



KARVY BAZAAR BAATEIN

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Bonus Mysteries Unrevealed!!

One must have often heard about the concept of bonus in the context of life insurance policies. As bonuses continue to form one of the important benefits under a policy eligible for participation in the profits of an insurance company, it becomes essential to understand the aspects that form the foundation of these bonuses.

Bonus declaration is subject to the performance of the insurance company. These are usually not guaranteed. Most of the insurance policyholders and sales persons are familiar with this fact. However, not many of us would have thought about what is actual basis and process behind the bonus declarations.

We at Karvy have always emphasized on the knowledge and understanding of the financial and investment products. And we believe that an understanding of the nitty-gritty involved behind the computation of bonus would help in appreciation of this important benefit in a much better manner.

Life insurance is important as it aims at compensating for the financial loss occurring because of loss of an invaluable human life. A life insurance policy aims at creation of an estate for the benefit of the life assured and dependants, from the very time the policy contract comes into force. And hence it protects the dependants from the financial embarrassment that they would be subject to due to the discontinuation of the income in the event of the death (or disability) of the bread winner.

However, as a life insurance policy is a valid contract, it needs

to have a valid consideration to form the basis for the promise of the insurance company to compensate for the above financial loss. This consideration is in the form of a premium of the policy and is usually payable periodically to the insurance company by the policyholder.

One of the major constituents of the premium for a life insurance policy is the '*mortality charge*' or the charge for provision of the risk cover to the life assured. The mortality charge is calculated taking into consideration the rate of mortality (the probability that a person will die in the within a time period, usually one policy year) that is applicable to the life assured at the time of commencement of the policy. These mortality rates are defined on the basis of the past experience of the insurance companies as regards the mortality of the insurable lives. An insurance company is conservative in estimation of these mortality rates, so as to safeguard its interests and also those of its existing policyholders against adverse mortality experience.

With the advancements in medical sciences and an overall increase in the standard of living, there is a consequent increase in the average life expectancy of an individual. This increased life span

results in an overall improvement in mortality with a better than average mortality experience for the insurance company. This in turn helps in reduction of the outlay of the company in form of death claims, leading to the surpluses / profits for the insurer as the provisions for meeting the claims far exceed the actual claims.

Initially when the insurance companies earned these surpluses, they were tempted to pass on a part of surplus to the policyholders to encourage them to take more insurance and also to advertise about the prosperity and the favorable money management of the insurance company. Most common means of distribution of these profits came to be known as **bonus** on the insurance policy.

As these surpluses happened regularly, the policyholder became used to receiving such bonuses. To cater to needs of the policyholders to participate in the profits of the insurance company, a regular provision was made in the premium rates, so as to enable the insurance company to announce the bonus. This provision, however, was made usually in the case of the life insurance policies that were declared as policies eligible for sharing the profits / surpluses of the company or simply speaking '*profit sharing policies*' or '*participating policies*'.

Bonus may be classified on the basis of the way this is provided to the policyholder. This classification being:

1. **Cash bonus** – this is a bonus paid to the policyholder in cash as and when the same is declared.
2. **Bonus resulting in the reduction of the premium** – when declared by the insurance company, this bonus results in reduction of the amount of the premium that is payable by the policyholder just after the declaration of the bonus.

3. **Reversionary bonus** – this bonus forms a part of the maturity benefits paid to the policyholder at the end of the policy term.

Bonus can be either guaranteed or non-guaranteed depending on the terms and conditions of the specific life insurance policy.

The availability of bonus to a policyholder more often than not depends on whether or not a policy is participating in the profits of the company. As stated earlier, the premium for the "*with-profit*" policies or participating policies, that is communicated to the proposer of the life assurance contract, does provide for the provision for loading with respect to the profit sharing.

Our discussion on bonus will not be complete if we do not look at the other factors contributing to bonus.

