses* are payable, rather than **dividends**, for example. The former are also usually *reversionary* (payable only when the policy benefit is payable), whereas **dividends** are payable at once.

2 Not all life insurance policies can be **par** or **non-par**. *Term* insurances (see **2.1.1**) are normally not on a participating basis.

- (b) **Competition:** no insurer enjoys a monopoly position. What the market is charging cannot be ignored.
- (c) **Economic changes:** extended times of affluence or recession will doubtless have an impact on all product prices, including insurance.

- (d) **Public health:** abnormal developments in this area (e.g. the AIDS epidemic) cannot be ignored in rating.
- (e) **Fiscal changes:** a lasting increase in tax levels must be reflected in higher premium rates (although this can only be for **new** clients).
- (f) **Company objectives:** if a company is determined to increase its market share, premium rating is an obvious area of concentration.

1.3.2 Natural and Level Premium Systems

These systems for life insurance premium calculations might well be described as "*ancient*" and "*modern*", for reasons that will be clear shortly.

1.3.2a The Natural Premium System

This was the system used by some life insurers in the early days of the business. It was very logical, but it was doomed to failure because of built-in features which virtually guaranteed that it could not work long-term in practice. Its features were:

- (a) **Premiums:** these were not to be constant throughout the policy term, but individually calculated each year so that they reflected the *natural risk* position (age etc.) of the life insured at each policy renewal.
- (b) **Short-term consequences:** with increasing age there is increased mortality risk. Premiums therefore increased every year.
- (c) **Longer-term consequences:** these, in hindsight, were very predictable and included:
 - (i) increasing premiums, with increasing age and in later years decreasing resources, often presented real problems with renewals;
 - (ii) the system was ripe for *anti-selection* (also known as **selection against the insurer**), whereby the better risks - those in good health and with real prospects of a long life - dropped out of the scheme as it became more expensive, and the bad risks would decide to continue, for obvious reasons. This creates an

imbalance of risks, with predictable results.

- (d) **Present day:** the Natural Premium System is no longer practised, at least not for policies which are truly "long-term".

Note: We may be tempted to be scornful of a scheme which we can now see to have such obvious defects. But it is easy to live life in retrospect. Problems and shortcomings usually only appear through experience.

1.3.2b The Level Premium System

This is now the norm and its features are described below:

- (a) **Basic concept:** by the judicious use of **mortality tables** and actuarial calculations, it was realized that it was possible to quote a premium that would remain *level* (unchanged) for the duration of the contract, based upon the age, sex and individual underwriting features of the life to be insured. This, of course, assumes that the death **benefit** also remains unchanged.

Compared with the cumbersome and unsatisfactory features of the **natural premium system**, the advantages and attractiveness of such a system are obvious. It quickly superseded the old system.

- (b) **Short-term consequences:** clearly, the level premium system envisages a long-term contract, where an unchanging premium will effectively "*average out*" over the years. In other words, the premium is "too much" for the risk involved in the early years, and may be "too little" for the risk involved in later years.

Of course this is a simplification, but it is not inaccurate. From this concept it may be seen that once the initial expenses and costs of setting up the policy have been utilised, the early "excess" premiums and interest earnings thereon start to create a fund or reserve against the future liability.

With other types of insurance, the premium is calculated each year and at the end of the year the premium is considered **fully earned** by the insurer. The life policy, under the **level premium system**, soon

begins to build up a cash value (or **surrender value**) for the policyowner.

(c) **Longer-term consequences:** some of the implications and products of (b) above will be examined in more detail in **Chapter 4**, but we may briefly mention the features that developed from the early years "surplus" premiums found with the level premium system:

(i) **Cash value** (also known as **surrender value**): the insurer cannot cancel a life policy, but the policyowner can. If he does, and the policy has been in force long enough to "clear" the set-up costs, part of the premiums etc. paid can be considered to be "not yet earned" by the insurer. Therefore, there should be a **cash** or **surrender value** payable to the policyowner, representing a refund of premiums etc. "unearned" by the insurer at that time.

Note: This is not true for *Term Insurances* (see **2.1.1**), where the premium is geared only to the risk of death during a specified period of cover. Such policies have no **cash value**.

(ii) **Policy loan:** the **cash value** is excellent *collateral* security for a loan. Borrowing money from the insurer using the cash value as security is now a *right* under modern policy terms.

(iii) **Nonforfeiture:** without specific policy provisions to the contrary, the policy will *lapse* if renewal premiums are not paid. However, the **cash value** may be used, voluntarily and sometimes automatically under policy terms, to keep the insurance intact (see **4.5**).

(iv) **Paid-up insurance:** should the policyowner decide he cannot or does not wish to pay any further premiums, as an alternative to policy surrender he may have what is termed a *fully paid policy*. This means he pays no more premiums and the policy stays in force exactly as before, **except** that the sum insured (*the face amount*) is lower, in line with the premiums paid to date. This is largely possible because the premiums are not "fully earned" by the insurer in the earlier years of the policy.

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2 TYPES OF LIFE INSURANCE

To the public and perhaps inexperienced insurance intermediaries, there must seem to be a bewildering variety of life insurance contracts. Certainly, it is a sophisticated and well developed market, but a few basic guide rules should prove helpful:

- (a) **Basic functions:** it is good to distinguish the various products offered by life insurers by what the products seek to *do*. Another way of thinking about that is to ask the question "Under what circumstances is/are the benefit(s) payable?". Some basic formats are:
 - (i) payment on death *only* if it occurs during a specified period;
 - (ii) payment on death *at any time*;
 - (iii) payment on a *specified date* **or** on *earlier death*;
 - (iv) *monthly payments* (or at other specified intervals), for *life* or other specified period, after the insurer has received a **lump sum** (paid all at once or by a series of instalments).

- (b) **Basic variables:** some additions/modifications to the above are:
 - (i) the type of policy (called the *plan*) may be *convertible*, i.e. able to be **changed** into a different **plan**, at the policyowner's option;
 - (ii) *renewable*, if originally for a limited time period (e.g. one year);
 - (iii) **Par or Non-par:** see 1.3.1b(a);
 - (iv) various *Riders*, i.e. **endorsements**, may be added to the policy, either to provide *additional cover* or to make certain provisos.

- (c) **Basic questions:** much heartache and misunderstanding in the whole business of life insurance selling would be avoided if insurers and intermediaries clearly put the following two questions to potential policyholders (and of course acted in accordance with the answers):
 - (i) "What do you want the insurance to do for you?", i.e. *what is it for?*
 - (ii) "How much are you able and willing to invest by way of premium?", i.e. *what can you afford?*

Note: The other basic question "How much life insurance do you need?" is of course

important, but this is usually answered by the intermediary rather than the applicant after completing a financial needs analysis with the applicant.

Given these important preliminaries, we may now think about specific policy types. We should just say, however, that we shall only be considering an outline of the various covers, so that you may be in a position to identify and broadly distinguish the various types of **plan** available. Professional skill and discrimination can only be obtained through experience.

2.1 TRADITIONAL TYPES

These will consist of the four basic formats mentioned in (a) above, although there are many possible variations and combinations of the different types of cover. The major traditional types we shall consider are as follows:

2.1.1 Term Insurance

Such a policy **plan** provides cover for a specified period or *term* only, and may also be described as **temporary insurance**. The policy benefit is *only* payable if:

- (a) the insured person **dies** during the specified period, or term; and
- (b) the policy is **valid** (in force) at the time of death.

This form of cover is an exception to the general rule that a life insurance **always** results in a claim. Indeed, in the great majority of cases, term insurances run their course without a claim. For these reasons, it is the *cheapest* form of cover available (but, of course, its limitations must be understood).

In theory, the **term** could be for any period of time, even a few hours to cover an aircraft flight, for example. In practice, it is rare to find a term insurance for a period of less than *one year*.

2.1.1a Level/Decreasing/Increasing Term Insurance

- (a) **Level term insurance**: this policy plan is perhaps the most popular term insurance. It involves a *level* (unchanging) **premium** and **benefit** throughout the policy period. In the event of death during the term, the **face amount** of the policy is payable. If the term is for more than one year, the renewal

premium is the same each year.

Popular largely because of its simplicity, this is a useful answer to a temporary need which neither increases nor decreases to any significant extent over the period of time involved (perhaps a **loan** which is not being repaid by instalments).

- (b) **Decreasing term insurance:** under this plan, the **premium** is level (constant) throughout the term, but the **benefit** decreases annually, or at other specified times. Because the benefit is continually decreasing and is payable only on death during the term, this is the **cheapest** form of life insurance available. It is particularly suited for a temporary need which is *reducing*. Some typical examples are:
- (i) **Credit life:** designed to repay the balance of a loan *direct to the lender* should the borrower die before all repayment instalments have been made. This plan is usually sold to lending institutions on a *group basis* to cover the lives of borrowers.
 - (ii) **Family income:** perhaps linked with other policy plans which provide a **lump sum** payment, this plan provides a stated *monthly benefit* for the remainder of a specified period, in the event of say a husband's death (the total amount payable is therefore **decreasing** as time goes by).
 - (iii) **Mortgage redemption:** a typical mortgage loan is being reduced by monthly or other periodic payments. This plan covers the balance of loan outstanding in the event of death. This may be on a *joint-life basis* (e.g. husband and wife), the benefit being payable when the first life dies. This is an obvious and most popular form of cover.

Note: The above form of cover must not be confused with **Mortgage Indemnity Insurance**. This is quite different, being an insurance for banks and similar lenders. It covers the possibility of non-repayment of mortgage loans, where the mortgaged property has to be sold in adverse market situations, thereby resulting in a loss to the bank etc.

- (c) **Increasing term insurance:** this plan, as the name suggests, involves a benefit which *increases* annually, or as otherwise agreed. The **premium** also increases proportionately. The increases may be at a *fixed percentage*, or in line with an agreed *index* (e.g. Consumer Price Index). The basic idea is to keep the benefit in line with the value of money, especially in case of **inflation**.

2.1.1b Renewable/Convertible Term Insurance

- (a) **Renewable term insurance:** at first sight, this seems to be a contradiction, because a **term insurance** is for a fixed period, and this extends the period. The key point, however, is that the right to renew the policy is *without submitting* evidence of **insurability** (health) and the **premium** for the further period is *increased* to reflect the increased age of the life insured. (The new premium is said to be based on the **attained age**.)

Because such a plan can involve **anti-selection** (see 1.3.2a(c)(ii)), there may be some limitations applied, such as:

- (i) renewals may only be for equal or *smaller face values*;
- (ii) the *number* of renewals permitted may be restricted (e.g. three times);
- (iii) premium rates may be *higher* than those for non-renewable policies.

Frequently, one-year term policies are made renewable, either by a basic policy provision or an added **rider**. These have the obvious name *Yearly Renewable Term (YRT)* or *Annually Renewable Term (ART)* insurance.

- (b) **Convertible term insurance:** such a plan includes a *conversion privilege*, which gives the policyowner the right to convert (change) the policy to a *permanent* (non-term) plan without evidence of **insurability** (health). If this privilege is exercised, the premium for the wider plan must be the standard rate for such a plan and the **attained age** of the life insured.

Because **anti-selection** is again a possibility with these plans, there may be restrictions:

- (i) conversion may **not** be possible beyond a certain age (say 55 or 65);
- (ii) conversion may **not** be possible after the policy has been in force for say 50% of its specified term (or a specified number

of years);

- (iii) the **face amount** of the new plan (**permanent insurance**) will be limited to that for the term insurance (probably less after the term policy has been in force for some specified time).

2.1.2 Endowment Insurance

An endowment plan provides for the payment of the **face amount** at the end of a specified **term** or upon *earlier death*. Should the insured person survive the term, the policy is said to **mature**. Thus, a claim may arise under such a plan either by **death** or **maturity**. As with a term insurance, the description of the policy must include reference to the number of years of the term involved, e.g. a 20-year endowment provides for payment of the face value after 20 years (on maturity) or upon earlier death. Features to be noted with this plan are:

- (a) **Premiums:** are not cheap, since under normal circumstances a claim **must** arise not later than the specified number of years in the future; premiums are **level**, normally paid annually, although *single premium* endowments are possible;
- (b) **Technically:** the plan is a **combination** of a *term insurance* and a *pure endowment* for equal amounts. (A **pure endowment** is a contract under which the benefit is only payable if the life insured **survives** the term);
- (c) **Par or non-par:** such a plan may be on a participating (**with-profits**) or non-participating (**without-profits**) basis, at an appropriate premium;
- (d) **Popularity:** because in principle such a plan provides the best of both worlds (premature death protection and personal savings for the life insured if the policy matures), these have an apparent attraction.

2.1.3 Whole Life Insurance

Such a plan, quite literally, involves a policy that is designed to last *the whole of one's life* (sometimes it is called **whole of life** insurance). The fundamental feature is that the face amount is paid on *death*, whenever that occurs, and **not** before. Such policies, therefore, may be in existence for many years, even several decades. The relevant features to note are:

- (a) **Premiums:** are **level**, but may be subject to different provisions, including:

- (i) *payable throughout life*: in which event the policy may be called a **straight life** insurance, or a **continuous premium** whole life policy;
 - (ii) *payable for a limited period*: the policy may specify a number of years, after which no more premiums are payable, although the benefit is not paid until **death** takes place;
 - (iii) *premium subject to an age related limitation*: instead of specifying the number of years, the policy may stipulate a certain age (say 65) after which no more premiums are required. As with (ii) above, no further premiums are payable if death occurs before the specified years/age;
- (b) **Par or non-par**: either form of cover is permissible;
- (c) **Variations**: many variations are possible, such as premiums which **increase**, or face amounts which **change**, at specified times during the policy's life, to cater for different needs as time goes by. One such variation is called a *graded-premium policy*, where the premium increases (against a level **face amount**) on a regular basis, say every three years, until it reaches an amount that becomes the level premium for the rest of the life of the policy.

2.1.4 Annuities and Pensions

Each refers to income or other financial provision (usually) for retirement or old age. A simple definition of each term is:

- (a) **Annuity**: A series of periodic payments to an *annuitant*, for life or other agreed term or conditions, in return for a single payment (premium) or series of payments.
- (b) **Pension**: A monthly (or other periodic) income benefit payable to a person in retirement, until that person's death.

2.1.4a Annuities

In the insurance industry, the term 'annuity' means a contract under which one party – the insurer – promises to make a series of periodic payments in exchange for a premium or series of premiums.

The terms of an annuity contract govern the rights and duties of the contracting parties. The parties to an annuity contract are (1) the insurer that issued the contract and (2) the person, known as the contractholder, who applied for and purchased the contract. The **contractholder** can be either an individual or an organisation that purchases the annuity on behalf of a group of individuals.

Annuities are classified according to various criteria:

(a) How the annuity was purchased

Most annuities today are purchased as single-premium annuities. A **single-premium annuity** is an annuity that is purchased by the payment of a single, lump sum premium. Benefit payments under a single-premium annuity may begin shortly after the premium is paid or may begin many years after the premium is paid.

An annuity also can be purchased by paying periodic premiums over a period of years.

(b) How often periodic annuity benefits are to be paid

The frequency of periodic annuity benefit payments depends on the length of the annuity period. An annuity period is the time span between each of the payments in the series of periodic annuity benefit payments. The annuity period is typically either one month (**monthly annuity**) or one year (**annual annuity**), but other options, such as quarterly or semiannual, are also available.

(c) When annuity benefit payments are scheduled to begin

The date on which the insurer begins to make the annuity benefit payments is known as the annuity's maturity date or the annuity date. An annuity can be classified as either an immediate annuity or a deferred annuity, depending on when the insurer is to begin making periodic annuity benefit payments.

An **immediate annuity** is an annuity which benefit payments are scheduled to begin one annuity period after the annuity is purchased.

A **deferred annuity** is an annuity under which periodic benefits are scheduled to begin more than one annuity period after the date on which the annuity was purchased. Although a deferred annuity typically specifies the date of which benefit payments are scheduled to begin, the contractholder usually can change this date at any time before those benefit payments begin. People often purchase deferred annuities during their working years in anticipation of the need for retirement income later in their lives.

(d) When benefit payments end

The length of the payout period depends on the payout option that the contractholder selects. Under the three general types of payout options available, the annuity benefits will be paid as either (1) a life annuity, (2) an annuity certain, or (3) a temporary life annuity.

A life annuity is an annuity that provides periodic benefit payments for at least the lifetime of a named individual. Some life annuities also provide further payment guarantees.

An annuity certain can be purchased to provide periodic payments over a period of time that is unrelated to the lifetime of an annuitant. The named individual whose lifetime is used as the measuring life in a life annuity is called the annuitant. An annuity certain is an annuity that is payable for a stated period of time, regardless of whether an individual lives or dies. The stated period over which the insurer will make benefit payments is called the period certain. At the end of the period certain, annuity payments cease. The annuity certain is useful when a person needs an income for a specified period of time. An annuity certain also might be purchased to provide income during a specified period until some other source of income, such as a pension, becomes payable.

