

NISM-Series-X-B — Investment Adviser (Level 2)

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CH-1 Basics of Insurance

Topic 1 — Risk and Its Management

- **Risk** — Uncertainty about a future loss. For a family it is any event that can damage income, assets or health and push its goals off track.
- **Peril** — The actual cause of a loss: fire, flood, theft, accident, illness, death.
- **Hazard** — A condition that makes a peril more likely or makes the loss bigger.

Hazard	Meaning	Example
Physical	Tangible condition that raises the chance or size of loss	Loose wiring in a cloth godown in Ludhiana
Moral	Dishonest intention of the insured	Inflating a theft claim or staging an accident
Morale	Carelessness because insurance exists	Leaving a car unlocked since "it is insured anyway"

Classifying risks

Basis	Types	Insurable?
Outcome	Pure risk — only loss or no loss (fire, death). Speculative risk — loss, no loss or gain (buying shares)	Only pure risks
Reach	Particular — hits one person or firm (theft of a car). Fundamental — hits large groups (war, pandemic, earthquake)	Particular readily; fundamental often excluded or limited
Economy	Static — losses even in an unchanging economy (fire, theft). Dynamic — from changes in economy, technology, tastes	Static mostly

Risk management techniques

Technique	What it means	Fits risks that are
Avoidance	Do not undertake the activity at all	High frequency, high severity
Reduction (loss control)	Prevent the loss or reduce its size	High frequency, low severity
Retention	Bear the loss yourself — emergency fund, deductibles	Low frequency, low severity
Transfer	Pass the financial loss to another — insurance, contracts	Low frequency, high severity

Example: Dr Meera Kulkarni runs a dental clinic in Pune. She avoids standing guarantor for a friend's loan, reduces risk with fire extinguishers and sterilisation drills, retains small equipment repairs from her emergency fund, and transfers fire and professional liability risk to insurers.

Remember this

- Insurance is the right tool for pure risks of low frequency and high severity.
- Moral hazard = dishonesty; morale hazard = carelessness.

Topic 2 — Concept and Working of Insurance

- **Insurance** — A contract in which the insurer promises to pay for a specified financial loss in exchange for a premium. The risk moves from the individual to a pool.
- **Pooling** — Many people exposed to a similar risk pay small premiums; the few who suffer a loss are paid out of the pool.

- **Law of large numbers** — The larger the pool, the closer actual losses come to expected losses. This makes premiums calculable.
- **Loss is not prevented** — Insurance only replaces the money consequence of a loss, wholly or partly.

Features of an insurable risk

- **Large number of similar units** — Enough homes, cars or lives to predict losses.
- **Accidental loss** — Not intended or controlled by the insured.
- **Definite and measurable** — Time, place, cause and amount can be established.
- **Not catastrophic for the whole pool** — Losses should not hit most members at once.
- **Affordable premium** — The chance of loss must be low enough for the premium to make economic sense.

How a premium is built

Element	Life insurance	General insurance
Risk cost	Mortality rate at the age	Expected claims = frequency × severity
Expenses	Commission, issue and servicing cost	Commission, survey and servicing cost
Interest	Earnings on invested premiums reduce the premium	Same, over a shorter period
Margins	Contingency, profit; bonus loading in participating plans	Contingency and profit

- **Reinsurance** — The insurer passes part of a large risk to a reinsurer. GIC Re is the national reinsurer. It lets insurers write big risks and keeps their results stable.
- **Who sells what** — Life insurers sell life covers; general insurers sell property, motor, liability and health covers; standalone health insurers sell health, personal accident and travel covers.

Feature	Life insurance	General insurance
Event insured	Death is certain; only timing is uncertain	Event may never happen
Contract length	Long term or whole life	Usually one year, renewable
Basis of payment	Benefit: agreed sum assured	Indemnity: actual loss up to sum insured
Insurable interest	At the start of the contract	At the start and at the time of loss
Savings element	Possible (endowment, ULIP)	None

Remember this

- Pooling plus the law of large numbers makes insurance work.
- Life cover pays a fixed benefit; general insurance pays an indemnity.