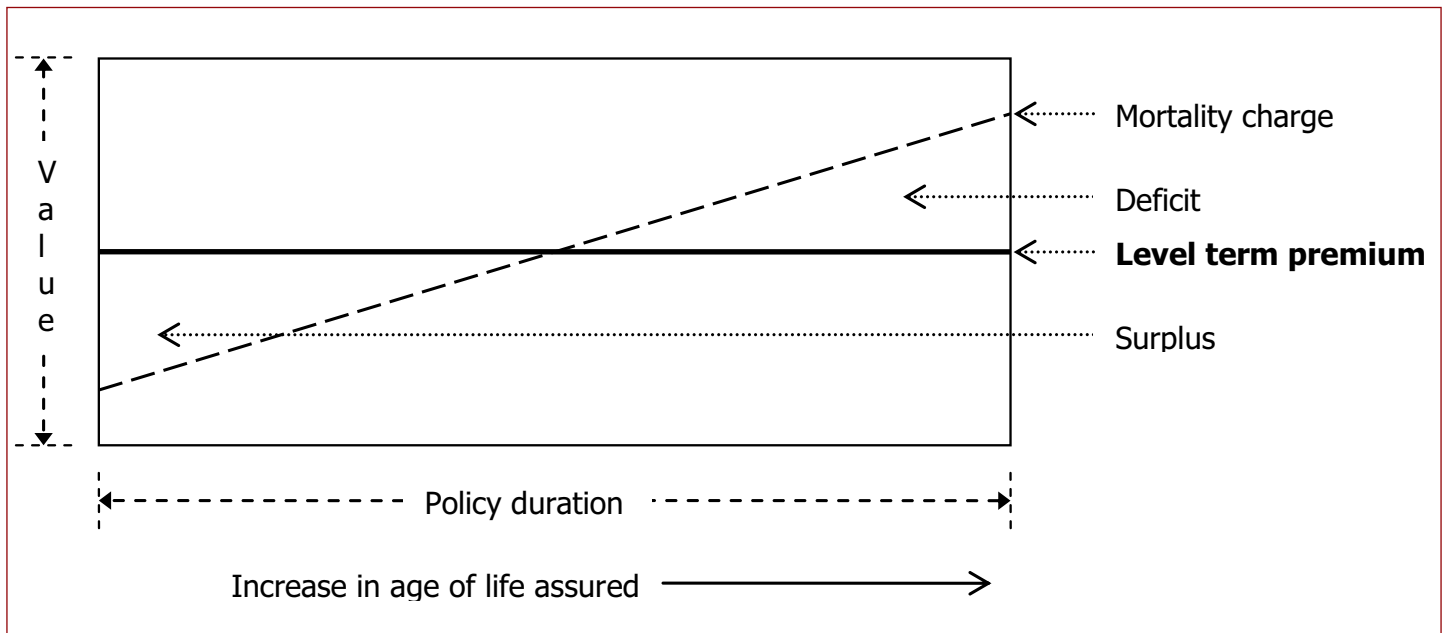
The mortality charge is dependant on the probability that the life assured will die during a particular time period. As the age of the person increases, this probability of death of the person during the year increases, thus increasing the mortality charge applicable. This will in turn require the premium amount to be increased with the increase in age.

On the contrary, usually the premium payable under any life insurance plan is fixed through the tenure of the plan. In other words, it is the same amount of premium that is paid by the policyholder through out the policy tenure under the level term premium. This is known as the '*level term premium*'.

Here, the total premium payable by a policyholder during the entire policy term needs to be sufficient to build up a corpus that will be enable the payment of the benefit(s) arising as claims under the policy, specially the maturity or survival benefits.

Under the level term premium, in the initial years the premium will be much more than the amount required for covering the insurance risk. This excess is invested judiciously in interest bearing securities. As the mortality rate increases with the age of the life assured, this excess decreases and during the final

years of the policy the level term premium alone is not sufficient to cover the insurance risk. At this point of time, the interest earned in the initial years combined with the premiums is used to provide cover to the risk.



The above interest being compounded, in majority of the cases the amount of interest actually earned is more than what is required for complementing the provision of the insurance cover in the later years of policy term.

This is a favorable interest experience for the insurance company as the interest earned is greater than the expectations. And in turn contributes to the surpluses for the company, thus calling for the same to be shared with the policyholders as bonus.

The premium calculation, apart from the mortality charge and the interest expected on investments, also includes a provision for the expenses to be incurred by the management of the insurance company towards the servicing of the policies undertaken by

the company. The efficient working of the insurance company as well as economies gained while dealing with large number of policies and other related factors assist making the actual management expenses being much lesser than their provision in the premium. The difference in its way contributes to the surplus, and hence to the bonus.