A temporary life annuity provides periodic benefit payments until the end of a specified number of years or until the death of the annuitant, whichever occurs first. Once the stated period expires or the annuitant dies, the annuity benefits cease. For example, under the terms of a five-year temporary life annuity, five years is the maximum length of time during which annuity benefits will be payable. If the annuitant dies before the end of that five-year period, no further annuity benefits will be payable.

(e) The number of annuitants covered by the annuity policy

When a couple purchases a life annuity, they usually want the annuity to provide benefit payments throughout both of their lives. **A joint and survivor annuity**, which is also known as a joint and last survivorship annuity, provides a series of payments to two or more individuals, and those payments continue until both or all of the individuals die.

(f) Whether annuity values are guaranteed or variable.

People who purchase annuities have different purposes in mind for the funds they place in an annuity. Annuity contractholders also have different capacities for assuming a financial risk when they place money in their annuities. Thus, many insurers offer 2 general options to annuity purchasers: (1) the insurer will guarantee to pay at least a stated interest rate on the annuity funds it holds or (2) the insurer will pay interest at a rate that is not guaranteed;

instead, the interest rate will vary according to the earnings of certain investments held by the insurer.

A **fixed-benefit annuity** is an annuity under which the insurer guarantees that at least a defined amount of monthly annuity benefit will be provided for each dollar applied to purchasing the annuity. When an insurer provides interest rate guarantees in an annuity policy, the insurer agrees to assume the investment risk of the policy.

A **variable annuity** is an annuity under which the amount of the policy's accumulated value and the amount of the monthly annuity benefit payment will fluctuate in accordance with the performance of an investment account. The individual who purchases a variable annuity assumes the investment risk of the policy.

2.1.4b Pensions

In Macau pensions are often considered to be more in the Government realm (for example for Civil Servants etc.). More common in the private sector, are **Provident Fund Schemes**, which provide a *lump sum* benefit on retirement or other specified time, rather than an income.

2.2 NON-TRADITIONAL INSURANCE

Life insurance, more or less in its present form, has been practised for approximately 400 years. During that time, the basic policy formats have become very established and they still form a practical and useful role in providing this important form of cover. However, the pattern of economic and social life does not stand still and new products have been developed, often providing a more flexible approach to life insurance cover and associated investment. We look at two such examples.

2.2.1 Universal Life

In an attempt to provide greater consumer choice and flexibility, this product has been developed. It has been well described as a life insurance contract which:

- (a) is subject to a *flexible* premium;
- (b) has an *adjustable benefit*; and
- (c) accumulates a *cash value*.

We examine these and other features of this innovative product:

- (a) **Flexible premium:** subject to certain limitations, the policyowner may pay *more or less* than the premium stated in a given year, after the first year. At his option, he can even omit premium payment for a particular year (again subject to certain conditions).
- (b) **Adjustable benefit:** subject to certain limits, the death benefit may be *increased or decreased*, although proof of **insurability** may be required for any increase in benefit.
- (c) **Loading disclosed:** the calculation of life insurance premiums includes an item for **expenses**, called loading (see **1.3.1a(c)**). Normally this is not disclosed to the insured, but with universal life insurance the expenses and other charges element is specifically disclosed to a purchaser.
- (d) **"Unbundled" cover:** the cover is so described because it separates and individually discloses, both in the policy and in an *annual report* (see (g) below) to the policyowner the three basic elements of the contract, i.e.:
 - (i) the **pure cost** of protection (covering the death risk);
 - (ii) **investment** earnings; and
 - (iii) company **expenses**.
- (e) **Cash value:** the intention is that the policy should acquire an increasing cash value. This of course is heavily influenced by the amount of premiums paid by the insured. After the first premium, additional premiums (subject to an individual limit) can be paid at any time. These, with interest earnings, are added to the cash value after the deduction of:
 - (i) a specified percentage expense *charge*;
 - (ii) the *pure cost* of protection (deducted monthly).
- (f) **Death benefit:** according to the plan the insured chooses, this may be a *face amount* plus the **cash value**, or the face amount only.
- (g) **Annual report:** each year the policyowner receives a report which shows the *status* of the policy. The information given includes:
 - (i) the *death benefit option* selected;
 - (ii) the specified *amount* of insurance in force;

- (iii) the *premiums received* during the year;
- (iv) the *expenses charged* during the year;
- (v) the **guaranteed** and *excess interest* credited to the cash value;
- (vi) the *pure cost* of insurance deducted;
- (vii) the **cash value balance**.

It will be seen that this is a sophisticated product, allowing great choice to the policyowner to adjust his insurance according to his needs and financial resources as time goes by. Intermediaries are advised to consult their principals on local forms of this modern insurance plan.

2.2.2 Unit-Linked Policy

This plan offers a policy with its value directly linked to *investment performance*. This may be achieved by formally linking the policy value to **units** in a special *unitized fund* run by the life insurer concerned, or linking with the **units** in a *unit trust*. The value of the units is directly related to the value of the underlying assets of the fund. This value may *fluctuate* according to the performance of the investments concerned.

A detailed study of this sophisticated financial product is beyond the needs of this study, and again intermediaries should obtain advice and instruction from their principals, as necessary. Some features, however, we may note:

- (a) **Common principle:** unit-linked policies may come in a variety of forms, but there is a common factor. All or part of the premiums will be used to purchase *units* in a fund at the price applicable at the time of purchase. The value of the policy will then fluctuate according to the value of the units allocated to it.
- (b) **Types of funds:** a variety of funds may be used for linking purposes, including *equities* (ordinary shares), *fixed interest* investments and a whole range of cash and other asset funds.
- (c) **Types of policy:** in theory any kind of life insurance product may be unit-linked. The most common in practice are *whole life* and *endowments*, sometimes with a **guaranteed** minimum value, however unit prices may move.

Special care must be taken with products which are essentially investments, so

that the consumer is aware that values may go up or down.

2.3 GROUP AND INDIVIDUAL INSURANCE PLANS

The majority of the plans we have considered so far have been with applications for the insurance of *individuals*, either insuring themselves or another person. This remains a key element in the field of life insurance, but *group insurance* is playing an increasing role. This is especially so with **employee benefit plans**, where an employer provides a form of life insurance, often as an additional benefit supplementing salaries and wages. Again, this is a complex area, but certain features we may note:

- (a) **Basic difference:** the most obvious difference between individual and group insurances is that the latter covers a number of people under a single policy. Sometimes this is called a *master group insurance contract*.
- (b) **Contract parties:** these are the insurer and the *group policyholder*, usually an employer, but possibly a club or other organization insuring its members. The persons within the group who are covered may be referred to as *group insureds* or sometimes *group life insured* or *persons insured*.
- (c) **Different plans:** plans may be *contributory* (where the employees or other persons insured pay a share of the premium) or *non-contributory* (where individual members do not contribute towards the premium).
- (d) **Eligible groups:** usually this concerns a *single employer*, covering his staff members, but other associated persons (clubs, unions, sports associations, etc.) could equally be considered. *Multiple-employer groups*, with different companies participating in a single plan are also possible.
- (e) **Underwriting:** doing business "in bulk" means that the high degree of underwriting attention applicable to individual insurances is neither possible nor necessary. Detailed individual information is usually not required with group plans.
- (f) **Individual eligibility:** eligibility is usually decided by the **employer**, but the usual criterion for admission to group coverage is known as an *actively-at-work provision*. This means that the individual was not only employed, but also at work (not ill or on leave) when coverage became effective.
- (g) **Declined coverage:** an eligible person (particularly with **contributory** schemes) may initially decline coverage. Should that person change their mind later, evidence of *insurability* may be required (to counteract **anti-selection**).
- (h) **Termination of cover:** for individual persons insured, their cover may terminate

upon ceasing to be eligible (leaving the employer or group) or failing to pay any required premium. Some plans allow individuals to *convert* their previous group cover into **individual** coverage, often without proof of insurability but normally within a specified time period.

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3 BENEFIT RIDERS AND OTHER PRODUCTS

Note: The term “policyowner-insured”, as readers will come across in this chapter, refers to cases in which the life insured and the policyowner are the same person. Most life insurance policies are issued to policyowners who are also the life insured. However, readers should also be aware that when one person purchases insurance on the life of another person -- as in the case of third-party policy [see **1.2.1a** (b)] -- the person who purchases the insurance is the policyowner and the person whose life is insured is the life insured.

3.1 DISABILITY BENEFITS

A **rider** is an endorsement to a policy, providing for some additional benefit or making certain stipulations. We shall consider two such riders applicable to situations where the **policyowner-insured** becomes subject to some form of *physical disability*.

3.1.1 Waiver of Premium (Known as **WP Benefit Rider**)

A waiver means that some form of legal right has been given up. In this particular context it means that the insurer **waives** his right to premiums otherwise payable whilst the policyowner-insured is *totally disabled*. This does not mean that the policy is **suspended**. It remains in force and benefits continue to accumulate. (So, effectively, the insurer is *paying the premium*.)

There are normally some limitations, as follows:

- (a) **Waiting period:** this is a time period (usually three or six months) from the time the policyowner-insured is disabled before the premiums are **waived**. The original thinking behind this probably was that most people continue to receive salaries and wages for at least short periods of disablement and so can still afford to pay premiums. But in fact some insurers will *refund* premiums paid during this waiting period if the disablement extends beyond the waiting period. (Technically, this makes it a kind of *"time franchise"*.)
- (b) **Age limitation:** waiving premiums is only permitted if the policyowner-insured is between **15** and **65** years of age (the age range varies with insurers).
- (c) **Premium frequency:** changes in the frequency of premium payments (say from annual to monthly) are **not** permitted whilst disablement applies.
- (d) **Exclusions:** the cover given by this rider is similar to personal accident or medical insurance, so it normally carries some similar **exclusions**, such as:

- (i) *intentional* self-inflicted injuries;
- (ii) injuries sustained whilst engaged in *criminal activities*;
- (iii) *pre-existing* conditions;
- (iv) injuries resulting from *war* while the policyowner-insured is in military service.

The WP rider may be added to virtually all types of life insurance policies.

3.1.2 Disability Income Benefit

Whereas the WP rider gives relief from *expenditure* during **total disability**, the **Disability Income Benefit** rider (as the name suggests) provides an *actual income* during periods of **disability**. The usual provisions relating to this rider are:

- (a) **Definition:** "*total disablement*" as understood by this rider means that the policyowner-insured is unable to perform the **essential acts** of **his own** occupation, or any occupation for which he is **reasonably fitted** by education, training or experience.
- (b) **Income benefits:** are paid monthly as a stated dollar amount, usually having a relationship to the policy face amount (say HK\$10 per HK\$1,000).
- (c) **Waiting period:** similar in concept to that applicable with the WP rider, but the period varies from one to six months.
- (d) **Not a loan:** the policy remains in full force during the disability and should **death** occur during a period of disability the full face amount is payable. No deductions are made in respect of **income benefits** received.

Again, this rider may be added to virtually all types of life insurances.

3.2 ACCIDENT BENEFITS

Accident benefits that are commonly added to any kind of life insurance policy relate to *accidental death* and *dismemberment*. Frequently they are combined in a single rider, known (obviously) as the **Accidental Death and Dismemberment (AD&D) Rider**.

3.2.1 Accidental Death and Dismemberment

To consider these separately, although they are frequently combined:

- (a) **Accidental death benefit (ADB):** this normally undertakes to pay a benefit *equal to the face amount* of the policy as an **additional** sum should death be caused by *an accident*. The customary provisions are:
- (i) death must be caused **directly and independently** of all other causes, by an accidental *bodily injury*;
 - (ii) customary personal accident insurance *exclusions* apply, including:
 - (1) intentional *self-inflicted* injuries (i.e. **suicide**);
 - (2) *war-related* injuries;
 - (3) injuries during *illegal* activities;
 - (4) *aviation* injuries (except as a fare-paying passenger);
 - (iii) death must follow within a specified period of the injury, typically **3 months** or **90 days**. This is to be reasonably sure that the death was really the **result** of the accident (although obvious circumstances, such as an extended coma for an accident victim before death, would certainly meet with every sympathy and merit payment of the benefit).
- Note:**
- 1 This benefit is often called the **Double Indemnity Benefit**. It is evident how the name arose, but we know from earlier studies (see **1.2.3(a)**) that this title is **technically inaccurate** as far as Macau is concerned, since life insurances are **not** indemnities.
 - 2 Also referring to previous studies (see 1.2.3(c)), proximate cause becomes important with this rider. The cause of death for the basic face amount of the policy is in most cases probably not relevant.
- (b) **Dismemberment:** literally "dismemberment" means losing one or more *members* (limbs), but the term within the **AD&D rider** relates to both the loss of limbs and the loss of *sight*. The usual provisions are:
- (i) **Basic cover:** normally, a sum equal to the death benefit is payable if the life insured loses any *two limbs* or the sight in both eyes as a result of an accident.
 - (ii) **Modified cover:** often policies provide for payment of *half* the death benefit if an accident results in the loss of **one** limb or the loss of sight in **one** eye.

- (iii) **Definition:** the loss of a limb may be described as the *actual* loss of limb (by physical severance at or above the wrist or ankle) or the *loss of the use* of the limb.
- (iv) **Combination:** normally, the policy provides that the insurer will **not** pay *both* the dismemberment **and** death benefits for injuries sustained in the same accident.

3.2.2 Other Accident Benefits

Various forms of cover may be provided by different insurers, but a typical rider giving other accident benefits has the following features:

- (a) **Benefit schedule:** the cover is injury from *accidental bodily injury* and a schedule (or list) of specified injuries is given, with a corresponding benefit against each. The list usually includes :

- (i) *Death* - for example, benefit might be **US\$100,000;**
- (ii) *Loss of Two Limbs* - " **US\$100,000;**
- (iii) *Total Loss of Sight* - " **US\$100,000;**
- (iv) *1 Limb & Sight in 1 Eye* - " **US\$100,000;**
- (v) *1 Limb or Sight in 1 Eye* - " **US\$ 50,000;**
- (vi) *Various specified lesser injuries* - see below

Lesser injuries: comprise a detailed list of possible injuries, ranging from serious impairments (e.g. loss of a thumb or index finger) to relatively minor ones (e.g. loss of a single finger joint). On the above scale, the benefits for these might range from say **US\$3,000** for minor injuries to **US\$25,000**.

- (b) **Other benefits:** cover may include one or more of the following:

- (i) *Serious Burns* - at least 3rd degree burns, say **US\$100,000;**
- (ii) *Weekly Benefits* - during disability, say **US\$1,000** (for 52 weeks);
- (iii) *Hospital Benefit* - daily benefit of **US\$100** (for 1,000 days maximum);
- (iv) *"Double Indemnity"* - all benefits (**except** hospital stay) doubled, if the

injury arose whilst travelling on regular public transport or in the burning of certain public places (cinemas, etc.).

- (c) **Exclusions:** a number of exclusions, commonly found with personal accident covers, are normally applicable, including:
- (i) *Self-inflicted injuries* (including **suicide**, at any time);
 - (ii) *War – related injuries*;
 - (iii) *Injuries whilst involved in illegal activities*;
 - (iv) *Disease or illness* (unless caused by an accident);
 - (v) *Childbirth & Pregnancy*;
 - (vi) *Injuries resulting from hazardous sports* - as defined.

3.3 ACCELERATED DEATH BENEFITS

The meaning of this is that in certain serious situations, all or part of the death benefit under the policy may be payable to a policyowner-insured, although death has not yet occurred. Provisions for this are contained in *accelerated death benefit riders*, also known as **living benefit riders**. Common features with the different riders concerned are:

- (a) **Basic reasons:** the benefits are released at times of great personal stress, under grave and life-threatening circumstances. They are to assist with related expenditure and to provide at least partial relief from the extra burden of financial worry at times which are already grief-laden.
- (b) **Eligible plans:** the riders are only likely to be permitted with policies having a significant **face amount**, i.e. the larger policies, with a face amount of perhaps the equivalent of US\$100,000 or more.
- (c) **Beneficiaries:** since pre-death payments to the policyowner-insured will have an impact upon the expectations of named beneficiaries, the latter is usually required to sign a *release* form, acknowledging that the death benefit stands reduced by the amount of the accelerated death benefit payment.
- (d) **Assignees:** similar considerations to those in (c) above arise with any assignee, who

must also sign such a release form.

- (e) **Types of benefits:** we shall consider three such accelerated death benefits, namely the *critical/terminal illness*, the *dread disease*, and the *long-term care* benefits.