Topic 3 — Principles of Insurance

- **Utmost good faith** — Both sides must disclose every material fact. A material fact is one that would change the insurer's decision or premium: smoking, past surgery, other policies held. Hiding it makes the contract voidable.
- **Insurable interest** — The proposer must suffer a financial loss if the event happens. One has it in one's own life (unlimited), spouse, children, dependent parents; an employer in a key employee; a creditor in a debtor (up to the debt); partners in each other. A neighbour has none.
- **Indemnity** — Put the insured back in the same financial position as just before the loss; no profit. Applies to property, motor and hospital-expense covers, not to life or

fixed-benefit covers.

- **Subrogation** — After paying the claim, the insurer takes over the insured's right to recover from the person at fault. It flows from indemnity.
- **Contribution** — If the same property is insured with two insurers, they share the loss in proportion to their sums insured. In health, the insured may choose which policy to claim first and claim the balance from the other.
- **Proximate cause** — The dominant, effective cause of the loss decides whether the claim is covered.
- **Loss minimisation** — The insured must act as a prudent uninsured person would to limit the loss.

Principle	Life	General
Utmost good faith	Yes	Yes
Insurable interest	At inception	At inception and at loss
Indemnity	No	Yes
Subrogation	No	Yes
Contribution	No — all policies pay	Yes
Proximate cause	Yes (accident benefits)	Yes

Example: Jasleen insures her Amritsar warehouse with Insurer A for ₹40 lakh and Insurer B for ₹60 lakh. A fire causes a loss of ₹20 lakh. A pays ₹8 lakh and B pays ₹12 lakh (40:60). If a careless tanker driver caused the fire, the insurers can recover from him through subrogation.

- **Section 45, Insurance Act, 1938** — Within 3 years from issue of the policy, start of risk, revival or addition of a rider, the insurer may repudiate a life policy for fraud or non-disclosure of a material fact, giving written grounds. After 3 years the policy cannot be questioned on any ground.

Remember this

- Indemnity, subrogation and contribution do not apply to life insurance.
- Section 45: a life policy becomes unquestionable after 3 years.

Topic 4 — The Insurance Contract: Parties and Key Terms

- **Proposer / policyholder** — Person who applies, pays the premium and owns the policy.
- **Life assured** — Person on whose life the cover is taken; may differ from the policyholder (a father insuring a child).
- **Nominee and appointee** — Nominee receives the claim money; an appointee receives it if the nominee is a minor.

Term	Meaning
Proposal form	Application with all material facts; basis of the contract
Premium	Price of cover, paid single, regular or for a limited term
Sum assured / sum insured	Benefit promised in life cover / maximum payable in general cover
Policy term, premium paying term	Period of cover; period over which premiums are payable
Grace period	Extra time to pay a due premium with cover intact: 30 days, 15 days for monthly mode (life)
Free-look period	30 days from receipt of the policy to return it if unsuitable
Rider	Add-on benefit for extra premium
Deductible / co-payment	Part of the loss borne by the insured, as a fixed sum / as a percentage

Term	Meaning
Exclusion	Event or cause the policy does not cover

- **Free-look refund** — Premium is refunded after deducting proportionate risk premium for the period on cover, medical examination cost and stamp duty.

Nature of an insurance contract

- **Contract of adhesion** — Drafted by the insurer; the buyer accepts it as it is. Any ambiguity is read in favour of the insured.
- **Aleatory** — Payouts are unequal and depend on chance: a small premium may bring a large claim, or nothing.
- **Unilateral** — Only the insurer makes an enforceable promise; the insured may stop paying premiums.
- **Conditional** — The insurer pays only if conditions are met: premium paid, timely intimation, documents supplied.
- **Personal** — General insurance covers the person in respect of the property, so it cannot be transferred without the insurer's consent; motor policies move with the vehicle on transfer.

Remember this

- Free-look period is 30 days; refund is net of risk premium, medical and stamp duty costs.
- Ambiguous wording is interpreted in favour of the policyholder.

Topic 5 — Underwriting, Premium Rating and Claims

- **Underwriting** — Assessing a proposal to decide whether to accept it and on what terms.
- **Life factors** — Age, gender, health, family history, habits (tobacco, alcohol), occupation, hazardous hobbies, income.
- **Financial underwriting** — The sum assured must be reasonable for the proposer's income and net worth; insurers use multiples of income or human life value.
- **General factors** — Construction, location, use and security of the property; claims history; driver profile for motor.