Closing the discussion with the fact that is worth a mention is that the bonus is declared on the overall surplus for an insurance company and not on the individual policy experiences. This surplus is calculated on the life assurance fund of the insurance company, which forms the basis for payment of all the liabilities with respect to the insurance policies underwritten by the company. Bonus is declared on this surplus.

Product Showcase :: Saral Jeevan Plan

Saral Jeevan Plan is a simple policy providing an immediate life insurance cover. It is a unit linked insurance policy introduced by Birla Sun Life Insurance Company Limited.

Suitability

The policy is suitable for an individual who is looking at a hassle-free insurance cover along with an opportunity to participate in the capital markets for creation of wealth.

Unique features

The policy provides a fast, easy and simple life cover. The proposer has to just agree to three statements mentioned in the application form*. The proposer / life assured gets an immediate life cover on submission of the application form along with the supporting documents.

* As per applicable policy conditions

Policy benefits

The Death benefit: In case of death of the life assured during the policy term, the death benefit will comprise of the sum assured and the fund value.

Maturity benefit: At the end of the policy term, the fund value will be payable as the maturity benefit.

Eligibility parameters

Age at entry – minimum – 18 years; maximum – 55 years

Maximum age at maturity – 65 years

Policy term – 10 years, 15 years and 20 years

Sum assured[#] – minimum – Rs.60,000, Rs.90,000 and Rs.120,000 for policy term of 10 years, 15 years and 20 years respectively; maximum – Rs.10,00,000

Premium payment term – is equal to the policy term. The applicable premium amount is as mentioned in the application form

Premium payment frequency – annual, semi-annual, quarterly or monthly

Mode of premium payment – cash (upto Rs.50,000), cheque / demand draft, credit card, salary deduction, ECS or direct debit

[#] the sum assured under this policy is in form of 'Covers'. Each cover represents Rs.10,000 worth of sum assured.

Investment funds

Policy holder has the option to choose from 8 investment funds. Investment can be allocated in any one of these funds or a combination of 2 or more funds. The details of the investment funds are:

Fund Name	Investment Objective	Risk Profile	Investment Allocation	
			In debt instruments, money market & cash	In equities & equity related instruments
Assure	Capital conservation at high level of safety and liquidity	Very low	100%	0%
Protector	Consistent returns by active management of fixed income portfolio	Low	90% to 100%	0% to 10%
Builder	Build capital & generate better returns	Low	80% to 90%	10% to 20%

Fund Name	Investment Objective	Risk Profile	Investment Allocation	
			In debt instruments, money market & cash	In equities & equity related instruments
Enhancer	Grow capital through enhanced returns with good balance of equity & debt	Medium	65% to 80%	20% to 35%
Creator	Optimum balance of growth & stability for long term capital appreciation	Medium	50% to 70%	30% to 50%
Magnifier	Maximization of wealth through diversified equity portfolio	High	10% to 50%	50% to 90%
Maximiser	Long term capital appreciation by active management of well diversified equity portfolio	High	0% to 20%	80% to 100%
Multiplier	Long term wealth maximization by active management of well diversified equity portfolio	High	0% to 20%	80% to 100%

The policy holder can switch the investment funds or re-direct the premium in various funds anytime during the year. There are no charges for switching between the funds in part or in full and or for the re-direction of the premiums. The premium re-direction can be made in each fund from 5% to 100% in the increments of 5%. Switch from one fund to the other in full or in part is allowed, subject to a minimum switching amount of Rs.5,000.

Policy charges

Premium allocation charges – There is no premium allocation charge deductible from the policy premium. This means that the entire policy premium will be invested in the chosen investment fund(s).

Fund management charge – This charge is deducted on a daily basis. Unit price of each fund is adjusted to reflect the fund management charge as detailed below.

Fund Name	Assure	Protector	Builder	Enhancer	Creator	Magnifier	Maximiser	Multiplier
Fund Management Charge	1.00%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%

The insurance company has the right to increase this charge any time in future subject to maximum 1.50% for all funds except for Multiplier which can be increased up to 1.75%.

Policy administration charge – This charge will be deducted on a monthly basis from each of the chosen investment funds on a proportionate basis. The details for the charge are:

Monthly charge per 'Cover' (i.e. every Rs.10,000 sum assured)			
Policy Year	Policy Term of		
	10 years	15 years	20 years
1 st year to 3 rd year	Rs.29	Rs.26	Rs.25
4 th year onwards	Rs.4	Rs.3	Rs.2.5
Plus Rs.40 (on the first cover only)			

The above charge is guaranteed to never increase for the first 3 policy years, after which it can be increased by maximum 5% per annum since inception.