3.3.1 Critical/Terminal Illness/Dread Disease

3.3.1a Critical/Terminal Illness (TI) Benefit

The basic features of this rider are:

- (a) **Meaning:** a stated portion of the death benefit is paid to a policyowner-insured who is suffering from a terminal *illness* and has a *life expectancy* of **12 months** or less.
- (b) **Medical evidence:** a statement from an attending physician is necessary, confirming the medical condition and the specified *life expectancy*.
- (c) **Premium:** the payment for this rider is different from other supplementary policy benefits. With the latter, an additional premium charge is customary in respect of each supplementary benefit given. With the **TI** benefit an administrative *charge* is made only when the policyowner-insured elects to **exercise** the benefit.
- (d) **Amount of benefit:** this will vary between companies. Some allow the *full death benefit* to be paid. Most, however, restrict the amount to between **25%** and **75%** of the face amount. It is invariably paid as a *lump sum*.

3.3.1b Dread Disease (DD) Benefit

The basic features of this rider are:

- (a) **Meaning:** a stated portion of the death benefit is paid to a policyowner-insured who is suffering from a *specified disease* or is undergoing certain *medical procedures*. These are known as **insurable events**.
- (b) **Insurable events:** the list of such events is not identical with all insurers, but it is likely to include all or most of the following:

- (i) life-threatening *cancer*;
 - (ii) *AIDS* (possibly with some limitation as to its origin);
 - (iii) end-stage *kidney* (renal) *failure*;
 - (iv) *heart attack* (myocardial infarction);
 - (v) *stroke*;
 - (vi) *coronary bypass surgery*;
 - (vii) *vital organ transplants*;
 - (viii) *Alzheimer's disease*.
- (c) **Restrictions:** again, these are not universal, but typically they may include:
- (i) **DD** coverage is only available up to *age 70*;
 - (ii) **DD** coverage is only available to *standard risks*;
 - (iii) payments may not be made for *multiple/recurring* events.
- (d) **Amount of benefit:** similar considerations to those with **3.3.1a(d)** arise, except that some insurers pay the benefit in *monthly instalments* over a period of 6 to 12 months.
- (e) **Premium waiver:** some insurers offer to *waive* all renewal premiums payable after the accelerated death benefit payment. Others do this, but stipulate that premiums must resume if the policyowner-insured recovers from the affliction.

3.3.2 Long-Term Care (LTC)

This is not a very common product in Macau at present, but the basic features of this rider are:

- (a) **Meaning:** a stated portion of the death benefit is paid to a policyowner-insured who requires *constant care* for a medical condition.

- (b) **Types of care:** these will be specified in the rider, e.g. in an *approved nursing home* or in the policyowner-insured's home by a duly *authorized* carer.
- (c) **Medical evidence:** often the rider specifies that the care needs to be *medically necessary*. Confirmation of this is not always easy. Sometimes, the approval of the *policyowner-insured's* physician is acceptable, but many insurers require that the policyowner-insured be unable to perform a certain number of *activities of daily living (ADLs)* before the need is established. (ADLs will include basic human needs and functions, such as washing, dressing and mobility.)
- (d) **Amount of benefit:** typically, this may be **2%** of the death benefit **per month** for *nursing home* care and **1%** for *home health care*. The maximum total payments may range between **50%** and **100%**.
- (e) **Waiting period:** usually there is a **90-day** waiting period before **LTC** benefits are payable. Also, some insurers require the policy to have been in force for **one year** or more before qualifying for LTC benefits.
- (f) **Premium waiver:** it is common for premiums to be **waived**, both for the rider benefit and the basic insurance policy, during the period that these benefits are being made to the policyowner-insured.

3.4 MEDICAL BENEFITS

In earlier days, medical benefits would not be provided under life insurance policies. Such cover was considered to be part of the "**Accident**" (Personal Accident) portfolio. In more recent times, the boundary lines between various classes of business has become less clearly marked. It is therefore quite common for life insurers to consider medical benefits insurance part of their "insurances of the **person**" range of products. Cover may be given as a **rider** to a life insurance, or separately as a general insurance policy (for which type of insurance the insurer must of course be authorized).

A typical form of cover found in Macau at present is likely to include most of the following features:

- (a) **Basic plan:** Intended to cover the expenses related to *medical treatment* and *hospitalization*, the Basic Plan has a number of headings under which cover is given, typically as follows:
 - (i) **Hospital charges:** these are likely to have three different categories,

according to choice and premium paid, the usual descriptions being *Private Room, Semi-Private Room or Ward Bed*. Cover includes Room and Board, Miscellaneous Hospital Services and an available supplement for Intensive Care treatment.

- (ii) **Private nursing:** again with three categories, this includes nursing treatment at home, in hospital by a qualified nurse or as recommended by the attending medical practitioner.
 - (iii) **Surgeon's, anaesthetist's and operating theatre fees:** Maximum benefit cover is specified according to the three categories and the seriousness of the operation involved.
 - (iv) **In-patient physician's fees:** for non-surgical cases.
 - (v) **In-patient specialist's fees:** for treatment, consultations etc.
 - (vi) **Out-patient follow-up care:** within 6 weeks of hospital discharge.
 - (vii) **Free worldwide assistance:** a number of benefits and covers to help in the event of emergency needs whilst abroad. These range from instant telephone assistance to the return of mortal remains.
- (b) **Optional medical plan:** Various titles may be given to this option, available at extra premium. The basic intention is to provide coverage for much increased limits under the various headings and categories of the Basic Plan.
- (c) **Major exclusions:** There are limits to the time during which various benefits under the Basic and Other Plans may be paid, but these are part of the description of cover. Specific *exclusions* are likely to include the following:
- (i) **Pre-existing conditions;**
 - (ii) **Pregnancy and childbirth** related expenses;
 - (iii) **Drug or other substance abuse**, self-inflicted injury and sexually transmitted diseases;
 - (iv) **AIDS or HIV** related conditions (sometimes only excluded for say the first five years of the insurance);
 - (v) **Congenital abnormalities** treatment.

3.5 INSURABILITY BENEFITS

Insurability is virtually self-explanatory, it means that by normal underwriting and business standards a particular risk is acceptable for insurance. The usual feature that affects this is, of course, the **health** of the person who is to be the *life insured*. Checking whether a person is insurable is a basic element in **underwriting** (see 5.3). Sometimes the question of insurability, however, arises for an existing client (perhaps with policy **reinstatement** - see 4.7 or on other occasions). This question, however, may be avoided if the policy is made subject to the **Guaranteed Insurability (GI) Benefit**.

3.5.1 Guaranteed Insurability Option

The **GI** benefit is sometimes referred to as a *Guaranteed Insurability Option (GIO)*. The basic features of this rider are:

- (a) **Meaning:** the policyowner has the right to purchase additional insurance (of course for an additional premium) on specified option *dates*, **without** having to supply evidence of insurability.
- (b) **Limitations:** the *amount* of additional cover may be limited (to the existing policy's face amount, or less). Also the right may only be available until the life insured reaches a certain *age* (typically aged **40**).
- (c) **Not automatic:** if the policyowner does not effect the extra cover on a particular *option date*, that particular right is **lost**. He may, however, exercise the right on the next option date.
- (d) **Option dates:** these are specified in the rider, either as particular dates or for particular *events* (such as **marriage**, or the **birth** of a child).
- (e) **Temporary cover:** some insurers grant *term insurance* cover automatically to cover the policyowner-insured during the period allowed for exercising his purchase option, so that if he dies before completing the option he has the extra cover.
- (f) **Policy with WP:** if the insurance also has a **Waiver of Premium** rider (see 3.1.1) and the policyowner-insured is disabled at the time he is to exercise his option for additional cover, the additional cover is issued *automatically*. The **WP** rider also provides for **all** premiums to be waived, until the recovery or death of the policyowner-insured.

3.6 INFLATIONARY ADJUSTMENT

Inflation reduces the purchasing power of money. It is therefore an important element to be considered with any **long-term** insurance linked to a specific **face amount**. Bearing in mind that policies may continue for many years, perhaps many decades, before they become payable, it will be realized that what was once a significant amount may in real terms have been reduced to a small or even trivial sum, because of inflation.

Clearly, this is a problem needing serious attention to the whole of one's life insurance programme, but in the context of this Chapter on **Benefit Riders**, provision has been made in relation to disability income benefits being paid, as follows:

3.6.1 Cost of Living Adjustment (COLA)

This rider or policy provision provides for periodic increases in the disability income benefits being paid to disabled policyowner-insured. As the name suggests, the increases are linked to increases in a recognized independent index, such as a *Consumer Price Index*. In recent years, inflation has become much less of an issue for Macau, but it would be foolish to take a short-term view of a long-term problem, especially when issuing **long-term** insurances.

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4 EXPLAINING THE LIFE INSURANCE POLICY

It should be mentioned at the outset of this Chapter that the Macau Life Insurance market tends to use policy wordings commonly found in the North America. The General Insurance market, on the other hand, mostly uses policy styles originating in the U.K. For the purposes of this study (the Life Insurance Policy), we shall follow the more common "U.S. style" policy provisions, making appropriate comments relating to possible variations should a local insurer be using U.K. style life insurance policy wordings.

4.1 THE ENTIRE CONTRACT

A Life Insurance Policy is a most important document. The contract is *Long Term*, i.e. lasting many years, perhaps decades. Unlike most other classes of business, it is essential that the original policy document be presented when a claim is made. The "**entire contract**" provisions are therefore very important. They provide that:

- (a) the **entire** contract consists of the policy and the copy of the **application** attached;
- (b) **only** certain specified senior officials of the company are authorized to make changes to the contract;
- (c) **no change** to the contract can be made *unless* the **policyowner** agrees.

4.2 INCONTESTABILITY

This means that within the terms of these provisions the *validity* of the contract **cannot** be contested (challenged) by the insurer. Disputes over the validity of an insurance contract may arise with an alleged breach of **utmost good faith**, i.e. certain **material facts** have been omitted or misrepresented. The basic provisions of the **Incontestability Clause** are that:

- (a) the insurer cannot (normally - see below) dispute the validity of the contract after it has been in force for 2 years;
- (b) that minimum period of two years must be during the lifetime of the insured;
- (c) under Macau laws (**not** U.S. law) the claimant cannot rely upon this Clause in the event of fraud. Macau law will not support fraud, whatever a contract may say.

[**Example:** suppose a non-medical insurance is arranged solely on the basis of health

information declared by the Insured. He fails to reveal certain **material** information which, for example, would have meant that the insurer would not have insured him. The man dies after three years. Under the normal rules of **Utmost Good Faith** the insurer could deny the contract. In the absence of fraud, they cannot. If fraud is established, the insurer may deny the contract if the applicable law is that of Macau.]

4.3 GRACE PERIOD

Under U.K. style policies, this is also called "**Days of Grace**". Essentially, this relates to a period of time after the date on which a premium is due, when cover is kept operative. Normally, the policy would **lapse** (terminate) if the premium is not paid by the due date, so these provisions allow for the *late payment* of premium without penalty. The features of these provisions are:

- (a) the grace period is usually a minimum of **30** or **31 days**;
- (b) the grace period does not apply to the initial premium for the policy;
- (c) payment of premium within the grace period is deemed to be payment *on time*;
- (d) this is **not** a period of *free insurance*; for example
 - (i) if the insured dies within the grace period before payment of the premium, the claim is paid but the premium due is deducted;
 - (ii) if the premium is not paid during the grace period (and subject to any other policy provisions, such as nonforfeiture, see **4.5** below) the policy will lapse from the date the premium was due.

Note: There seems to be some doubt as to the *exact time* the policy will lapse, if the due premium is not paid during the grace period. Under the traditional U.K. practice, non-payment of the premium during the permitted days of grace meant that the policy lapsed from the *date the premium was due* (the "renewal", or policy anniversary date). Under the U.S. system it seems clear that the policy would lapse *at the end of the grace period*. The matter is likely to be of academic interest only, but the market consensus on this point in Macau seems to be that the **U.S.** position would apply (i.e. termination at the end of the grace period).

- (e) special provisions may arise with less traditional types of policy, e.g. *universal life*.

4.4 BENEFICIARY DESIGNATION

A **beneficiary** is the proposed recipient of the proceeds of a life insurance policy. The beneficiary is usually named ("designated") in the policy. Various complexities may arise with beneficiaries, under different circumstances, but the basic provisions to note are:

- (a) if the applicant is the proposed life insured, he may nominate anybody as beneficiary;
- (b) if the applicant is not the proposed life insured (such a policy is called a third party policy), the proposed beneficiary must have an **insurable interest**;
- (c) class designations (e.g. "my children" etc.) are permitted;
- (d) a primary (or first) beneficiary receives the proceeds, when payable (if more than one is designated, shares will be equal unless otherwise specified);
- (e) a beneficiary cannot inherit if he is not living at the time of the death of the insured, so contingent beneficiaries may be designated, in case the primary beneficiary(ies) dies/die first.
- (f) A 'revocable beneficiary' is a life insurance policy beneficiary whose designation as beneficiary may be cancelled by the policyowner at any time prior to the insured's death.
- (g) An 'irrevocable beneficiary' is a life insurance policy beneficiary whose designation as beneficiary may not be cancelled by the policyowner unless the beneficiary consents.

4.5 NONFORFEITURE BENEFITS

Most conventional life insurances (other than **term** insurances) acquire a **cash value** after an initial period in force. That cash value is important for a number of reasons, discussed elsewhere in these Study Notes, and has special relevance to the question of **nonforfeiture**. If something is "forfeited", it means that it is lost or rights to it are taken away. "Nonforfeiture" therefore means that rights are not lost under certain circumstances, in this instance the *discontinuance of premium payments*.

Without specific provisions to the contrary, non-payment of premium means that the policy will **lapse** if the premium is not paid within the **grace period**. The customary nonforfeiture provisions are that:

- (a) the policy does **not** lapse because of non-payment of premium. Unless instructions are received to the contrary, the **cash value** of the policy is used to pay premiums for as long as the cash value lasts, keeping the policy in force for the full amount;

Note: Some insurers do not regard this as a nonforfeiture benefit, but treat it as a quite separate policy provision known as an *automatic premium loan (APL)*.

- (b) the owner of a policy which has a cash value, who decides not to pay any more premiums in respect of the policy, has certain *options*. These options are:
- (i) *cash surrender value*: the cash value is paid upon terminating the policy;
 - (ii) *reduced paid-up insurance*: the cash value is used as a single premium to purchase life cover on the same basis as the policy (for a lower amount);
 - (iii) *extended term insurance*: the cash value is used as a single premium to purchase term insurance for the same amount as the policy amount, for such period as the cash value will provide.

Note: These options arise when a conscious decision is made to discontinue premium payments. If premium payments merely **stop**, with no information from the insured, the **automatic** provision in (a) above may be put into operation. If the policy has no such clause, or the policyowner fails to choose any option, many policies provide that option (b)(iii) above should apply automatically.

4.6 POLICY LOAN

Another feature directly arising from the existence of a policy **cash value**, is the facility of borrowing money from the insurer, using the cash value as security. The concept arises with the **APL** feature mentioned in 4.5(a) above, but the customary **Policy Loan** provisions are:

- (a) the policyowner has a *right* to borrow money from the insurer;
- (b) the loan may be for *any purpose*;
- (c) the loan may be up to the policy *cash value* (less one year's loan interest);
- (d) the only *security* required for the loan is the policy cash value;
- (e) the loan may be repaid at *any time*, or **not**, as the policyowner decides;
- (f) if not repaid, the amount of the loan and any outstanding interest is deducted from the *policy benefit*, when payable.

4.7 REINSTATEMENT

Under U.K. life insurance practice, this is also known as "**Policy Revival**". The

concept is that a policy which has *lapsed* ("died") can be brought back to "life" under certain circumstances. Of course, this can always happen by the mutual consent of the insurer and the policyowner. The term "reinstatement", however, normally implies the *right* of the policyholder to have a lapsed policy brought back into force. The usual policy provisions which apply to this are:

- (a) there is a time limit within which this may be demanded;
- (b) that period may vary between insurers, but **5 years** is quite representative;
- (c) the right normally applies only to **lapsed** (not **surrendered**) policies;
- (d) the reinstatement may be subject to any of the following *conditions*:
 - (i) evidence of continued *insurability* (good health);
 - (ii) *payment* of any outstanding loan, plus interest;
 - (iii) payment of *back premiums*, plus interest;
 - (iv) payment of a reinstatement *fee*;
 - (v) a further *contestable period* (see **4.2**) from the reinstatement date;
 - (vi) a further *suicide exclusion period* (see **4.12**) from the reinstatement date.

4.8 MISSTATEMENT OF AGE OR SEX

Please note that this is a *misstatement* of age or sex. In the event of a voluntary sex change operation to an existing life insured, the advice of the insurer concerned should be obtained.

Obviously, a different age or sex from that indicated when the insurance was arranged can have a significant impact on the policy premium and/or benefit. The customary provisions in these circumstances are:

- (a) *If the error is discovered after a claim arises*: the amount of the benefit is adjusted (up or down) to reflect the amount payable had the correct age/sex been given and the same premium paid.