Decision	When used
Standard acceptance	Normal risk; ordinary premium
Rated-up (extra premium)	Higher risk: smoker, high BP, risky job
Acceptance with exclusion or lien	Cover with a specific condition excluded, or reduced benefit in early years
Postponed	Temporary condition, e.g. recent surgery
Declined	Risk too high to insure

- **Adverse (anti-) selection** — People at higher risk are keener to buy cover. Underwriting, medical tests and waiting periods protect the pool from it.

Claims

Type	Key points
Maturity / survival benefit	Paid on or before the due date against discharge form
Death claim	Claim form, death certificate, policy document, ID of nominee; early claims (within 3 years) are investigated
General insurance claim	Prompt intimation, survey and assessment of loss, settlement or repudiation
Health claim	Cashless at a network hospital or reimbursement with bills

- **Death claim timelines** — A claim needing no investigation is settled within 15 days of receiving all documents; where investigation is needed, it is completed within 45 days.



- **Penal interest** — Delay beyond the permitted time makes the insurer liable to pay interest to the claimant.

Remember this

- Rated-up = accepted at extra premium; declined = not accepted at all.
- Waiting periods and medical tests are defences against adverse selection.

Topic 6 — Regulation and Policyholder Protection

- **Insurance Act, 1938** — Main law on insurers: registration, investments, nomination (section 39), assignment (section 38), section 45.
- **IRDAI** — Insurance Regulatory and Development Authority of India, set up under the IRDA Act, 1999. It regulates insurers and intermediaries and protects policyholders.
- **Policyholder rights** — Policy document with key features, free-look, grace period, nomination, time-bound claims and grievance redress.

Distribution channels

Channel	Whom it represents
Individual agent	Up to three insurers in each of life, general and health
Corporate agent (bancassurance)	Tie-up insurers; banks are the largest corporate agents
Insurance broker	The client; places business with any insurer
Web aggregator, insurance marketing firm	Comparison and sale of products of tie-up insurers
Direct	Insurer's own online or branch sales

Where an investment adviser fits

- **Individual IA** — Under Reg 22(1) of the SEBI IA Regulations, an individual IA cannot provide any distribution service, so cannot earn commission by selling insurance.
- **Family members** — Under Reg 22(2), the IA's family cannot distribute products to the IA's advisory clients.
- **Non-individual IA** — Client-level segregation; any distribution must be through a separate SBU or subsidiary at arm's length.
- **Role** — The IA assesses need, recommends cover and product type for a fee; the client buys directly or through any channel.

Grievance redress

- **Insurer first** — Complain to the insurer's grievance officer; insurers must resolve complaints within 14 days. IRDAI's Bima Bharosa system tracks complaints.
- **Insurance Ombudsman** — Under the Insurance Ombudsman Rules, 2017, for disputes up to ₹50 lakh. Approach after the insurer rejects the complaint or does not reply within 30 days, and within 1 year of the insurer's reply. No fee is charged.
- **Award** — Passed within 3 months of receiving all requirements; binding on the insurer once the complainant accepts it. The complainant may still go to a consumer commission or court.
- **GST** — From 22 Sep 2025, premiums on individual life and individual health policies are exempt from GST (earlier 18% on most such policies); group policies remain taxable.

Remember this

- Ombudsman limit ₹50 lakh; approach within 1 year; award within 3 months.
- An individual IA cannot sell insurance for commission (Reg 22(1)).

Topic 7 — Insurance in the Financial Plan

- **Protection comes first** — An emergency fund and adequate insurance form the base of the financial plan; investments are built on top.
- **Insurance protects goals** — If the earner dies, is disabled or is hospitalised, insurance money keeps the goal plan funded.
- **Who needs life cover** — Anyone whose death would cause financial loss to others. A retired person with no dependants, or a child, usually does not.
- **Insure the big, rare losses** — Retain small losses through deductibles and the emergency fund; this keeps premiums low.