Mortality charge – This charge is deducted on a monthly basis for the provision of the life insurance cover. The charge depends on the age of the life assured at the time of commencement of the policy.

Policy revival charge – This charge is Rs.100 at present and is subject to increase to maximum Rs.1,000 in the future, subject to the IRDA approval.

Partial withdrawals / policy surrender

Free partial withdrawals are allowed from the fund value after 3 years from commencement of the policy. The minimum amount of partial withdrawal is Rs.5,000 and there is no limit to the maximum value, subject to a balance of fund value equal to Rs.12,000.

The policy can be surrendered anytime during the policy term. There will be no surrender charges from the 4th policy year. However, if the policy is surrendered before the completion of 3 policy years, the surrender value (i.e. the fund value less surrender charges) will be paid only at the end of 3 policy years.

Tax benefits

Premium payable under the policy is eligible for deduction under Section 80C of the Income Tax Act, 1961. Also, the benefit payments are exempt from tax under Section 10(10D) of the Act.

Important: In this policy, the investment risk in the investment portfolio is borne by the policyholder.

Product Showcase :: Mahalife Gold

Mahalife Gold is a whole life assurance policy from Tata AIG Life Insurance Company. A whole life policy provides a life insurance cover for the entire life of a person. The cover is available upto a very high stipulated age, usually 100 years. And thus, the death benefit becomes payable to the nominee in case of the death of the life assured at any time.

Suitability

The policy is suitable to individuals aged upto 60 years, who require a life long insurance cover.

Unique features

Premium is payable for the first 15 years of the policy. The life insurance cover is available till 100 years of age.

Policy provides a guaranteed annual coupon of 5% of the sum assured, every year for the rest of the insured's term from the 10th policy anniversary.

Policy also provides for annual cash dividends from the 6th policy anniversary onwards. These cash dividends are however non-guaranteed and are subject to the performance of the insurance company.

Policy provides the Automatic Premium Loan facility. Here, if the policy holder is unable to pay the premium within the grace period, the premium due then will be advanced as an automatic loan. This facility is available if the policy has acquired the cash value and this cash value is greater than the premium in default and any indebtedness.

Policy benefits

The sum assured under the policy is available either on maturity of policy at 100 years of age of life assured or on his/her earlier death.

However, in case of death of the life assured before attaining 4 years of age, the amount payable will be as per the below table:

Age at the time of death	Amount payable (in Rs.)
0 years	20% of sum assured
1 year	40% of sum assured
2 years	60% of sum assured
3 years	80% of sum assured

Eligibility parameters

Age at entry – minimum – 0 years; maximum – 60 years

Premium payment – Amount of premium is decided on the age of the life proposed to be insured (age at entry) and is dependant on the coverage chosen.

Policy provides for the premium payment as per four age bands. These are: 0 years to 35 years; 36 years to 45 years; 46 years to 50 years; and 51 years to 55 years. Premium for the ages 56 years to 60 years are at age specific rates.

Sum assured – minimum – Rs.25,000; maximum – no limit, subject to underwriting guidelines.

Riders available

The policy provides the option of additional covers such as:

1. Accident Benefit Rider
2. Disability Benefit Rider
3. Critical Illness Benefit Rider
4. Term Rider

The availability of riders is limited in case of life assured being a minor.

Policy surrender

If all premiums have been paid for at least 3 full years, the policy will acquire a guaranteed surrender value. This value will be equal to 30% of the total premium paid excluding the first year's premium and extra premiums, if any.

Tax benefits

Premiums paid under the policy are eligible for deduction under the provisions of Section 80C of the Income Tax Act, 1961. The policy benefits are exempt from tax under the provisions of Section 10(10D) of the Act.