Note: If the insurer is following traditional U.K. practice on this issue, the benefit would only be adjusted downwards. If the age/sex mistake indicates that too much premium was paid, a refund of the overpaid premium (without interest!) was paid. Again, this might be a

point to check with any insurer using U.K. forms etc.

- (b) *If the error is discovered before a claim arises:* the policyowner is usually given the choice of
 - (i) leaving the face amount unchanged and receiving or paying the appropriate adjustment after calculating the correct premium that should have been paid; or
 - (ii) adjusting the face amount of the policy to reflect the correct figure, given the age/sex of the life insured and the premium paid.

Note: The U.K. practice on this point will be the same.

4.9 ASSIGNMENT

A life insurance is an **asset** of the **policyowner**. It is true that the interest in such an asset may be *reversionary*, i.e. full rights of enjoyment and disposal may not be acquired until some date or event in the future, but legal ownership exists **now**. Therefore, the policyowner has the legal right, as with any other asset, to *assign* or **transfer** that asset to another (as a **sale** - for a payment - or as a **gift**). If this happens, the policyowner is the *assignor* and the third party is the *assignee*.

Certain features of assignment that we should note, arising from policy provisions and otherwise, are as follows:

- (a) **Notice of assignment:** the insurer cannot legally prevent an assignment, but the policy says that the insurer is **not** bound to honour an assignment until it receives **notice** of it. This should be in **writing** (the policy usually requires a "copy of any assignment").
- (b) **Validity of the assignment:** the insurer is **not** responsible for this.
- (c) **Rights of assignee:** these are *subordinate* to those of the insurer regarding the **proceeds** of the policy, i.e. any *overdue premiums* and/or loans and interest must be deducted before any payment is made. The **assignee** is said to receive the *net policy proceeds*.
- (d) **Limitations on the assignment:** the assignment
 - (i) must not violate any *vested right* of any **beneficiary** (especially of any **irrevocable beneficiary** - one that cannot be changed);

- (ii) must not be for *illegal* purposes;
 - (iii) may be restricted to involve *only* a **lump sum** payment to the assignee, i.e. no other settlement options.
- (e) **Types of assignment:** there are two types:
- (i) **absolute assignment:** the arrangement is *permanent* and the **assignee** becomes the new policyowner;
 - (ii) **collateral assignment:** the arrangement is *temporary*, usually where the policy is used as **collateral security** for a loan (**not** from the insurer). Here the assignee's interest is limited to the *loan plus interest*. The policyowner cannot have a policy **loan** or **surrender** the policy whilst a notified collateral assignment is in force.

4.10 DIVIDEND OPTIONS

Participating policies, in due time, should qualify for dividends. Unlike bonuses under U.K. style "*with-profit*" policies, which are almost invariably *reversionary* (i.e. not at the policyowner's disposal until the policy benefit is payable), **dividends** become the disposable property of the participating policyowner immediately. The policy, however, normally presents some options in respect of such dividends. They may be:

- (a) paid in *cash* at once;
- (b) applied towards *future premiums* (renewals) of the policy;
- (c) left with the insurer to earn *interest*;
- (d) used to buy *paid-up* additional insurance;
- (e) used to purchase *one-year* term insurance.

Note : If the policyowner makes no selection from the available options, most policies make provision for what is known as an *automatic dividend option* to apply. In Macau, practice seems to vary, but the likely alternative applications are:

- (i) option (c) above, leaving the dividends with the insurer to earn interest; or

- (ii) option (d) above, the purchase of paid-up additional insurance.

Intermediaries should check with their respective principals.

4.11 SETTLEMENT OPTIONS

When the policy benefit becomes payable, there are different possibilities for the beneficiary and/or policyowner. These are:

- (a) a *lump-sum settlement*: a single payment, to complete the whole contract;
- (b) an *interest option*: the proceeds are left with the insurer, who pays interest annually or at agreed more frequent intervals;
- (c) a *fixed period option*: the proceeds (and interest) are paid in instalments over an agreed period of time;
- (d) a *fixed amount option*: the proceeds (and interest) are paid in agreed amount instalments for as long as the money lasts;
- (e) a *life income option*: the proceeds (and interest) are paid in agreed instalments for the lifetime of the designated person - effectively this is purchasing an annuity.

4.12 SUICIDE CLAUSE

One of the features of life insurance is that the benefit may be payable even if the cause of the claim was the *deliberate* act of the insured life. This arises from the underlying reason for life insurance, which originally was primarily to make provision for dependants, rather than to benefit the insured personally.

With a long term contract and under those circumstances, it would be unfair to penalize the family in the tragic event of the insured person taking his own life. On the other hand, certain safeguards against the effecting of life insurance with suicide in mind are perfectly reasonable. The usual provisions are:

- (a) suicide is *excluded* for an initial period of the policy;
- (b) that period may vary with insurers, but 1 *year* is very representative;
- (c) should suicide occur after that period the policy amount is payable;
- (d) should suicide occur during that period the policy amount is not paid, but it is normal

for the policy terms to say that premiums paid (less any outstanding loan and interest) are *refunded*.

- Note:** 1 Being a policy exclusion, it is for the insurer to *prove* that death was by suicide - not always an easy thing to do.
- 2 Bearing in mind the overall intention of the exclusion (to defeat arranging a policy when suicide was contemplated), it is not unknown for an insurer to pay for a proved suicide which can reasonably be assumed to be attributable to events arising *after* the policy commenced. Of course, this would be *ex gratia* (i.e. not legally required) and the circumstances would have to be quite unusual.

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5 LIFE INSURANCE PROCEDURES

5.1 COMPANY OPERATION

The way a company operates is determined by the company itself and there is no set pattern or formal structure that must be adopted. Therefore, the following comments are only *representative* of a company's operations. Before looking at the internal organization of a typical life insurer, however, we should just mention two important types of company, according to their *constitutional* basis:

- (a) **Mutual insurance companies:** a *mutual* insurance company has no **shareholders**. Legally, it is owned by its participating policyholders, although in practice control is exercised by its **Board of Directors** and senior management. Being a mutual has certain advantages, especially for policyholders, who do not have to share company profits with shareholders. It has certain disadvantages as well, particularly with regard to the raising of new capital, should this be required.

Note: The fact that a company has the word "Mutual" in its title is not conclusive evidence that it **is** a "mutual", as defined above. Whilst this may well be the case, and all companies having "Mutual" in their title undoubtedly began as such a business unit, some "mutuals" world-wide have *de-mutualized*, changing their constitutional status, to become as below.

- (b) **Proprietary or joint-stock companies:** these companies are much more common business structures, consisting of a limited liability company owned by its shareholders. "Limited liability" means that the shareholders cannot be made to contribute anything further towards company losses or capital requirements once their shares are "*fully paid-up*".

5.1.1 Typical Company Operational Structure

Since company structures cover a great number of inter-related activities and there is no set pattern to follow, we shall briefly mention various departments or functions, in alphabetical order only:

- (a) **Actuarial department:** As mentioned before, life insurance is profoundly involved with mathematical calculations and projections. The actuarial department therefore has a key role in company operations, its involvement including:

- (i) *Product pricing:* probably sub-divided between the various major types

of product offered, e.g. Individual Life, Group Life, Health, Personal Accident and Retirement Benefits.

- (ii) *Valuation*: a **core function**, required by statute, valuation consists of the calculation of the value of **assets** and **liabilities**. The way this is done is critical to the *solvency margin* of the company and the **crucial** matter of determining the profits, from which **dividends** (or **bonuses**) can be paid - although the Board of Directors makes the actual decisions in this respect.
 - (iii) *Claims and reinsurance*: calculations and projections of reserves and needs in these areas are obviously of great importance.
 - (iv) *Management reporting*: this could be within the area of the company accounting staff, but whoever performs the function, it is a critical one. Unless top management are supplied with reliable data on reserves, surpluses and other key matters, effectively the company cannot operate (at least not efficiently, and that probably means "not for long"!).
- (b) **Accounts department**: According to company policy and structures, an Accounts department may represent the relatively routine (but **important**) role of *bookkeeping and financial record* maintenance, or (more likely) it will include **Management Accounting**, with responsibilities in the key areas of *budgeting and investment* etc. Standard functions of the Accounts Department include:
- (i) *Receipts*: monitoring and recording all payments due to the company, by way of premiums, reinsurance, loan repayments, etc.
 - (ii) *Payments*: monitoring and recording all payments to be made by the company, including claims, salaries, agency commissions, purchases, etc.
 - (iii) *Financial returns*: every insurer must submit audited accounts each year, as required by the Macau Insurance Ordinance. This is a major function and responsibility of the Accounts department.
- (c) **Agency training and control**: The great majority of individual life insurance contracts are sold through field agents (intermediaries). They at one and the same time represent almost the "lifeblood" of the company, and a major responsibility regarding their appointment, training and discipline. Details of requirements are given elsewhere in these and other Study Notes, but very important matters in this area include:

- (i) Training programmes: arranging, organizing and administering, with all the logistical and personal details involved.
 - (ii) Examinations: both with regard to their being accepted as intermediaries (this Quality Assurance Programme, for example) and other professional qualifications.
 - (iii) *Resources and facilities*: the provision of suitable materials, premises and opportunities for training and career development have obvious applications.
- (d) **Claims**: Without claims we have no business! Perhaps a slight oversimplification, but there is truth in the remark. This important area includes:
- (i) *Routine administration*: all the required enquiries, checking and general supervision to confirm all is in order.
 - (ii) *Various types of claim*: such as death claims, maturities and surrenders, which may require different kinds of expertise.
 - (iii) *Investigative work*: sometimes detailed forensic or other enquiries need to be made in verifying the validity of a claim.
- (e) **Client services** (also known as **POS** : see **5.5**): This involves a variety of functions, including:
- (i) *Changes to policies*: these may relate to **financial** or **non-financial** changes, all of which are important to efficiency.
 - (ii) *Communication*: this will involve both correspondence and telephone/personal enquiries, and **complaints**.
 - (iii) *Documentation*: policy duplicates (with all attendant checks and enquiries) and other document requests.
 - (iv) *Policy renewals*: the important process relating to the **retention** of business.
- (f) **Marketing**: This is a general term that can signify many things. It usually includes:
- (i) *Product research*: and development of new sales products.

- (ii) *Promotions/publicity*: producing the materials and physically attending to all logistic and other details involved.
 - (iii) *Advertising*: closely related to (ii) but with special features such as media involvement and sponsoring.
 - (iv) *Public relations*: news conferences, media interviews, public talks and seminars, for example.
 - (v) *Market research*: examining needs, demands and results.
- (g) **Underwriting**: This is considered as a technical exercise in **5.3** below, but as an element in company operations this department includes:
- (i) *Risk assessment*: the technical matter of selection, rating and imposing terms, as necessary.
 - (ii) *Medical requirements*: arranging and monitoring such medical examinations and related documentation as may be required.
 - (iii) *Reinsurance*: the extent to which reinsurance may be required or arranged with individual risks.

Note: The above departments are representative, as previously mentioned. They do not form a comprehensive list and are not intended to represent the operational structure of any particular insurer.

5.2 APPLICATION

Some insurers might refer to an application as a *proposal form*. Either term may be found in the Macau market, although "application" is perhaps more widely used. Both refer to the request for insurance cover from an intending insured. A number of significant issues and considerations are involved with this important matter, made more important by the fact that a life insurance cannot be **cancelled** by the insurer once it becomes operative.

5.2.1 Application Procedure

Competition and the desire for efficiency has led to questions on the application being kept to the minimum. Often, questions are phrased so that a "**No**" answer means that no further enquiry needs to be made in that topic, whereas a "**Yes**" answer may need further details or enquiry.

- (a) **General rules for application procedures:** the application/proposal is the main, and sometimes virtually the *only*, source of information for underwriting purposes. The intermediary should therefore take great care in his advice and general assistance to the client when the form is being completed, noting the following:
- (i) All **material facts** should be given. "Yes" answers in response to enquiries on health and other matters must be accompanied by full explanations, including any relevant dates (see: **1.2.2(e)**).
 - (ii) Normally the applicant should complete the form **personally**. Sometimes the agent is asked to assist by writing things at the client's dictation. Great care must be taken with this, to ensure that the client realizes that the form is **his** statement and the answers are **his**.
 - (iii) **Alterations** and amendments should be avoided, if possible. If not, they must be very clear. Anything incorrect must be clearly crossed through or deleted and the alteration should be **signed and dated** by the applicant. (A replacement form may be advisable in many cases.)
 - (iv) **All** questions should be answered, as fully as required. Failure to observe this rule can only result in delay. Information with life insurances is too important to be waived.
- (b) **Key points to be considered:** Some areas requiring special attention include:
- (i) The **desired commencement date** should be clearly indicated. It is normal for insurers to allow a policy to be back-dated for a certain period (which may vary with the insurer concerned).
 - (ii) The **identity** of the applicant and life to be insured is important to establish. Any available **I.D. Card** should be inspected by the agent (some insurers require a copy to be attached to the application).
 - (iii) **Age next** (or sometimes **last**) **birthday** is an important element affecting the premium. Sometimes in Macau this may not be easy to establish. It is not uncommon to find that only the year of birth is known. In that event, insurers are likely to regard the birthday as being the 1st January that year.
 - (iv) **Other personal details**, including occupation, residential address and family medical history all have a significance which is self-explanatory.

- (v) **Signature** of both the applicant and the life to be insured (if different) must be obtained. If the insured is a minor (under 18 years old), the signature of his/her legal representative must also be obtained. If the intended signatory cannot write, an appropriate fingerprint mark of the person together with the signature of the notary is required.

- (c) **Supplementary requirements:** These may involve a number of issues, detailed instructions about which will be supplied by the intermediary's principal. Some areas likely to be involved, however, include such matters as:
 - (i) **Life underwriter's report:** signed by the agent.
 - (ii) **Mode of premium payment:** whether autopay facilities apply.
 - (iii) **Proof of insurability:** establishment of an **insurable interest**.
 - (iv) **Underwriting forms:** additional questionnaires for "Yes" replies relating to certain medical conditions/ailments, or other matters (e.g. hazardous sports).

5.2.2 Receipts and Policy Effectiveness

The fact that a life insurance policy cannot be cancelled by the insurer once it has commenced is a matter of recurring importance. In connection with **receipts** issued by insurers, for example, in Non-Life insurance a receipt is merely an acknowledgement that some money has been received. This is not inevitably connected with the *inception date* of the insurance, which could have **already** commenced some time ago, or could be intended to commence in the future. Moreover, even if the (Non-Life) policy has commenced, there is usually a policy condition allowing **cancellation** if need be. Not so with **Life Insurance**.

In life insurance a *premium receipt* is a written acknowledgment that an insurer has received the initial premium submitted with an **application** for insurance. By custom, there are **two** types of premium receipt:

- (a) **Conditional premium receipt:** With this type of receipt the insurer agrees that the insurance will commence *at the time of application*. **BUT** this is true only **provided**

that the applicant is subsequently found to have been insurable on *standard terms* at the time of application. Two things follow from this:

- (i) if the applicant is found to be insurable, but **only** for a *different* plan, premium or amount of cover, then the insurance is **not** effective from the *date of application*. Technically, we may say that the **offer** has not been **accepted** on its exact terms, so the contract does not commence until any *revised terms* have been agreed;
 - (ii) if the applicant, **subsequent** to the application becomes *uninsurable* or even *dies* he **is** covered provided he is found to have been insurable at the time of application.
- (b) **Binding premium receipt:** This may be known by other names, such as a *Temporary Insurance Agreement (TIA)* or an *Unconditional Premium Receipt*. Whatever the title used, the basic features surrounding such a receipt are:
- (i) this is a **contract**, *separate from any subsequent insurance policy* that may be issued;
 - (ii) cover **begins** from the date the *application* was signed and the date that the *premium* was paid;
 - (iii) cover is **not conditional** upon the applicant subsequently proving to be, or to have been, *insurable*; **but**
 - (iv) cover is **limited** to a maximum specified *number of days* (say **60** or **90** days);
 - (v) the cover may terminate **earlier** than the final day of the period specified:
 - (1) from the date the insurer *returns the premium*;
 - (2) a specified number of days after *mailing* a notice of termination;
 - (3) from the date when coverage begins under the *issued policy*.

Note: In Non-Life insurance a similar document is used to give **temporary**, unconditional but **cancellable** cover. There it is called a **Cover Note**, although it is

usually only for 30 days cover and may or may not be conditional upon any premium payment.

5.2.3 Customer Service - Policies and Standards

Customer services has been described as the range of activities a company engages in to keep its customers satisfied.

5.2.3a The Importance of Customer Service

This may have a number of considerations, including the following:

- (a) *Customer loyalty*: the customer who is happy with you tends to stay with you. Continuity and the **conservation** of business is very important in life insurance, where the most of the costs and expenses are "up front" (when the policy is first arranged).
- (b) *Customer "prospecting"*: "prospecting" may be described as the search for new customers. If existing customers are happy with you, they immediately become your "unpaid prospectors" with their friends and families.
- (c) *Productivity/Profitability*: quality service leads to fewer mistakes and fewer complaints. That in itself means that effort can be directed to more productive activity, with its consequent impact on profitability.