Life stage	Main risks	Covers that matter
Young, single	Accident, illness	Health, personal accident; term if loans or dependent parents
Married, young children	Early death, illness	Large term cover, family floater, PA
Mid-career	Critical illness, high liabilities	Term top-up, critical illness, super top-up
Pre-retirement	Rising health costs	Higher health sum insured, CI
Retired	Medical costs, longevity	Health cover, annuity; life cover only for estate needs

- **Do not mix insurance and investment** — Bundled plans give small cover per rupee of premium and modest returns. "Buy term and invest the rest" usually gives more cover and more wealth.
- **Cover property at replacement value** — Under-insurance means a proportionate cut in claims.
- **Review triggers** — Marriage, birth of a child, home loan, job change, big salary jump, retirement.

Example (illustrative): Rohan, 30, Jaipur, budgets ₹50,000 a year for insurance. An endowment plan would give about ₹10 lakh of cover. A term plan of ₹1.5 crore costs a small part of that budget; the balance goes into a SIP for his goals.

Remember this

- Sequence: emergency fund → health cover → life cover → investments.
- Retain small, frequent losses; insure large, rare ones.

Topic 8 — Estimating Life Cover: Human Life Value Method

- **Human life value (HLV)** — The economic value of a person to the family: present value of the income the person would have contributed to the family until retirement.
- **Step 1** — Take current annual income.
- **Step 2** — Deduct own living expenses, income tax and own insurance premiums to get the family's share (contribution).
- **Step 3** — Count the years left to retirement.
- **Step 4** — Discount the contribution at a suitable rate; if income growth is ignored, use a moderate rate.

$$HLV = C \times \frac{1 - (1 + r)^{-n}}{r}$$



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N1. [Numerical] Arjun Malhotra, 35, of Chandigarh earns ₹18,00,000 a year. His own expenses, tax and premiums take ₹6,00,000. He plans to work till 60. Using a discount rate of 7%, find his HLV.

Item	Value
Annual income	₹18,00,000
Self-maintenance, tax, premiums	₹6,00,000
Contribution (C)	₹12,00,000
Years to retirement (n)	25
Discount rate (r)	7%

Solution:

Formula:

$$HLV = C \times \frac{1 - (1 + r)^{-n}}{r}$$

$$\frac{1 - 1.07^{-25}}{0.07} = 11.6536$$

$$HLV = 12,00,000 \times 11.6536 = 1,39,84,300$$

HLV ≈ ₹1.40 crore. Existing cover is deducted to find the further cover needed.

Answer: HLV ≈ ₹1,39,84,300 (about ₹1.40 crore)

- **Strengths** — Simple; ties cover to earning power; insurers use it for financial underwriting.
- **Limitations** — Ignores existing assets, liabilities and specific goals; very sensitive to the discount rate and income growth assumed.
- **Rule-of-thumb multiples** — "x times annual income" is only a rough check, not a plan.

Remember this

- HLV = PV of the earner's contribution to the family until retirement.
- A higher discount rate gives a lower HLV.

Topic 9 — Needs-Based (Expense) Method and Adequacy Check

- **Idea** — Cover should fund what the family will need if the earner dies today, less what is already available.
- **Use real rates** — Family expenses grow with inflation; discounting at an inflation-adjusted (real) rate captures this.

Add (needs)	Less (resources)
PV of family living expenses for the years needed	Liquid financial assets: FDs, MFs, PPF, shares
Outstanding loans: home, car, personal	Existing personal life cover
PV of goals: children's education, marriage	Other assured inflows (spouse's income, if planned)
Emergency fund and final expenses	

N2. [Numerical] On Arjun's death his family would need ₹7,20,000 a year for 22 years. Assume a real rate of 2%. The home loan outstanding is ₹35,00,000, PV of children's goals is ₹30,00,000 and an emergency/final-expense fund of ₹3,00,000 is needed. He has ₹40,00,000 of investments and a personal term plan of ₹25,00,000 (his employer's group cover is ignored). Find the additional cover required.

