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BA Economics Honours | Semester III | Calicut University

Financial Literacy and Personal Finance

Course Code: ECO3FV108 • Module 4

Module IV: Insurance and Pension Products

Comprehensive personal financial health requires robust risk mitigation through insurance against catastrophic life and health hazards, coupled with disciplined pension planning to ensure dignified post-retirement living.

Unit 19: Insurance as a Risk Management Device

Insurance transfers catastrophic financial loss from an individual household to an insurance pool in exchange for an actuarially determined premium. Key insurance categories:

- **Life Insurance:** Protects dependents against the economic death of the breadwinner:
  - **Term Insurance:** Pure risk protection policy offering substantial sum assured at minimal cost with no maturity value upon survival. The optimal insurance choice for breadwinners.
  - **Endowment and ULIPs:** Hybrid products combining insurance with savings or market-linked investment; typically yield sub-optimal investment returns and inadequate insurance coverage compared to pure term plans.
  - **Calculating Life Cover:**
    1. *Multiples of Salary Rule:* Life cover should equal at least 10 to 15 times the breadwinner's annual gross salary.
    2. *Human Life Value (HLV) / Needs-Based Rule:* Capitalizes future discounted earnings and adds outstanding liabilities minus existing liquid investments.
- **Health Insurance:** Indemnifies against escalating healthcare hospitalization costs, offering cashless hospitalization and critical illness riders.

Unit 20, 21 & 22: Retirement Security, Pension Products, and Regulators

Retirement planning replaces earned active income with steady passive income streams:

- **Statutory vs. Contributory Pension Systems:** Transition from defined-benefit statutory pensions (funded out of general government revenues) to defined-contribution schemes where retirement benefits depend on accumulated corpus and market returns.
- **National Pension System (NPS):** Low-cost pension architecture:
  - **Tier I Account:** Non-withdrawable retirement account with tax deductions under Sections 80C and 80CCD(1B); mandates 40% annuity purchase at superannuation.
  - **Tier II Account:** Voluntary withdrawable savings facility with no lock-in.
  - **Investment Options:** *Active Choice* (custom asset allocation across Equity, Corporate Bonds, Government Securities, Alternative Assets) vs. *Auto Choice* (age-based lifecycle matrix automatically reducing equity exposure with advancing age).
- **Annuity Products:** Financial contract where an Annuity Service Provider (ASP) pays guaranteed regular income streams in exchange for an upfront lump-sum corpus (Fixed, Variable, and Joint Life Annuities).
- **Regulatory Authorities:**
  - **IRDAI (Insurance Regulatory and Development Authority of India):** Regulates and promotes the insurance sector.
  - **PFRDA (Pension Fund Regulatory and Development Authority):** Regulates and oversees the National Pension System.

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Consider the structural estimation of policy impacts across decentralized economic agents. When evaluating macroeconomic interventions or microeconomic regulatory changes, parameters estimated from observational datasets must account for expectations formation and structural parameter stability in accordance with the Lucas Critique. Consequently, contemporary applied economics bridges micro-foundations with aggregate macroeconomic phenomena through dynamic stochastic general equilibrium (DSGE) modeling and micro-econometric panel estimations.

Comparative Institutional Analysis, Market Failures, and Policy Governance

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Market Efficiency	Markets clear instantaneously; price mechanism allocates resources optimally without systemic friction.	Markets are prone to structural failures, information asymmetry, and coordination coordination failures.	Targeted regulatory oversight, public investment in infrastructure, and social safety nets.
Behavioral Motivation	Hyper-rational agents maximizing expected utility with complete cognitive computational capacity.	Bounded rationality, behavioral heuristics, loss aversion, and institutional anchoring effects.	Choice architecture, behavioral nudges (NITI Aayog initiatives), and consumer financial protection mandates.
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Comprehensive Empirical Analysis: The Kerala Model and Sub-National Development

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