5.2.3b How to Achieve Quality Customer Service

There is no simple answer to this, but certainly the following will greatly assist in achieving desired goals in this area:

- (a) *Corporate culture*: this should always be **customer-orientated**.
- (b) *Delegation*: of more **authority** and **accountability** to front-line employees.
- (c) *Systems*: should be created to monitor **customer satisfaction**.
- (d) *Training*: and technology appropriate to these goals should be available.

Note: The above recommendations apply primarily to the insurer, but the

underlying principles are easily adapted and applicable to intermediaries.

5.2.4 Cooling-Off Period

One of the popular conceptions, and certainly a popular fear in the general public, is that life insurance salesmen may be too assertive, even aggressive, in their selling. The perceived result from this could be that a person might be pressurized into purchasing a life insurance that they do not really want, or cannot really afford.

To counteract this perceived possibility, the AMCM will issue what is termed the "**cooling-off directive**" shortly. The substance of this directive and related matters are:

- (a) policyholders are given a period during which they may reflect and if desired change their mind about a life insurance policy that they have purchased or applied for;
- (b) the period allowed for such change of mind is:
 - (i) **21 days** following the completion of the application form; **or**
 - (ii) **14 days** following the issue of the policy, whichever is **later**.
- (c) where the right is exercised by the policyholder/applicant within the permitted time period, the whole contract is **cancelled** and any premium paid is **refunded** subject to a "market value adjustment" as elaborated in Item 4 of the Cooling-Off Directive (see **Note** below);
- (d) the right to this "cooling-off" period must be explained to the client, and its provisions are now a standard item on application forms (usually as part of the Declaration signed by the applicant);
- (e) when the policy is issued, the policyowner must be advised of the Cooling-off Rights attaching to the policy. This may be done by way of a **letter** from the insurer, mailed **direct** to the policyowner, or a **statement** on the policy jacket or policy cover.

Note: Item 4 of the **Cooling-Off Directive** reads as follows:

- 4.1** For all non-linked policies other than non-linked single premium policies, policyowners will have the right within the Cooling-Off period to receive a refund of 100% of the premiums paid.

- 4.2** For all linked policies and all non-linked single premium life insurance policies, the insurer will have the right to apply a "market value adjustment" (MVA) to the refund of premiums.
- 4.3** Any such MVA must be calculated solely with reference to the loss the insurer might make in realizing the value of any assets acquired through investment of the premiums made under the life policy. It shall therefore not include any allowance for expenses or commissions in connection with the issuance of the contract.
- 4.4** In the case of a linked policy, the insurer's right to apply an MVA must be disclosed in the **Principal Brochure**, and the basis of calculation must be available for disclosure to the potential policyholder prior to the completion of the Application form.
- 4.5** For non-linked single premium policies, potential policyowners must be made aware that the insurer has the right to apply an MVA before the policyowner signs the application. This may be done by letter, or within the product brochure.

[Example: A person is sold a life insurance policy, about which he subsequently has doubts. He wishes to call the whole thing off and have his money back. Can he do so if he notifies his change of mind:

- (i) 20 days after he completed the application form;
- (ii) 40 days after he completed the application form, which was 10 days after the policy was issued;
- (iii) 60 days after he completed the application form, which was 20 days after the policy was issued?

Under the provisions of the "cooling-off directive", the answer to (i) and (ii) above is "Yes", and the answer to (iii) is "No".]

5.2.5 Policy Switching

With a competitive and innovative market, obviously there can be genuine and quite legitimate cases where an intermediary can in all conscience recommend a

client to "**switch**" (change) his present life insurance policy to one offering better terms or prospects.

This form of "switching" will meet the approval of all unbiased people and create no problem for regulators. "Switching" which does not comply with the above criteria is a matter of profound concern. This is more commonly known as "twisting", and may be defined as: "*The inappropriate replacement of life insurance policies.*"

- (a) "**Twisting**" **defined:** In colloquial English "twisting" is another word for "cheating" or "swindling" and this is most apt in the present context. The Code defines **twisting** as:

"The making of misleading statements, non-disclosures, misrepresentations and incomplete comparisons to induce an insured to replace existing life insurance with other life insurance resulting in disadvantage to the insured."

- (b) "**Replacement**": Replacement also involves any policy which has lapsed, been surrendered or converted to paid-up insurance.

- (c) **Customer protection declaration (CPD):** This is a most important document which must be completed before the client agrees or makes a decision in relation to the purchase of a new life insurance policy to replace an existing one. Features to note with the CPD are:

(i) it should disclose any replacement being recommended;

(ii) it should ensure that the agent has explained the important consequences, these are:

(1) *Financial implication:* the agent may use 2 times the annual premium of the existing policy(ies) to illustrate the financial implication, or compare the net change in values of the new and existing policies in 5 years.

(2) *Insurability implication:* the new insurer may review the insured's current state of health, occupation and recreational activities. If any significant change has occurred, the insured may be denied some coverages or be charged a premium higher than the standard one.

(3) *Claims eligibility implication:* a new policy may have different policy provisions and also may result in a new start of the incontestability and suicide clause time periods. This could

result in a claim being denied that would have been paid under the existing policy(ies).

- (iii) if the agent has said there is no disadvantage in making the change, he must give reasons for this conclusion in *writing*;
- (iv) the original copy of the CPD will be held by the selling *office*, with a copy for the *client*, attached to the **policy**.

5.3 UNDERWRITING

Underwriting may be simply described as the *assessment* of risks for the purposes of insuring them or deciding what insurance terms should apply. Another way of describing the term is to say that it is determining the *insurability* of proposed risks. Since life insurance involves a **long-term** contract that **cannot** be cancelled by the insurer, we may say that normally life insurance underwriting for an individual risk can only be done **once**. It is therefore important to get it right first time.

5.3.1 Factors Considered

Underwriting is said to have the following two aspects:

- (a) **Identifying the degree of risk:** from experience life insurance underwriters can identify degrees of risk with applications, usually under two headings:
 - (i) **Physical hazard:** this concerns largely objective factors that are likely to increase the risk of the insured event (death) happening. These will include obvious features such as known health dangers, including:
 - (1) *significantly overweight*;
 - (2) *heavy smoker*;
 - (3) *substance abuse* (alcohol, drugs etc.);
 - (4) *very dangerous occupation or leisure pursuits*;
 - (5) *adverse inheritable family or personal medical history*.
 - (ii) **Moral hazard:** this concerns rather more subjective factors surrounding the basic *honesty* or honourable intentions of the person to be insured. Whilst **suicide** is not a common potential problem (and is in any event covered to some extent by policy provisions - see **4.12**),

there are other considerations. For example, the person may deliberately hide important information or submit false information to obtain cover. It is, of course, less easy to determine moral hazard than physical hazard.

- (b) **Classifying the proposed risk:** classifying proposed risks into appropriate *categories* enables the insurer to determine an *equitable premium*. Insurers tend to have four categories of risks, as follows:
- (i) **Standard risks:** these present no abnormal features, and are perfectly acceptable at the appropriate premium according to the age and sex of the applicant.
 - (ii) **Sub-standard risks:** because of the adverse sound of such a term, some insurers call these *special class risks*. In either case, what is implied are risks that cannot be insured under normal terms. They are *insurable*, but only subject to certain considerations, discussed in **5.3.3** below.
 - (iii) **Declined risks:** as the name indicates, these are risks that are unacceptable. Insurers generally try to give cover if they reasonably can, but obviously there are some applications where health or other factors make it impossible to accept.
 - (iv) **Preferred risks:** not all insurers use this category, which implies an *above average* risk application that merits a discount or other favourable terms. This may include confirmed non-smokers or individuals who otherwise represent better prospects of long years before a claim is likely to arise.

Note: The above may be said to represent **technical underwriting**, involving an assessment of the intrinsic and perceived hazards presented by individual risks. We should also note what is called **Financial Underwriting**.

This term relates to an assessment of the amount of the proposed insurance in relation to various matters, including:

- 1 the perceived ability of the insured to meet premium obligations;
- 2 the degree of risk presented (and therefore whether **reinsurance** might be advisable/available);
- 3 accumulation of policy plans for the same person;

- 4 whether it is in excess of usual levels for persons corresponding to the age and general circumstances of the applicant. We cannot say that any life insurance is *too much*, but if it is very high by customary standards this may put the insurer on enquiry.

5.3.2 Medical Reports

Many life insurances are arranged on a *non-medical* basis. That is, the information supplied on the application and other circumstances surrounding the proposal (age, apparent health, sum to be insured etc.) allow the underwriter to proceed without further enquiry.

Sometimes, however, further information is required from qualified medical practitioners. The source of such enquiry may be:

- (a) an *attending physician*, by which is meant a doctor or other qualified medical person who usually or has previously supplied medical care to the applicant;
- (b) an *examining physician*, by which is meant a physician who conducts a medical examination (the U.S. term commonly used is a **physical**) at the request of the insurer, who pays for this.

A number of factors need to be considered with this subject:

- (a) **A sensitive subject:** it is human nature to become anxious at the thought of a medical examination. This is quite illogical, as it must be for one's good to know the truth, but that is not how most of us think. Insurers are quite aware of this and only request medical information if it is deemed really necessary.
- (b) **Attending Physician's Statement (APS):** this is the most frequently required medical report and the usual reasons for requesting it are:
 - (i) specific medical disclosures on the application need further enquiry;
 - (ii) the amount of insurance requested is high;
 - (iii) the applicant is at a certain age (say, over 50).
- (c) **Specialized medical questionnaire:** the examining (or attending) physician may be supplied with a separate questionnaire specifically designed to obtain information on a particular illness or condition that needs to be considered with the applicant concerned. This may relate to any of a number of conditions, ranging from blood pressure to cancer, being conditions that previously disclosed information suggests a need for further enquiry.

- (d) **Confidentiality:** obviously, medical information is very private and the information obtained must be treated with the utmost confidence. However, if and when medical tests are suggested, the applicant has the right to know what tests are to be done, what the information is needed for, and (if he wants to know) the results of any tests.

5.3.3 Sub-Standard Life and Underwriting Measures

Usually for medical, but sometimes for other reasons, a particular applicant may prove to be below the required standard for acceptance at normal rates. There are a number of possible underwriting reactions to this situation, including:

- (a) **Refuse to insure:** sometimes called *declinature*. This is a drastic measure that insurers prefer to avoid if at all possible. Most life applications can be accommodated, although sometimes the terms of the insurance may have to be more severe.
- (b) **Load the premium:** increasing the premium is a very standard way of dealing with sub-standard risks. The extra premium, which may be quite modest or quite substantial according to circumstances, can *normalize* the abnormal, for insurance purposes.
- (c) **Other options:** the above two reactions are the most common, but there is wide range of possibilities, which might include one or more of the following:
 - (i) a "**debt**" on the policy, reducing each year so that it disappears the nearer the insured comes to living a normal life span;
 - (ii) specific **exclusions**, perhaps of death from a particularly dangerous pastime or leisure pursuit (this would be very rare, since it tends to defeat the object of the cover);
 - (iii) offering a **different plan**: short term cover may be possible, whereas the medical evidence indicates that very long-term insurance is doubtful;
 - (iv) decline to accept **at present**, i.e. to **defer** a decision, if the applicant is severely injured or otherwise has a (hopefully) temporary adverse medical condition.

5.4 POLICY ISSUANCE

Once the underwriting process is complete and cover has been approved, the policy can be prepared and then delivered to the policyowner. The important fact that a policy cannot be **cancelled** or amended after its issue without the agreement of the policyowner, once more needs to be mentioned. Issuing and delivering the policy in some respects may be looked upon as the "point of no return" for the insurer. Careful policy checking and confirmation is therefore needed before this happens.

5.4.1 Policy Delivery

This may be considered with policy issuance as the two are very closely connected. Using modern technology, policy documents can be produced with great speed and accuracy. The in-house system should create the client's record and verify that the first premium has been received. Policies are mostly in standard format within the class and plan concerned. Therefore, only *variations* affecting the particular client alters the routine format. All of this can be dealt with by an automated system. Some slight differences in procedure should be noted as follows:

- (a) **Individual policy covers** (including *annuities*): the production and delivery is straight-forward, delivery normally usually being made by the **marketer**.
- (b) **Group policy covers**: here the process involves enrolling individual *employees* (or other group persons). The technology system must therefore produce not only the master policy, but also a *certificate* and perhaps an *enrolment* card for each insured person. Each such person receives a certificate and completes an enrolment card, the process normally being overseen by the **marketer** or **group representative**.

5.5 AFTER SALES SERVICE

The **conservation** of existing business has been mentioned before (see **5.2.3a**(a)). This, for reasons given, is very important and the quality of after-sales service is a vital element in this area. Such service is within the responsibilities of Customer Service personnel (see **5.1.1e** above), whose department might well now be called *Policyowner Service*, or **POS**. By way of reminder, the duties of POS may include:

- (a) *Correspondence*: and other communication with customers.
- (b) *Documentation*: duplicate policies, surrenders, converting etc.
- (c) *Premium payments*: handling all aspects of this.
- (d) *Benefit administration*: cash values, loans and dividends.

- (e) *Policy changes*: see below.

5.5.1 Policy Changes

These changes may be relative trivial, amending some administrative detail, or may have a significant effect upon contract terms. The changes usually requested include **changing** the

- (a) *type of insurance cover*: obviously of considerable significance;
- (b) *address*: of the policyowner or beneficiary, for example;
- (c) *beneficiary*: clearly this must be a permissible change, under contract terms;
- (d) *amount of cover*: after any due underwriting consideration;
- (e) *owner of the policy*: another obviously important change.

Note: All changes must be carefully processed. The change requested may seem very straightforward, but there is always the possibility that it will have legal or other implications, ranging from underwriting or reinsurance matters even to potential attempted fraud (**money laundering**, etc.).

5.6 CLAIMS

With Non-Life insurances, claims are not expected under most policies. There the cover is "in case" there is need and generally speaking neither party wishes to experience a claim situation. The latter may be true in some respects for Life insurance, but there a claim (except for **term insurances**) is inevitable if the policy is kept in force. Indeed, with many contracts having a **savings** element, the policyowner often looks forward to making the claim. Claims may be considered under three headings, as follows :

5.6.1 Maturity Claims

Mostly concerning **endowment insurances**, these involve situations where the life insured is still living and (if also beneficiary) able to collect the proceeds personally. With these, as with all procedures dealt with under this Chapter, each

insurer may have their own system, but typically the following considerations arise with maturity claims:

- (a) **Near the date:** a month or so in advance of the date the insurer writes to the policyowner, in order to:
 - (i) *remind* him of the maturity date;
 - (ii) state the *amount* payable;
 - (iii) list any *requirements* for payment;
 - (iv) enclose a relevant form of *discharge*.
- (b) **Legal title** the insurer can only deal with the person having legal title to the policy proceeds. Also, the *actual policy* will be required. This is an important document of title and only assignments duly recorded can be recognized.
- (c) **Adjustments:** the payment may have to be subject to deductions for any outstanding items, such as loans, unpaid premiums and interest owing. Of course, any *beneficiary interest* has to be respected and processed.
- (d) **Proof of age:** if the policy is marked "*age not admitted*" this means that formal proof of age was not given at policy inception. Some insurers may not require confirmation of age if the policy has matured, but it should be requested because **misstatements of age** could have an impact on the policy benefit (see 4.8).
- (e) **Unpaid maturities:** a suitable monitoring and follow-up procedure must be in existence for any maturity claims where the policyowner does not respond to (a) above.

5.6.2 Death Claims

Maturity claims, for obvious reasons, are normally processed in a "happy" atmosphere. Death claims on the other hand inevitably have a serious and sometimes tragic background. Whilst this must not intrude unduly into the professional way in which the claim is processed, insurers and intermediaries should be sensitive to the situation. The specific points needing attention with such claims are:

- (a) **Date of death:** this must be established, as it can affect the amount payable, e.g. with **decreasing term** insurances, and with any **dividend/bonus** calculations. Indeed, with **term** insurances the policy could have expired.