Item	Value
Annual family expense	₹7,20,000
Years (n), real rate (r)	22, 2%
Home loan	₹35,00,000
Goals (PV)	₹30,00,000
Emergency and final expenses	₹3,00,000
Investments	₹40,00,000
Existing term plan	₹25,00,000

Solution:

$$\frac{1 - 1.02^{-22}}{0.02} = 17.658$$

$$7,20,000 \times 17.658 = 1,27,13,795$$

$$\text{Total need} = 1,27,13,795 + 35,00,000 + 30,00,000 + 3,00,000 = ₹1,95,13,795.$$

$$\text{Resources} = 40,00,000 + 25,00,000 = ₹65,00,000.$$

$$\text{Additional cover} = 1,95,13,795 - 65,00,000 = ₹1,30,13,795.$$

Answer: Additional term cover ≈ ₹1.30 crore

- **Do not count** — Self-occupied house, car, household jewellery in use; they are not meant to be sold to run the home.
- **Employer group cover** — Lasts only while employed; treat it as a bonus, not as core cover.
- **Compare methods** — Look at both HLV and the needs figure; recommend a sum that the budget can carry and round it up.
- **Health and disability** — Size health cover on local hospital costs and add disability or income cover where income would stop.

Remember this

- Needs method = PV of needs + liabilities + goals – liquid assets – existing cover.
- Ignore job-linked group cover and personal-use assets.

NISM-Series-X-B | Module A | CH-1 | MCQs

Q1. Gurpreet leaves his insured car unlocked in a busy Amritsar market, saying the insurer will pay if it is stolen. This attitude is an example of: [Ref: Topic 1, p. 2]

- (a) Physical hazard (b) Moral hazard (c) Morale hazard (d) Speculative risk

Q2. Anand is the sole earner for a family of four in Kochi. The chance of his early death is low but the loss would be very large. Which technique suits this risk best? [Ref: Topic 1, p. 2]

- (a) Retention through an emergency fund
(b) Avoidance of the activity causing risk
(c) Loss reduction through annual check-ups
(d) Transfer through a term insurance plan

Q3. Consider: I. The law of large numbers makes the losses of a big pool more predictable. II. Insurance prevents the insured event from taking place. Which is/are correct? [Ref: Topic 2, p. 2]

- (a) I only (b) II only (c) Both I and II (d) Neither I nor II

Q4. Sanjay insures his Surat godown with Insurer P for ₹30 lakh and Insurer Q for ₹45 lakh. A fire causes a loss of ₹15 lakh. Under the principle of contribution, Insurer P pays: [Ref: Topic 3, p. 2]

- (a) ₹6 lakh (b) ₹7.5 lakh (c) ₹9 lakh (d) ₹15 lakh

Q5. Mohan's parked car is damaged by a speeding truck. His insurer settles the claim and then recovers the amount from the truck owner. Which principle allows this recovery? [Ref: Topic 3, p. 2]

- (a) Contribution (b) Subrogation
(c) Proximate cause (d) Utmost good faith

Q6. Which principle does NOT apply to a life insurance policy? [Ref: Topic 3, p. 2]

- (a) Utmost good faith (b) Insurable interest
(c) Indemnity (d) Proximate cause

Q7. Priya's life policy was issued four years ago. After her death the insurer finds she had not disclosed diabetes in the proposal. What is the position under Section 45? [Ref: Topic 3, p. 2]

- (a) Insurer may repudiate for non-disclosure
(b) Policy cannot be questioned after 3 years
(c) Only premiums paid are refundable
(d) Claim is paid after an IRDAI ruling

Q8. Kunal received his new life policy 20 days ago and finds the terms unsuitable. What can he do? [Ref: Topic 4, p. 3]

- (a) Return it under free-look; refund is net of risk premium, medical and stamp duty
- (b) Nothing, as the 15-day free-look period has ended
- (c) Return it and get a full refund including stamp duty
- (d) Surrender it and receive only the surrender value

Q9. Vikram, 42, smokes and has high blood pressure. The insurer accepts his term proposal but charges a higher premium than for a healthy 42-year-old. This decision is: [Ref: Topic 5, p. 3]

- (a) Standard acceptance
- (b) Postponement
- (c) Declinature
- (d) Rated-up acceptance

Q10. Soon after learning of a serious family history of heart disease, Kiran rushes to buy a large health and life cover. Insurers guard against such behaviour mainly through: [Ref: Topic 5, p. 3]

- (a) Subrogation and contribution
- (b) Underwriting and waiting periods
- (c) Grace periods and free-look
- (d) Reinsurance and pooling

Q11. Rakesh is registered as an individual investment adviser. He wants to earn commission by selling term plans to his advisory clients. Which is correct? [Ref: Topic 6, p. 4]