KARVY Regional Offices: **Hyderabad:** Karvy Centre, 8-2-609/K, Road #10, Banjara Hills, Hyderabad-34, Ph: 040 - 2331 2454/2332 0251 ◇ **Ahmedabad:** 201-203, Shail, Opp: Madhusudhan House, Behind Girish Cold Drinks, Off C G Road, Ahmedabad - 380 006, Ph: 079 - 2642 0422/2640 0527/28 ◇ **Aurangabad:** Shop No.214/215, Tapadiya City Centre, Nirala Bazar, Aurangabad - 431 001, Ph: 0240-2363517/23/24/30 ◇ **Bangalore:** No.59, Skanda, Putanaroad, Basavanagudi, Bangalore - 560 004, Ph: 080 - 2662 1192, 2662 1193 ◇ **Bhopal:** Kay Kay Business Centre, 133, Zone 1, M P Nagar, Bhopal - 462 011, Ph: 0755 - 3013113, 3010728 ◇ **Chandigarh:** Sco 371-372, Above HDFC Bank, Sector 35-b, Chandigarh - 160 022, Ph: 0172 - 5071726, 5071727 ◇ **Chennai:** G-1, Swati Court, 22, Vijaya Raghava Road, T Nagar, Chennai, Ph: 044-2815 3445 ◇ **Cochin:** Kochi, G 39, Panampally Nagar, Opp: Kerala State Housing Board, Kochi-682 036, Ph: 0484-2310884, 2322152 ◇ **Coimbatore:** SNV Chambers, 482/483, Cross Cut Road, Opp: Power House, Gandhipuram, Coimbatore-641 012, Ph: 0422 - 2237 501 to 506 ◇ **Indore:** DM Towers, 105, 106 & 107, Above Standered Chartered Bank, Near Jangeerwala Chowrah, Indore - 452 001, Ph: 0731 - 3014200-19 ◇ **Jaipur:** S-16/A, Land Mark, Opp Jai Club, Mahaveer Marg, C-Scheme, Jaipur-302 001, Ph: 0141 - 2375039, 99, 2363321 ◇ **Kolkata:** Jatin Bagchi, Road-16, Jatin Bagchi Road, Ground Floor, Kolkata -700 029, Ph: 033 - 2465 5006, 2465 5392 ◇ **Lucknow:** 94, Mahatma Gandhi Marg, Opp: Governor House, Hazratganj, Lucknow - 226 001, Ph: 0522 - 2236820 to 26 ◇ **Ludhiana:** Ground Floor, Sco 2, Aptech Building, Feroze Gandhi Market, Ludhiana - 141 001, Ph: 0161-3018445, 3018460 ◇ **Mumbai:** Transworld Bldg., 16-26, Bake House, Maharashtra Chamber of Commerce Lane, Opp: MSC Bank, Fort, Mumbai - 400 023, Ph: 022 - 2204 0229/230 ◇ **Nagpur:** 230-231, 3rd Floor, Shriram Shyam Bazar, Next to NIT Building, Sadar, Kingsway, Nagpur - 440 001, Ph: 0712 - 5612374, 5612375 ◇ **Nasik:** F-1, Suyojit Sankul, Sharanpur Road, Nashik - 422 002, Ph: 0253 - 5602542/43 ◇ **New Delhi:** 105-106, Arunachal Building,19, Barakhamba Road, Connaught Place, New Delhi -110 001, Ph: 011 - 41520316, 66305325, 2332 4401, 4409 ◇ **Pune:** Rachana Trade Estate, Law College Road, Erandwane, Pune - 411 004, Ph: 020-6604 8790 to 95 ◇ **Vadodara:** Sayajigunj, 31-34, Payal Complex, Near Vadodara Stock Exch, Opp: Vakal Seva Kendra, Sayajigunj, Vadodara - 390 005, Ph: 0265 - 2225 168/169, 2361 514 ◇ **Vijayawada:** 39-10-7, Opp: Municipal Water Tank, Labbipet, Vijayawada-520 010, Ph: 0866 - 2495 200, 400, 500 ◇ **Vizag:** 47-14-4, Eswar Paradise, Dwaraka Nagar Main Road, Vishakapatnam - 530 016, Ph: 0891-2752915 to 18

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Karvy, with over 20 years' expertise in the financial market, presents yet another product with you in mind – Karvy Financial Planning, KFP. Our advisor will help you achieve all your financial goals through effective management of your finances. Call us for an appointment. In the meantime, you could make up your mind on what to do with all that free time.

Golf

Music lessons

Pool

Pottery

Some activities you
could take up soon

Investment Planning

Insurance Planning

Tax Planning

Contingency Planning

Retirement Planning


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by **S. Gopichand** on behalf of Karvy Stock Broking Limited.

Editor: S. Gopichand

Personal Finance Team:

Atul, Pradeep, Murugavel

Designed by: Raju, Priya

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