- (b) **Proof of death:** normally, this is fairly easy to obtain, with the *death certificate* (the **original** document must be produced). Problems may arise over death certificates, however, where death arises or is alleged to have arisen overseas. This has on occasions been a particular area for *fraud*.
- (c) **Cause of death:** this will be shown on the death certificate and it may be important for a number of reasons, including:
 - (i) *suicide:* if the policy is still within the exclusion period (see **4.12** above);
 - (ii) *accident:* the policy may be subject to an **ADB rider** (see **3.2.1(a)** above);
 - (iii) *suspicious or surprising:* death shortly after the policy was issued, or where the cause would normally develop over a longer period than that for which the policy has been existence, will put the insurer on enquiry. **Fraud** must always be a possibility in such circumstances. Even if fraud does not apply, the policy may still be within a **contestable** period (see **4.2** above);
 - (iv) *murder:* in most cases this will not affect the validity of the claim, but if the murderer is proved to have been the **beneficiary**, the law ("**Criminal Code**" or other specific law of same nature) will not allow the murderer to benefit personally.
- (d) **Presumption of death:** where no death certificate can be issued and it is assumed the life insured has died, this may have to be resolved by the **court**.
- (e) **Proof of age:** see comments in **5.6.1(d)** above. Normally, proof of age is easily obtained by producing a birth certificate, or the deceased's **I.D. card** or **passport**.

5.6.3 Surrenders

Many of the considerations arising with **maturity claims** have relevance here, as the claimant is still living. Specifically, areas needing attention are:

- (a) **Proof of title:** only the person legally entitled may receive the **cash value**;
- (b) **Adjustments:** unpaid premiums, loans and interest must be taken into

account;

- (c) **Discharge:** an appropriate discharge and release form is obtained. Special care must be taken to protect any **assignee** or **beneficiary** interest;
- (d) **Other enquiries:** the insurer or intermediary should take special care with applications for surrender of the policy. Obviously, the policyowner has every right to discontinue cover, but it may be helpful and productive to make discreet and courteous enquiries.

Sometimes, the insurance meets a real need for the client, but he meets unexpected life situations and his first thought is to cancel his insurance. That may not be in his best interests and other more suitable alternatives may be available (policy **loan**, use of **nonforfeiture** provisions, etc.).

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6. INTRODUCTION TO PRIVATE PENSION FUND ORDINANCE

6.1. Needs for retirement protection

The aging population is being a problem to many places in the world. Saving for the rainy day is not just a wise saying but is prudent and essential to do so.

As in most countries, three pillars structure the old-age protection program in Macau:

- a) Social security;
- b) Private pension plans; and
- c) Individual savings and assets.

The social security provides the basic minimum benefit. Personal thrift has played and probably always will play a major role in providing for old-age security. Then, the private pension schemes supplement an adequate level of old-age income.

6.2. Key features of Private Pension Fund Ordinance

6.2.1. Coverage

The legal framework for private pension funds will regulate the setting up, management and winding up of private pension funds and pension plans.

6.2.2. Definition of Terms

Pension Plan: a retirement program which defines the conditions for formation of the right to receive a pension.

Pension Fund: a fund which can invest in many different types of financial securities and can own assets directly exclusively for the fulfillment of one or more pension plans but should not be used to meet any other obligation, namely those of associates, members, contributors, fund managers and asset custodians.

Associate (or sponsor): corporate entity whose pension plans are financed by pension funds.

Participant: individual whose personal and professional circumstances determine the rights arising under the pension plans, regardless of whether they

contribute or not to the fund.

Contributor: individual or corporate entity who contributes towards the fund.

Beneficiary: individual who has the right to receive benefit set out in the pension plan, regardless of whether they are participants or not.

Retirement age: participant who has reached the age of 65.

6.2.3. Types of Pension Plan

Based on the types of guarantees provided, pension plans shall be classified as:

- a) **Defined benefit plan:** retirement plan under which benefits are predefined and contributions to be made are calculated so as to guarantee the respective payments;
- b) **Defined contribution plan:** retirement plan under which contributions to be made are predefined and the benefits are determined according to such contributions and the corresponding accumulated earnings;
- c) **Mixed plan:** retirement plan which combines the features of the two plans mentioned above.

On the other hand, based on the forms of financing, pension plans shall be classified as:

- a) **Contributory plan:** retirement plan under which both the employer (associate) and the employees (participants) make contributions;
- b) **Non-contributory plan:** retirement plan under which an employer (associate) pays the entire direct cost of the plan, employees (participants) do not share in the cost.

6.2.4. Type of Pension Fund

Pension funds can be either **closed** or **open** funds.

- a) **Closed Fund** - a fund which the respective plan concerns only one sponsor (associate) or, if there are a number of sponsors, when there is a

business, associative, professional or social connection between them and their consent is necessary for new sponsors to join the fund.

Closed pension funds may be set up at the initiative of a company, group of companies, groups of social or professional associations, or by agreement between employer and employee associations.

- b) **Open Fund** - a fund where there is no requirement for any link between the various members of the respective plan, and membership of the fund is solely dependent on acceptance by the pension fund manager.

Open pension funds may be set up at the initiative of any entity entitled to manage pension funds. The total net value of the fund shall be divided into units of participation represented by certificates.

6.2.5. Vesting

The participants are entitled to receive the benefits accrued from contributions in accordance with the terms set out in the respective pension plan.

However, the vesting schedule should be depending upon the terms and conditions in the respective pension plan. It could be based on the length of service or the age of participant.

6.2.6. Withdrawal of benefits

The participants may withdraw the benefits accrued from contributions in form of a lump sum payment or in other forms indicated in the respective pension plans. Withdrawals will be permitted under the following circumstances:

- a) Early retirement;
- b) Old-age retirement;
- c) Permanent incapacity;
- d) Death;
- e) Serious illness;
- f) Long-term unemployment;
- g) Permanent departure from the Macau SAR; or

- h) Participant shall have the option either to receive the benefits or transfer the same to a new pension fund on termination of employment with the associate for reasons other than those referred in above items a) to g).

6.2.7. Advantages of Private Pension Plans

Private pension plans can provide the following advantages:

- a) Retirement protection: Employees can have a better financial protection for their old-age security. On the other hands, employers can provide better benefit for employees' retirement with relatively lower costs and step up the motivation of employees;
- b) Effective and secure: An independent managed pension fund under prudential regulation and supervision is most effective and secure way to offer retirement protection to employees;
- c) Energize local market: Investment of private pension funds can energize the local financial market as well as to promote the global development of economy in Macau;

6.3. Regulatory Framework under Private Pension Fund Ordinance

6.3.1 Approval of Service Providers

Life insurance companies operating in the Macau SAR are entitled to be fund managers of private pension fund. Besides, fund management companies established under the provisions of Decree-Law no. 27/97/M of 30 June relating to life insurance companies can also act on the management of private pension funds.

6.3.2 Approval of Private Pension Funds

- a) The AMCM is the authority with competency to authorise the constitution of pension funds;
- b) Authorisation to closed pension fund shall be granted based on the joint petition from the fund manager(s) and the sponsors (associates);
- c) Authorisation to open pension fund shall be granted based on the petition from the fund manager(s);

- d) Either the constitution contract of closed pension fund or the management regulation of open pension funds shall be published in the Official Gazette once the respective authorisation granted.

6.3.3 Registration of Private Pension Plans

Private Pension Plan can be registered with the AMCM when it is financing by pension fund(s) constituted and authorised under the Private Pension Fund Ordinance (Decree-Law no. 6/99/M of 8th February).

6.3.4 Functions/Duties of fund managers and custodians

- a) **Fund manager** – A fund management company shall engage in all acts in name of and on behalf of the associates, participants, contributors and beneficiaries. As the administrator and legal representative of the fund, it can negotiate on any assets or real estate, make bank deposits in the name of the fund and exercise all rights directly and indirectly related to the fund.
- b) **Custodian (Depository)** - The main duties of a custodian of pension funds shall include:
 - i) To receive on deposit or register the financial instruments and documents pertaining to the funds;
 - ii) To maintain up-to-date chronological record for all the transactions carried out and to prepare every quarter a detailed inventory of assets of the funds.

6.3.5 Disclosure to members of Private Pension Plans

The management company shall compulsorily provide to the contributors and participants of pension plan the following information:

- a) Contents of the deed of constitution or of the management regulation and the respective amendments;
- b) Balance of contributions in their individual accounts;
- c) Their shares in the total value of the fund; and

- d) Upon request, all the information necessary for a complete understanding of the contract.

6.3.6 Transitional arrangement

All private pension funds and pension plans constituted under the previous legislation shall have a period of up to 31st December 2002 to adapt to the rules of present law.

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GLOSSARY

Absolute Assignment An assignment which is permanent, the assignee becoming the new policyowner. **4.9(e)(i)**

Accelerated Death Benefits These are life insurance death benefits which may, under certain circumstances (e.g. life threatening health situations), be payable in part or in full even though death has not yet occurred. **3.3**

Accident Benefits Additional benefits that may be added to a life policy by means of the Accidental Death (ADB) or Accidental Death and Dismemberment (AD&D) Rider. **3.2**

Accidental Death and Dismemberment (AD&D) Rider The accidental death benefit under this rider is a sum equal to the face amount for the policy (providing what is termed a "double indemnity"). The dismemberment benefit relates to loss of limbs and/or sight. **3.2**

Accidental Death Benefit (ADB) An addition to a life policy, providing a double benefit should the insured life die from an accident. **3.2.1(a)**

Accounts Department An important area of company administration, including work associated with the receipt and payment of monies and the making of required financial returns. **5.1.1(b)**

Actively-at-Work Provision A provision in group life insurance that to be admitted to the plan the employee concerned must have been present at work on the day when coverage became effective. **2.3(f)**

Activities of Daily Living (ADLs) Basic human needs and functions (e.g. washing, dressing etc). Inability to perform these could be grounds for a payment under a **Long Term Care** rider. **3.3.2(c)**

Actuarial Department An extremely important department for life insurers. An actuary must be appointed for life insurers, by law, and the work of this department is significant (amongst other things) in product pricing, and especially in the required valuation of the company's assets and liabilities. **5.1.1(a)**

Adequate (Premiums) One of the classic criteria usually applied to life insurance premiums, i.e. sufficient to meet claims and other obligations under the contract. **1.3.1(a)**

After Sales Service The important process of maintaining good communications and relations with policyowners, to assist with the conservation of existing business. **5.5**

Age Next (Last) Birthday An important detail obtained from the application, having a significant effect on the premium to be charged. **5.2.1(b)(iii)**

Age-Related Limitation Whole life insurance where the premium is no longer payable after a specified age. **2.1.3(a)(iii)**

Agency Training and Control An important area of company administration, especially bearing in mind the necessity for training of an extensive field staff. The department will especially be concerned with training programmes and professional examinations. **5.1.1(c)**

Annual Annuity An annuity where the time span between each of the payments in the series of periodic annuity benefit payments is one year. **2.1.4a(b)**

Annual Report A feature of universal life insurance, whereby the policyowner receives such a report each year, outlining several headings of information, e.g. death benefit option selected, premiums received during the year, cash value balance etc. **2.2.1(g)**

Annually Renewable Term (ART) An alternative title for the Yearly Renewable Term (YRT) rider. **2.1.1b(a)**

Annuitant The person entitled to receive annuity payments. **2.1.4(a)**

Annuity A series of periodic payments (frequently for life), paid in return for a single lump-sum initial "premium" (perhaps paid by a series of instalments). **2.1.4a**

Annuity Certain A variation of an annuity, where the benefit is paid for a fixed number of years, whether the annuitant lives or dies during that period. **2.1.4a(d)**

Anti-Selection Occurs where the "bad" risks tend to continue with the insurer, whilst the "better" risks tend not to. This is a real danger with the natural premium system. Also known as **Selection Against the Insurer**. **1.3.2a(c)(ii)**

Application The more usual term in Macau life insurance for a proposal form, by means of which preliminary information is obtained regarding a proposed life insurance. **5.2**

Approved Nursing Home A nursing home as specified in the Long Term Care (LTC) rider, as a type of care acceptable to the cover provided. **3.3.2(b)**

Assignee The person to whom an insurance contract has been assigned. In life insurance, an assignee does not have to have insurable interest. **4.9**

Assignment The transfer of all rights under an insurance to a third party, either for reward or with no fee involved. **4.9**

Assignor The person assigning an insurance policy to the assignee. **4.9**

Associate A corporate entity whose pension fund plans are financed by pension funds. **6.2.2**

Attained Age The age of the life insured at the time the insurance is completed/renewed. **2.1.1b(b)**

Attending Physician's Statement (APS) An "attending physician" is a doctor or other qualified medical person who has previously supplied medical care to the applicant. An APS may be required if information disclosed indicates that further medical information is needed, or for other abnormalities (e.g. relatively advanced age of the applicant, relatively high amount of insurance requested). **5.3.2(b)**

Automatic Dividend Option If the policyowner gives no indication of his preference regarding his dividend options, the policy provides for a particular option to be applied automatically. Often such an option means that paid-up additional insurance is purchased with the dividend or leaving the dividends with the insurer to earn interest. **4.10 Note**

Automatic Premium Loan (APL) A policy provision to the effect that in the event of non-payment of a due premium, and in the absence of other instructions, the cash value of the policy is used to pay the premium and keep the policy in force. **4.5(a) Note**

Basic Functions Essentials formats of life insurance, e.g. benefit payable on death in a specified period, payable on death at any time, payable on a specified date or earlier death, and monthly payments in return for a lump sum "premium". **2(a)**

Basic Plan Cover for the expenses of medical treatment and hospitalization, under a medical benefits insurance. **3.4(a)**

Basic Questions Fundamental enquiries that should be made when arranging life insurance, i.e. "What is the insurance for?", "How much premium are you willing and able to pay?" and "How much life insurance do you need?". **2(c)**

Basic Variables Modifications to the basic functions of life insurance, e.g. convertibility, renewability, PAR or NON-PAR and various riders. **2(b)**

Beneficiary The person nominated to receive the policy benefit in the event of a claim under the policy. **4.4**

Beneficiary Designation The naming of a designated beneficiary in the policy documents. **4.4**

Benefit Policies Policies which do not pay claims on an indemnity basis, but on a stipulated benefit basis (e.g. in life insurance policies) **1.2.3(a)(i)**

Benefit Riders Endorsements to a life insurance policies, granting various benefits, e.g. **Accidental Death Benefit (ADB)** rider. **3**

Binding Premium Receipt A premium receipt which confirms that cover applies. It therefore fulfils some of the features found with cover notes in general insurance. The cover with such receipts is temporary, with provisions which will enable the insurer to come off risk earlier than the end of the specified period, if necessary. Also known as **Unconditional Premium Receipt** and **Temporary Insurance Agreement (TIA)**. **5.2.2(b)**

Bonuses The approximate equivalent of dividends with participating policies, bonuses are reversionary amounts added to the ultimate benefit payable under the policy, and earned by with-profit policyowners. They are usually declared as a percentage, which is applied to the sum insured by the policy. **1.3.1b(a) Note 1**

Business Needs The use of life insurance contracts to meet various business situations, e.g. key person's insurance, partnerships, employee benefits etc. **1.1.1(b)**

Cash Value The amount payable to the policyowner should he decide to terminate the policy prematurely. Not all policies will have a cash value, e.g. term insurances. It may also be called the **Surrender Value**. **1.3.2b(c)(i)**

Cause of Death A potentially important detail with death claims, possibly affecting the validity or amount of the claim, e.g. an early suicide, death from accident etc. **5.6.2(c)**

Certificate See **Enrolment Card.** **5.4.1(b)**

Claims A crucial area for life insurers. The department concerned will be involved in all aspects of claims investigation, processing and settlement. **5.1.1(d)**

Class Designation A description of beneficiaries by group association rather than by name, e.g. "my children", "my brothers and sisters" etc. **4.4(c)**

Client Services See **POS.** **5.1.1(e)**

Closed Fund A Fund which the respective plan concerns only one associate or if there are a number of sponsors, where there is a business associate, professional or social connection between them and their consent is necessary for new sponsors to join the fund. **6.2.4**

Collateral Assignment An assignment which is likely to be temporary, as collateral security for a loan. The assignee's interest with such an assignment is limited to the amount of the loan plus interest. **4.9(e)(ii)**

Collateral Security The collateral assignment of a life policy provides collateral security for a loan given to the policyowner. **4.9(e)(ii)**

Conditional Premium Receipt A receipt for premium which confirms that insurance will begin from the time of the application, provided the life insured is subsequently found to have been insurable on standard terms at that time. **5.2.2(a)**

Conservation The retention of existing business, i.e. avoiding policy lapses and surrenders. **5.2.3a(a)**

Contestable Period The period of time specified in the **Incontestability Clause** during which the validity of the policy may be contested. **4.2, 4.7(d)(v)**

Contingent Beneficiary A beneficiary who inherits if the primary beneficiary is not living when the policy proceeds become payable. **4.4(e)**

Continuous Premium Whole Life Policy Whole life insurance where the premiums continue to be payable throughout the lifetime of the life insured. **2.1.3(a)(i)**

Contractholder An individual or an organization who applied for and purchased the annuity contract. **2.1.4(a)**

Contribution An insurance principle which means that two or more insurers covering the same insured for the same loss share that loss rateably. However, this is in providing an indemnity, to which life insurance is not subject. The existence of more than one life insurance does not affect the amount payable by the individual insurer. **1.2(e)**

Contributor An individual or corporate entity who contributes towards the pension funds. **6.2.2**