- (a) Allowed if he discloses the commission
- (b) Allowed only for pure term plans
- (c) Not allowed: an individual IA cannot distribute
- (d) Allowed through his spouse as agent

Q12. Consider: I. The Insurance Ombudsman handles complaints up to ₹50 lakh. II. The Ombudsman's award binds the complainant even if he does not accept it. Which is/are correct? [Ref: Topic 6, p. 4]

- (a) Neither I nor II
- (b) II only
- (c) Both I and II
- (d) I only

Q13. For whom is a large new life cover LEAST necessary? [Ref: Topic 7, p. 4]

- (a) Rina, 34, single mother of two with a home loan
- (b) Mr Bose, 72, widower with no dependants and a pension
- (c) Ajay, 40, sole earner supporting his parents
- (d) Fatima, 29, co-borrower on a joint home loan

Q14. Nisha's annual contribution to her family is ₹10,00,000 and she has 20 working years left. At a discount rate of 8%, her human life value is closest to: [Ref: Topic 8, p. 4]

- (a) ₹2.00 crore
- (b) ₹1.25 crore
- (c) ₹98.18 lakh
- (d) ₹80.00 lakh

Q15. The Iyer family's total needs (PV of expenses, loans and goals) are ₹1.60 crore. They hold liquid investments of ₹35 lakh, a personal term plan of ₹40 lakh and employer group cover of ₹20 lakh. Under the needs method, the additional cover advised is: [Ref: Topic 9, p. 5]

- (a) ₹65 lakh
- (b) ₹85 lakh
- (c) ₹1.05 crore
- (d) ₹1.25 crore

Answer key

Q	Ans	Q	Ans	Q	Ans	Q	Ans	Q	Ans
1	c	4	a	7	b	10	b	13	b
2	d	5	b	8	a	11	c	14	c
3	a	6	c	9	d	12	d	15	b

Topic 1 — Types of Life Insurance: An Overview

- Protection plans** — Pay only on death within the term. Lowest premium per rupee of cover.
- Savings plans** — Combine cover with a maturity or survival benefit: endowment, money-back, whole life.
- Investment-linked plans** — ULIPs; benefits depend on the value of units in chosen funds.
- Annuity / pension plans** — Convert a lump sum into a regular income for life or a fixed period.

Basis	Category	What it means
Profit sharing	Participating (par / with-profit)	Shares in the surplus of the par fund through bonuses; at least 90% of the surplus goes to policyholders
Profit sharing	Non-participating (non-par)	Benefits fixed or guaranteed at the start; no bonus
Link to market	Non-linked (traditional)	Insurer bears investment risk; benefits as declared or guaranteed
Link to market	Linked (ULIP)	Policyholder bears investment risk; value = units × NAV
Number of lives	Individual, joint life, group	One life, two lives (often spouses), employees or members

- Death benefit floor** — In every life policy the death benefit is at least 105% of the total premiums paid.
- Standard products** — IRDAI has prescribed simple, uniform products such as Saral Jeevan Bima (term) and Saral Pension (immediate annuity) so that buyers can compare insurers easily.

Remember this

- Par plans share surplus via bonus; non-par benefits are fixed.
- In a ULIP the investment risk is borne by the policyholder.

Topic 2 — Term Insurance and Its Variants

- Pure term plan** — Pays the sum assured if death occurs within the term; nothing on survival. Cheapest way to buy large cover.
- Premium drivers** — Age, term, sum assured, health, tobacco use, gender, payout mode.
- Lock in young** — A level premium fixed at 30 stays the same for the whole term; buying later costs much more.

Variant	Feature	Suits
Level term	Same cover throughout	Income replacement
Increasing term	Cover rises by a fixed % each year	Inflation-protected need
Decreasing / mortgage reducing	Cover falls in line with a loan balance	Home-loan protection
Return of premium (TROP)	Premiums returned on survival	Those wanting money back; costs much more
Income-payout term	Pays monthly income to family instead of or with a lump sum	Families who may mismanage a lump sum
Joint life term	Covers two lives, often spouses	Dual-income couples with joint loans

- Saral Jeevan Bima** — Standard term plan: entry age 18–65, policy term 5–40 years, maximum maturity age 70, sum assured ₹5 lakh to ₹25 lakh; same terms with every insurer.