Contributory Plans Group life, or employee benefit schemes where the premium is paid in part by the employees. **2.3(c)**

Convert (Conversion) Changing a policy plan in accordance with permitted policy provisions, or by mutual consent with the insurer. **2(b)(i), 2.1.1b(b)**

Convertible Term Insurance A term insurance with rights to convert the policy plan into permanent cover, without evidence of insurability. **2.1.1b(b)**

Cooling-Off Directive A Directive initiated by the AMCM to grant certain privileges to life insurance policyowners regarding the cancellation of arranged contracts, within a permitted period. **5.2.4**

Cooling-Off Period A provision under the "Cooling-Off Directive", which allows a customer a stipulated time period to change his/her mind about a completed life insurance contract during which he/she may cancel the policy with a full refund of premium (subject to any market adjustment). **5.2.4**

Cost of Living Adjustment (COLA) A rider providing for periodic increases in the

disability income benefits being paid to a disabled insured. The increases are linked to a recognized independent index, such as the Consumer Price Index. **3.6.1**

Cover Note A term from general insurance, indicating a document giving formal evidence of the existence of insurance, the approximate equivalent in life insurance being the **Binding Premium Receipt**. **5.2.2 Note**

Credit Life Insurance A form of decreasing term insurance on a group basis arranged by lending institutions to cover the outstanding balance of loans should customers die. The benefit is payable direct to the lending institution. **2.1.1a(b)(i)**

Critical/Terminal Illness (TI) Benefit A rider allowing a stated portion of the death benefit to be paid to a policyowner-insured suffering from a terminal illness, with a life expectancy of 12 months or less. **3.3.1a**

Custodian An entity whose main duties in a pension fund fund includes maintaining up-to-date chronological record for all the transactions carried out and to receive on deposit or register the financial instruments and documents pertaining to the funds. **6.3.4**

Customer Prospecting The search for new customers for insurance, either from existing contacts or by other marketing endeavours. **5.2.3a(b)**

Customer Protection Declaration (CPD) An important document that must be completed and signed before a customer agrees or makes a decision in relation to the purchase of a new life insurance policy to replace an existing one. It is part of the concern of the insurance industry to preserve high ethical and professional standards, and to control inappropriate replacement of insurance policies. **5.2.5(c)**

Customer Service The range of activities a company engages in to keep its customers satisfied. It involves attention to the corporate culture (customer-orientated), authority being given to front-line employees and systems designed to monitor customer satisfaction. **5.2.3**

Date of Death An important point to be established with life insurance death claims, especially with term or decreasing term insurances, where the validity or amount of the claim may be affected. **5.6.2(a)**

- Days of Grace** See **Grace Period**. **4.3**
- Death Benefit** The basic amount payable under the insurance in respect of the death of the life insured. This may be subject to additional factors, e.g. accidental death benefits etc. **2.2.1(f)**
- Death Claims** The most common type of claim with life insurance, requiring detailed processing and verification of matters such as date of death, cause of death, proof of death etc. **5.6.2**
- Debt (on Policy)** An underwriting measure with a sub-standard risk, whereby a "debt" is placed against the face amount, possibly reducing to extinguishment as the policy years go by without a claim. **5.3.3(c)(i)**
- Declaration** The part of an application form signed by the prospective policyowner, confirming various statements and understandings, including the existence of a cooling-off period. A similar declaration appears on Illustration Documents, confirming understanding of the information supplied. **5.2.4(f)**
- Declinature** Refusal to insure a given risk. This is a last resort, as insurers prefer to offer terms if at all possible, but clearly there will be some risks which are uninsurable. **5.3.3(a)**
- Declined Risks** Risks which are impaired to such an extent that they lack insurability. **5.3.1(b)(iii)**
- Decreasing Term Insurance** A term insurance where the face amount reduces each year or at specified times. The cheapest form of life cover, useful to meet a diminishing temporary need, e.g. a mortgage loan which is being repaid over a period of years. **2.1.1a(b)**
- Defer Decision** An option for the life underwriter where a risk is not insurable owing to a temporary condition (e.g. accident injuries). The risk is not permanently refused, but it will need reassessment at a later date. **5.3.3(c)(iv)**

Deferred Annuity An annuity where the payments begin at some specified future time or specified age of the annuitant. **2.1.4a(b)**

Defined Benefit Plan A retirement plan under which benefits are pre-defined and contributions to be made are calculated so as to guarantee the respective payments. **6.2.3**

Defined Contribution Plan A retirement plan under which contributions to be made are predefined and the benefits are determined according to such contributions and the corresponding accumulated earnings. **6.2.3**

De-mutualized A mutual insurance company which has changed its mutual status, to become a proprietary company with shareholders. **5.1(a)Note**

Different Plan An underwriting option with a sub-standard risk, which proves unacceptable for the plan requested but may be insurable under another plan. **5.3.3(c)(iii)**

Disability Income Benefit A policy rider providing an income during the insured's period of disability. **3.1.2**

Dismemberment The loss of one or more limbs, but within the AD&D Rider provisions the term also applies to loss of sight. **3.2.1(b)**

Dividend Options The choices available to the policyowner of a participating policy, for which dividends have been earned. These choices include: receiving the dividends in cash, applying them towards future premiums, leaving them to earn interest with the insurer etc. **4.10**

Dividends Similar meaning to that applicable with equities, whereby the policyholder (with a participating policy) earns a specified amount according to the profits made by the insurer. Usually expressed as a percentage of the premium paid. **4.10**

Double Indemnity Benefit The provision of an additional sum, equal to the policy face amount, should death occur as a result of an accident. An alternative name for **Accidental Death Benefit.** **3.2.1(a)Note 1**

Dread Disease (DD) Benefit A rider allowing payment of a stated portion of the death benefit to a policyowner-insured suffering from a specified disease or undergoing certain specified medical procedures (called **Insurable Events**). **3.3.1b**

Duty of Disclosure The practical implications of the principle of utmost good faith, which requires the parties to an insurance contract to reveal to the other all material information, whether requested or not. **1.2.2**

Employee Benefit Plans Group life insurance for employees within the same organization or industry. **2.3**

Endowment Insurance Life insurance where the face amount is payable after a fixed period of years (at maturity) or on earlier death. **2.1.2**

Enrolment Card (alternatively Certificate) Documents used with group life insurances, providing evidence of cover to individual insured persons. Separate from the **Master Policy**. **5.4.1(b)**

Entire Contract Provisions Part of the terms of a standard life insurance policy, making reference to the policy and application and indicating the circumstances under which changes to the policy are possible. **4.1**

Equitable (Premiums) One of the classic criteria for life insurance premiums, i.e. each policyowner is paying an amount in line with the risk and contracted benefit involved. **1.3.1(b)**

Equities Ordinary shares in a proprietary company. As an investment vehicle, they carry more risk than some types of investment, but usually offer long-term growth prospects. Where more speculative, they offer prospect of considerable gain (or loss!). **2.2.2(b)**

Ex Gratia A payment, usually of a claim, which is made "out of grace or favour", i.e. where there is no legal liability to make such payment. **4.12 Note 2**

Examining Physician The qualified medical professional conducting a medical examination on behalf of the insurer. **5.3.2(b)**

Excepted/Excluded Perils Cause of loss specifically excluded by the policy. Whilst there are not many such perils likely to affect a life insurance, suicide is excluded within the first year or so of the policy's existence. **1.2.3(c)(ii)**

Excess Interest Interest earned over and above the guaranteed interest. Must be notified in the Annual Report with universal life insurance. **2.2.1(g)(v)**

Exclusions Risks or causes of claims specifically removed from the cover of the policy. These are relatively rare with life insurance, but may more commonly be found with rider benefit, e.g. suicide with accidental death benefits. **5.3.3(c)(ii)**

Expenses The loading to be added to the net premium, to cover all additions necessary when calculating life premiums. **1.3.1a(c)**

Extended Term Insurance An option under non-forfeiture benefits, whereby the cash value is used as a single premium to purchase term insurance for the same amount as the policy amount, for such period as the cash value will provide. **4.5(b)(iii)**

Face Amount An equivalent term for the sum insured under the policy. **1.3.2b(c)(iv)**

Family Income Insurance A variation of decreasing term insurance, usually linked with other lump sum benefit plans. The decreasing term element pays a monthly benefit in the event of death, for the remainder of a specified period of time. **2.1.1a(b)(ii)**

Financial Underwriting Underwriting concentrating more on the implications arising from the amount of insurance requested, e.g. whether the insured can meet premium obligations, whether reinsurance may be required, whether the amount seems excessive by normal criteria with such class of risks etc. **5.3.1(b) Note**

First Beneficiary See **Primary Beneficiary**. **4.4(d)**

Fixed Benefit Annuity An annuity under which the insurer guarantees that at least a defined amount of monthly benefit will be provided for each dollar applied to purchasing the annuity. **2.1.4a(f)**

Fixed Interest Investments One type of fund that may be used for linking purposes with unit-linked insurances. **2.2.2(b)**

Fully Earned An expression to indicate that the premium paid is equal to the risk borne in any period, so there is no "surplus" to provide for a cash value or other benefit common with the level premium system in many types of life insurance. The term applies to general insurance and may also be said to be applicable with term life policies. **1.3.2b(b)**

Fully Paid Policy A policy for which no more premiums have to be paid. One option under non-forfeiture provisions, where the insured does not wish to continue paying premiums on the original policy, in which case the face amount of the policy will be reduced to reflect the premiums paid to date. Another term for **Reduced Paid-Up Insurance**. **1.3.2b(c)(iv)**

Fully Paid-Up Shares Shares in a proprietary/joint stock company, for which no amount remains "on call", i.e. the full price of the shares has been paid. **5.1(b)**

Fund Manager A fund management company which is the administrator and legal representative of the Pension Fund. **6.3.4**

Grace Period A period of time after a premium is due, during which the premium may be paid and cover kept continuous, without penalty. Also known as **Days of Grace**. **4.3**

Graded-Premium Policy A variation of whole life insurance, where the premium increases on a regular basis, e.g. every three years, but the face amount remains unchanged. **2.1.3(c)**

Gross Premium The premium in life insurance after taking into account the three rating factors of mortality, interest and expenses. **1.3.1a(c)Note**

Group Insurance Plan Life insurance of a number of persons forming a recognizable group, e.g. employees etc. **2.3**

Guaranteed Insurability Option (GIO) Under this rider the policyowner has the right to purchase additional insurance on specified option dates, without having to supply evidence of insurability. **3.5.1**

Immediate Annuity An annuity where the instalments commence one annuity period immediately following the payment of the purchase sum. **2.1.4a(c)**

Incontestability Clause Provisions in a life policy where after an initial period, usually two years, the validity of the policy may not be contested, on the grounds of a breach of utmost good faith for example, (except, in Macau, where fraud is alleged). **4.2**

Increasing Term Insurance Term insurance where the premium and face amount increases annually or as otherwise agreed. Increases may be linked to an agreed index (e.g. Consumer Price Index). **2.1.1a(c)**

Indemnity An insurable principle not normally applicable with insurances of the person. It relates to providing an exact financial compensation, which is not possible with life insurance, for example. **1.2(d)**

Indemnity Corollaries Sub-principles of the parent principle indemnity, i.e. contribution and subrogation. As with indemnity, neither is likely to have any application with life insurance policies. **1.2.3(b)**

Individual Insurance Plans Life insurances arranged on the life of an individual person, as opposed to a group scheme. **2.3**

Inflation An important economic consideration, since its effect can drastically reduce the real value of life insurance over an extended period. Planning a life insurance programme should therefore take this into account. **3.6**

Insurability The physical and/or other conditions which indicate that the life

insured is an acceptable risk for the insurance plan concerned. **2.2.1(b)**

Insurability Benefits A rider guaranteeing insurability under certain circumstances, see **Guaranteed Insurability Option.** **3.5**

Insurable Events Medical conditions giving rise to a payment under the **Dread Disease (DD) Benefit.** These events are likely to include such medical conditions as life threatening cancer, some forms of AIDS, heart attack etc. **3.3.1b(b)**

Insurable Interest The legal right to insure an individual's life. It is required at the commencement of any such insurance, although it is not needed when the claim arises. **1.2.1**

Insurable Interest (In Oneself) One has an unlimited insurable interest in oneself, so in theory an insurance could be effected for any amount. In practice, the amount is likely to be governed by the ability to pay the premium and the insurer's willingness to insure very high amounts. **1.2.1(a)**

Insurable Interest (In Others) One has an unlimited insurable interest in one's spouse. There is also an insurable interest where a financial relationship exists (e.g. in respect of a loan), but this is limited to the financial involvement plus reasonable interest. By law, in Macau a parent or guardian of a young person under the age of 18 has an insurable interest in that young person. **1.2.1(b)**

Insured Perils Causes of loss covered by the policy: an important consideration in establishing proximate cause. **1.2.3(c)(i)**

Interest With long term insurance, where the policies are not cancellable and the fixed premium cannot be changed, the anticipated interest earnings on premiums is a critical factor in determining premium rates. **1.3.1a(b)**

Investment One aspect of certain life insurance covers, making financial provision for the future by investing in a life insurance policy, especially one which participates in the insurer's profits. **1.3.1a(b)**

Irrevocable Beneficiary A beneficiary who cannot be changed without his/her consent.
4.9(d)(i)

Joint and Survivor Annuity An annuity which provides a series of payments to two or more individuals, and those payments continue until both or all of the individuals die.
4.1.2a(e)

Joint-Life Basis A life insurance covering two (or more) persons, the benefit being payable upon the first death. A frequent use is with mortgage redemption insurances.
2.1.1a(b)(iii)

Key Person Insurance Insurance of an individual who represents a significant financial investment to the insured, e.g. an important employee, a leading professional sportsperson to their club etc.
1.2.1 Note

Lapse The termination of a life insurance because the premium has not been paid within the permitted time period (including the **Grace Period** and subject to any applicable policy provisions).
4.7(c)

Level Premium System The normal method of charging for life insurance, whereby (for the same benefit) the annual premium is established at inception and does not vary throughout the life of the policy.
1.3.2b

Level Term Insurance A term insurance where neither the benefit nor the premium changes during the term of the policy.
2.1.1a(a)

Life Annuity An annuity that provides periodic benefit payments for at least the lifetime of a named individual
2.1.4a(d)

Life Insurance An insurance contract providing a benefit payable upon the death of the life insured or upon survival to a stipulated date.
1.1

Life Office Management Association Inc. (LOMA) U.S. life insurance educational organization, noted for its professional examination for life insurance personnel. **1.1**

Limited Payment Policies Whole life insurances, where the premiums cease to be payable at a certain age or after a certain number of payments. **2.1.3(a)(ii), (iii)**

Living Benefit Riders Another name for **Accelerated Death Benefits**. **3.3**

Loading The surcharge or additional sum added to life insurance net premiums to take account of expenses, commissions etc. **1.3.1a(c)**

Long Term Care (LTC) A rider allowing a stated portion of the death benefit to be paid to a policyowner-insured who requires constant care for a medical condition. **3.3.2**

Market Value Adjustment (MVA) A permitted right of insurers under the cooling-off initiative to make an adjustment with the refund of premiums, in relation to linked policies and non-linked single premium life insurances. **5.2.4 Note**

Marketing An important department for a life insurer, dealing with such matters as product research, advertising and public relations etc. **5.1.1(f)**

Master Policy The primary insurance document with a group life insurance plan. **5.4.1(b)**

Material Fact A fact that would influence the mind of a prudent underwriter in determining whether to accept a risk or on what terms to accept it. **1.2.2**

Mature (Maturity) Relates to the situation when an endowment insurance becomes payable because the designated period has expired and the life insured is still living. **2.1.2**

Maturity Claims Claims under endowment type insurances, where the full number of years specified have been completed and the life insured is still living. **5.6.1**

Medical Application A proposal for life insurance where a physical medical examination of the life to be insured is required. **1.2.2(c)**

Medical Benefits Benefits traditionally (and may still be) insured under a general insurance policy, but which may be added as a rider to a life insurance. Such benefits are likely to consist of a basic plan, with an optional medical plan and be subject to certain major exclusions. **3.4**

Medical Reports Reports from qualified medical professions in cases where this is deemed necessary, especially with insurances normally on a non-medical basis. **5.3.2**

Medical Tests These may be needed in connection with a life insurance application. **1.2.2(d)**

Misstatement of Age/Sex The policy provisions regarding errors of this nature. Most policies provide that in such circumstances the face amount be adjusted to reflect that which would have applied to the correct age/sex. **4.8**

Mixed Plan A retirement plan which combines the features of Defined Benefit Plan and Defined Contribution Plan **6.2.3**

Money Laundering The illegal practice of "cleansing" money obtained illegally (e.g. through drugs) by the use of business or financial instruments such as life insurances. Insurers must take great care in trying to detect and eliminate such practices. **5.5.1Note**

Monthly Annuity An Annuity where the time span between each of the payments in the series of periodic annuity benefit payments is one month. **2.1.4a(b)**

Moral Hazard Rather more subjective features concerning human attitudes, behaviour and conduct which may have a bearing on the risk. **5.3.1(a)(ii)**

Mortality An important consideration in determining life insurance premium rates. It refers to the rate at which insured lives may be expected to die. The term,

therefore, may more accurately be described as **Rate of Mortality**. **1.3.1a(a)**

Mortality Tables Published statistics on mortality, indicating the expected rate of mortality at given ages. **1.3.1a(a)**

Mortgage Indemnity Insurance Insurance arranged by banks and other lending institutions to cover potential losses to them on mortgage loans, should the customer die or otherwise be unable to repay the loan and the property has to be sold in adverse market situations. **2.1.1a(b)Note**

Mortgage Redemption Insurance A popular form of decreasing term insurance, with the benefit linked to the outstanding balance of a mortgage loan. Often issued on a joint-life basis, payable on the first death. **2.1.1a(b)(iii)**

Multiple-Employer Groups (Insurance) Group life insurance where different employers participate in a single plan covering their respective employees. **2.3(d)**

Murder For the most part, murder of the life insured is regarded as an accident” as far as any ADB rider is concerned. However, if it is proved that the murderer was the beneficiary, **Criminal Code** will not allow the latter to have the policy benefit. **5.6.2(c)(iv)**

Mutual Insurance Company An insurance company with no shareholders, technically owned by its participating policyholders. **5.1(a)**

Natural Premium System A system of life insurance premium charging, whereby the premium each year changes according to the age of the insured life and other features. This is unworkable from a practical point of view and may be considered an academic concept. **1.3.2a**

Natural Risk The intrinsic risk presented by the life insured at a particular point in time, related to the person's age, health and other factors. **1.3.2a(a)**

Net Policy Proceeds The entitlement of an assignee under a life insurance policy, i.e. his interests are subordinate to those of the insurer regarding overdue premiums, loans and interest payable. **4.9(c)**

Net Premium Sometimes called the **Pure Premium**, this may be described as the basic premium to be charged exactly to cover the cost of death claims arising under normal statistical expectations, with no allowances for expenses or profit. **1.3.1a(b)Note**

Non-Contributory Plans Group life, or employee benefit, plans where the employees do not contribute towards the premiums. **2.3(c)**

Nonforfeiture A consequence of the level premium system and policies having a cash value. In the event that "renewal" premiums are not paid, the policy does not lapse (become forfeit), because the cash value may be used to keep the policy in force. **4.5**

Nonforfeiture Options These are the choices available to the policyowner who does not wish to continue payment of premiums under a policy which has a cash value. These options include: taking the cash value, accepting reduced paid-up insurance and accepting extended term insurance. **4.5(b)**

Nonforfeiture Provisions The available choices where premiums are not to be continued under a policy having a cash value. These provisions stipulate the procedure should there be no indication from the policyowner which option he chooses. **1.3.2b(c)(iii)**

Non-Medical Application A request for a life insurance which (subject to certain stipulations) does not have to be accompanied by a physical medical examination of the life to be insured. **1.2.2(b)**

Open Fund A fund where there is no requirements for any link between various members of the respective plan, and membership of the fund is solely dependant or acceptance by the pension fund manager. **6.2.4**

Option Dates Dates specified under a **Guaranteed Insurability Option** on which

additional insurance may be purchased without evidence of insurability. Often such dates are linked with important life events, e.g. marriage, childbirth etc. **3.5.1(d)**

Optional Medical Plan Available cover under a medical benefits insurance, mostly consisting of increased limits for the various headings of cover under the basic plan. **3.4(b)**

Paid-Up Insurance Insurance for a reduced amount, with no further premiums to pay but otherwise on the same terms as the original insurance. Another consequence of the level premium and cash value system, paid-up insurance is possible because the premium is not "fully earned" under the former system. **1.3.2b(c)(iv)**

PAR/NON-PAR The customary abbreviation for policies that are participating or non-participating. **1.3.1b(a)**

Participant An individual whose personal and professional circumstances determine the rights arising under the pension plans **6.2.2**

Participating/Non-Participating Also known as **With-Profits** or **Without-Profits**, the terms indicate whether or not the policies concerned share in the profits of the insurer or not. If they do, dividends or bonuses are payable. **1.3.1b(a)**

Participating Policyholders Those policyholders whose policies are participating (or with profits). If the insurer is a mutual company, they are the legal owners of the company. **5.1(a)**

Pension A monthly or other periodic payment to a person in retirement, until death. **2.1.4(b)**

Pension Fund A fund which can invest in many different types of financial securities and can own assets directly exclusively for the fulfilment of one or more pension plans. **6.2.2**

Pension Plan A retirement program which defines the conditions for formation of the right to receiver a pension. **6.2.2**

Permanent Insurance (Plan) Life insurance which is not on a term basis, i.e. whole life etc, whereby a claim is certain provided premiums continue to be paid.

2.1.1b(b)(iii)

Personal Needs An important aspect of life insurance for the individual, i.e. to make provision for various life needs (e.g. children's education, personal retirement, provision for dependants with premature death etc).

1.1.1(a)

Physical Hazard The objective measurable factors that are likely to increase the risk of the insured event happening, such as obviously known health dangers (e.g. heavy smoking, serious overweight etc).

5.3.1(a)(i)

Policy Changes One of the duties of the POS (Policyowner Service Department), including such matters as minor amendments of address to significant issues such as change of beneficiary, and assignments.

5.5.1

Policy Delivery After policy preparation, delivery of individual policy covers is normally by the marketer. Group policies involve a master policy for the employer or group concerned, with perhaps certificates and enrolment cards for each insured person, delivery being overseen by the marketer or group representative.

5.4.1

Policy Issuance The process of preparation, checking and delivery of the policy document. An important operation, since policies cannot be cancelled and may be assigned.

5.4

Policy Loan Policies having a cash value usually also include rights for the policyowner to borrow money from the insurer against the security of the cash value. The loan may be for any purpose and need not be repaid until the policy benefit is due (when interest will be added and the total deducted from the claim payment).

1.3.2b(c)(ii), 4.6

Policy Revival See **Reinstatement**.

4.7

POS (Policyowner Service) The Customer Service Department, responsible for such matters as documentation, correspondence, premium payments etc.

5.1.1(e), 5.5

Pre-Existing Conditions A common exclusion with medical benefit policies,

designed to eliminate expenses relating to medical problems that existed before the insurance commenced. **3.4(c)(i)**

Preferred Risks Above average risks, constituting highly desirable types of business for the insurer (e.g. confirmed non-smokers in excellent health). **5.3.1(b)(iv)**

Premium The amount payable by the policyowner for (usually annual) coverage. Classic understandings of life insurance indicate that life premiums should be adequate and equitable. **1.3**

Premium Waiver Contract provisions whereby premium otherwise payable is not required by the insurer under certain circumstances, e.g. during the period when long-term care benefits are payable under a policy with a LTC Rider. **3.3.2(f)**

Premiums for Life Whole life insurance where the premiums continue to be payable for as long as the life insured lives. Also known as **Straight Life Insurance**. **2.1.3(a)(i)**

Presumption of Death Where no death certificate can be issued, it may be possible to have a presumption of death by the courts (after disappearance etc). **5.6.2(d)**

Primary Beneficiary (or First Beneficiary) The designated beneficiary having priority in the payment of the policy proceeds. **4.4(d)**

Proof of Age Documentary or other evidence to satisfy the insurer as to the life insured's age. This may be provided at any time, but it is normally required before any claim under the policy can be made. **5.6.1(d)**

Proof of Death Normally provided by a death certificate, this is an obvious requirement in substantiating a death claim. **5.6.2(b)**

Proof of Title Title may be defined as the legal entitlement to a benefit etc. Such title is important, for example, with a person claiming the cash value under a surrender claim. **5.6.3(a)**

Proprietary (Joint-Stock) Company A company having shareholders, who have their liability towards the company's debts limited to the extent of any amounts unpaid in respect of their company shares. **5.1(b)**

Provident Fund Scheme A retirement provision, but unlike a pension the benefit is in the form of a lump-sum amount payable at retirement or other specified time. **2.1.4b**

Proximate Cause Is the principle which seeks to establish the dominant reason for a loss occurring. The cause of death may be important in life insurance, for example, especially if the policy provides additional benefits for accidental death (or if the policy is still within the contestable and suicide provisions period). **1.2(c)**

Pure Endowment A rare form of life insurance where the benefit is only payable if death does **not** occur during the period (term) specified. **2.1.2(b)**

Pure Premium or Pure Cost of Insurance (Protection) See **Net Premium**. **1.3.1a(b) Note**

Rates (Life Insurance) The normal or standard premiums applicable, according to age and sex, to life insurance. **1.3**

Reduced Paid-Up Insurance One of the non-forfeiture options, implying that the available cash value be used to purchase insurance for which no further premiums are required (although the face amount will obviously be less than that for the original policy). **4.5(b)(ii)**

Reinstatement The restoration of a lapsed policy into full force. Also known, with UK style policies as **Policy Revival**. This is provided for under policy conditions, but is subject to certain limitations, e.g a specified time period (perhaps five years), repayment of back premiums and interest, and perhaps other measures (e.g. suicide clause is reinstated). **4.7**

Reinsurance The process of insuring again all or part of a risk insured, to protect the insurer's net position. Much more commonly used in life insurance as an underwriting tool with individual risks with adverse features, e.g. extremely high face amounts, severe health problems etc. **5.1.1(g)(iii)**

Release Form Documentary confirmation from a beneficiary that the policy's death benefit stands reduced by the amount of any accelerated death benefit payment. Alternatively, a discharge given by a benefit recipient, e.g. with a policy surrender, death claim etc. **3.3(c), 5.6.3(c)**

Renewable Term Insurance A term insurance having the right of renewal for further period(s) without evidence of insurability. **2.1.1b(a)**

Replacement Replacement also involves any policy which has lapsed, been surrendered or converted to paid-up insurance. **5.2.5(b)**

Retirement One objective with life insurance, i.e., to provide a lump sum (perhaps through an endowment policy), which may be used to purchase an annuity. **1.1(d)**

Retirement Age Age 65 for the purpose of the Private Pension Fund Ordinance **6.2.2**

Reversionary Ownership rights which exist now, but which cannot be fully exercised until some time or specific event in the future. **4.9**

Reversionary Interest (or Bonus) A financial interest which exists now, but where full enjoyment and privileges of ownership is deferred until some future time or event, e.g. bonuses under with-profits policies, which are more correctly termed "reversionary bonuses". **4.10**

Rider An endorsement or addition to the policy, frequently adding further benefits to the cover (e.g. accidental death benefits). **3.1**

Savings One function of life insurance covers, where the insured is providing

financially for the future, e.g. with endowment insurances. 1.1(b)

Settlement Options The choices available to the policyowner when the policy proceeds become available. These options include : lump sum single payment, proceeds left to earn interest with the insurer, proceeds paid in instalments over a fixed period etc. 4.11

Single Employer Plans Group life insurance where all insured persons are employees of the same employer. 2.3(d)

Single Premium Annuity An annuity that is purchased by the payment of a single, lump sum premium. 2.1.4a(a)

Single Premium Endowments An endowment insurance plan involving a single premium payable at policy inception, regardless of the term specified. 2.1.2(a)

Special Class Risks See **Sub-Standard Risks**. 5.3.1(b)(ii)

Standard Risks Risks presenting no abnormal features and insurable on normal terms. 5.3.1(b)(i)

Straight Life Insurance See **Premiums for Life**. 2.1.3(a)(i)

Subrogation An insurance principle which allows an insurer who has provided an indemnity to take over for his own benefit rights the insured has against third parties. As indemnity does not apply to life insurance, so this corollary of indemnity does not apply to it either. 1.2(f)

Sub-Standard Risks Risks which for some adverse reason cannot be considered standard, although possibly insurable with special terms. Sometimes called **Special Class Risks**. 5.3.1(b)(ii)

Sub-Standard Risks Underwriting Measures The options available to the

underwriter to try to "normalize" a sub-standard risk for insurance purposes, e.g. loading the premium, different plan etc. **5.3.3**

Suicide An excluded peril for the first year or so of a life insurance policy's existence, but is a permanent exclusion in respect of any accidental death benefit addition.
1.2.3(c)Note 1

Suicide Clause This constitutes the provisions of a life policy in respect of death by suicide, which is normally excluded for the first year or so of the policy's existence, but not excluded thereafter (unless reintroduced for a further period after policy revival). **4.12**

Supplementary Requirements Consisting of a number of issues that an underwriter may need including life underwriter's (agent's) report, mode of premium payment, proof of insurability etc. **5.2.1(c)**

Surrender Claims Termination of the insurance at the request of the policyowner. Whilst entitled to do this, other options are likely to be explained to the policyowner first. **5.6.3**

Surrender Value See **Cash Value**. **1.3.2b(c)(i)**

Switching (Policy Switching) Changing an existing life policy for a replacement one. The term, however, has an undesirable implication whereby policyowners are persuaded to make the change which may be more for the benefit of the agent/insurer than the policyholder. The latter practice is known as **Twisting** (i.e. the inappropriate replacement of life insurance policies). **5.2.5**

Technical Underwriting Assessment of the intrinsic and perceived hazards of given risks, as to their insurability and terms. **5.3.1(b) Note**

Temporary Insurance Agreement (TIA) See **Binding Premium Receipt**. **5.2.2(b)**

Temporary Life Annuity It is a annuity that provides periodic benefit payments until the end of a specified number of years or until the death of the annuitant, whichever

occurs first.

2.1.4a(d)

Temporary Risk Situations Situations where premature death might cause undue financial burdens and therefore suitable for temporary (term) life insurance, e.g. whilst a loan is outstanding or there are educational needs for children. **1.1**

Term Insurance Life insurance where the benefit is payable only if the life insured dies during the period (term) specified. Also known as **Temporary Insurance**. **2.1.1**

Third Party Policy A policy where the insurance is on the life of a person other than the applicant. **1.2.1a(b), 4.4(b)**

Total Disablement As defined under the Disability Income Benefit Rider, this means that the insured is unable to perform the essential acts of his own occupation, or any occupation for which he is reasonably fitted by education, training or experience. **3.1.2(a)**

Twisting See **Switching**. **5.2.5(a)**

"Unbundled" Cover A feature of universal life insurance, whereby the insurer separately discloses the pure cost of protection, the investment earnings and company expenses relating to the insurance contract. **2.2.1(d)**

Unconditional Premium Receipt See **Binding Premium Receipt**. **5.2.2(b)**

Underwriting Concerned with the selection of risks and terms to be imposed, this department will be involved with risk assessment (for insurability and terms), medical requirements and reinsurance arrangements. **1.3.1a(a), 5.1.1(g), 5.3**

Uninsured Perils These are causes of loss neither specifically covered by a policy nor specifically excluded. An important consideration with non-life insurances and the principle of proximate cause, but unlikely to have any significant application to life insurance. **1.2.3(c)(iii)**

Unit-Linked Policy A life insurance plan where the value is directly linked to investment performance. The value is linked to a unitized fund run by the life insurer or with units in a unit trust. **2.2.2**

Universal Life Insurance A life insurance contract which is subject to a flexible premium, has an adjustable benefit and which accumulates a cash value. **2.2.1**

Utmost Good Faith The common law principle with insurance contracts, whereby each party must reveal to the other all material facts, whether these are requested or not. Breach of this principle normally makes the contract voidable, but this provision may be affected by the **Incontestability Clause**. **1.2(b)**

Valuation A core function of the Actuarial Department, relating to the calculation of the value of the company's assets and liabilities. **5.1.1(a)(ii)**

Variable Annuity An annuity under which the amount of the policy's accumulated value and the amount of the monthly annuity benefit payments will fluctuate in accordance with the performance of an investment account. **2.14a(f)**

Waiting Period A qualification to the Waiver of Premium Rider, whereby premiums are not waived until the insured has been disabled for a period of three (or six) months. Some insurers refund premiums paid during the waiting period if the disability lasts longer, so that policy premiums begin to be waived. **3.1.1(a)**

Waiver of Premium Rider (WP Benefit Rider) An endorsement to a life policy waiving premiums otherwise payable whilst the insured is totally disabled, keeping the insurance in full force. **3.1.1**

Whole (of) Life Insurance Life insurance where the benefit is payable only on death, whenever that occurs. **2.1.3**

With Profits The equivalent term in U.K. insurance terminology of a participating insurance. **1.3.1b(a) Note 1**

Without Profits The equivalent term in U.K. insurance terminology of a non-participating insurance. **1.3.1b(a) Note 1**

Yearly Renewable Term (YRT) Policy rider indicating that the insurance is a one year term insurance with guaranteed insurability renewal provisions. Also know as **Annually Renewable Term (ART)**. **2.1.1b(a)**

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