

Insurance Laws And Practices

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INSURANCE LAWS AND PRACTICES

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SYLLABUS

Insurance Laws and Practices

Objectives:

- To acquaint students with the basic knowledge related to the insurance sector.
- To provide a platform for students to identify the various insurance needs of the society and industry in the current market scenario.

Sr. No.	Description
1.	Insurance: Evolution & meaning of Insurance, need for insurance, nature, functions of insurance, Scope of Insurance, role in economic development.
2.	Contract of Insurance: types of Insurance contract, condition necessary for contract, Insurance documents: Proposal form, policy form, cover notes, certificate of insurance, endorsements, concept of partial insurance.
3.	Principles of Insurance: Basic Principles.
4.	Insurance Legislation and IRDA: The Insurance act 1938, salient features of IRDA Act, Role & Function of IRDA.
5.	Life Insurance: Classification of policies prevailing in market, Annuity, Mortality tables & role of LIC.
6.	Marine Insurance: Introduction, elements of general contract, policies, clauses, marine losses, payment of claims.
7.	Fire Insurance: Introduction, elements of fire insurance, kind of policies, payment of claim under fire insurance, Re-insurance.
8.	General insurance: Motor Insurance, health insurance, Catastrophe Insurance.
9.	Privatization of Insurance sector: current scenario of insurance industry in India.
10.	Actual Services, Recent Trends in Insurance Sectors

Unit 1: Evolution and Meaning of Insurance

Notes

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Objectives

Introduction

- 1.1 Evolution of Insurance
- 1.2 Definition of Insurance
- 1.3 Meaning of Insurance
- 1.4 How Insurance Works?
- 1.5 Indian Insurance Industry
- 1.6 Role of Insurance in Financial System
- 1.7 Summary
- 1.8 Keywords
- 1.9 Review Questions
- 1.10 Further Readings

Objectives

After studying this unit, you will be able to:

- Discuss the evolution of insurance
- Define and explain the meaning of insurance
- Explain how insurance works
- Discuss the Indian insurance industry
- Describe the role of insurance in financial system

Introduction

You must be aware that people seek security. A sense of security may be the next basic goal after food, clothing, and shelter. An individual with economic security is fairly certain that he can satisfy his needs (food, shelter, medical care, and so on) in the present and in the future. Economic risk (which we will refer to simply as risk) is the possibility of losing economic security. Most economic risk derives from variation from the expected outcome. One measure of risk, used in this study note, is the standard deviation of the possible outcomes. As an example, consider the cost of a car accident for two different cars, a Porsche and a Toyota. In the event of an accident the expected value of repairs for both cars is 2500. However, the standard deviation for the Porsche is 1000 and the standard deviation for the Toyota is 400. If the cost of repairs is normally distributed, then the probability that the repairs will cost more than 3000 is 31% for the Porsche but only 11% for the Toyota.

You will find it interesting to note that modern society provides many examples of risk. A homeowner faces a large potential for variation associated with the possibility of economic loss caused by a house fire. A driver faces a potential economic loss if his car is damaged. A larger possible economic risk exists with respect to potential damages a driver might have to

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pay if he injures a third party in a car accident for which he is responsible. Historically, economic risk was managed through informal agreements within a defined community. If someone's barn burned down and a herd of milking cows was destroyed, the community would pitch in to rebuild the barn and to provide the farmer with enough cows to replenish the milking stock. This cooperative (pooling) concept became formalized in the insurance industry. Under a formal insurance arrangement, each insurance policy purchaser (policyholder) still implicitly pools his risk with all other policyholders. However, it is no longer necessary for any individual policyholder to know or have any direct connection with any other policyholder. In this unit, we will study about the meaning and evolution of the concept of evolution.

In the next unit, you will study about the insurable risk and various kinds of risk. The unit will also explain the need for insurance and the importance of insurance in business. The next unit will also summarize the requirements of an insurable risk.

1.1 Evolution of Insurance

You need to know that insurance is a form of risk management, primarily used to hedge against the risk of a contingent loss. In essence, insurance is simply the equitable transfer of a risk of a loss, from one entity to another, in exchange for a premium.

Gambling transactions also hedge against risk, but it offers the possibility of either a loss or a gain. Gambling creates losers and winners, whereas in insurance offers financial support sufficient to replace loss, not to create pure gain. Gamblers can continue spending, buying more risk than they can afford, but insurance buyers can only spend up to the limit of what carriers would accept to insure; their loss is limited to the amount of the premium.

Gamblers, by creating new risk transfer, are risk seekers. Insurance buyers are risk avoiders, creating risk transfer in terms of their need to reduce exposure to large losses.

Remember, the early methods of transferring or distributing risk were practiced by Chinese traders as early as the 3rd millennia B.C. These merchants travelling treacherous river rapids would cleverly distribute their wares across many vessels to spread the loss due to any single vessel's capsizing. Modern profit insurance was manifested in Babylon almost 2000 years B.C., in a contract of loan of trading capital to travelling merchants. The contract contained a clause that the risk of loss due to robbery in transit was borne by the party providing the loan. In consideration for bearing this risk, the lender calculated interest on the loan at an exceptionally high rate.

Roman Life Depicted

You will find out that the Greeks and Romans introduced the origins of health and life insurance to us around 600 AD, when they organized guilds/ benevolent societies which afforded members certain benefits, such as proper burial rites, or a financial contribution towards burial costs or travelling expenses of members of the army. In exchange for this benefit, members of the society made regular contributions to it.

During this time, Achaemenian (Iranian) monarchs were the first to 'insure' their people to some extent, formalising the process by registration thereof at court. In accordance with tradition, during Norouz – the beginning of the Iranian New Year – the heads of different ethnic groups presented gifts to the monarch. The purpose of these gifts was to ensure (insure) that whenever the gift-giver was in trouble, the monarch (and the court) would help him. In return, whenever the giver was in trouble or needed finance, the court would check the gift's registration, and could even – if the amount exceeded 10,000 Derrik – double that in return.

All these instances gave effect to the concept of mutual assistance in case of loss, but the actual concept of mutual assistance came to the fore in guilds and similar associations and societies which existed in Europe and England during the middle-ages.

Just remember that these associations afforded members (or their dependants) assistance in case of loss caused by perils such as fire, shipwreck, theft, sickness or death. Originally, the extent of the assistance was determined by the actual need of the member who suffered the loss, eventually, however, he would be assisted to the extent of his actual loss. In many of these guilds individual members, and not merely the guild itself, were under a legal duty to assist those members who suffered a loss. Once provision was made for the latter to have a corresponding legal right to claim such assistance, the development towards proper mutual insurance was completed.

Separate insurance contracts (i.e. insurance policies not bundled with loans or other kinds of contracts) were invented in Genoa in the 14th century, as were insurance pools backed by pledges of landed estates. These new insurance contracts allowed insurance to be separated from investment, a separation of roles that first proved useful in marine insurance. Insurance became far more sophisticated in post-Renaissance Europe, and specialized varieties developed.

On 3 December 1591, one hundred Hamburg house-owners concluded the so-called "Hamburg fire contracts", which are generally regarded as some of the first examples of true mutual insurance contracts that we have today.

Toward the end of the seventeenth century, London's growing importance as a centre for trade increased demand for marine insurance. In the late 1680s, Mr Edward Lloyd opened a coffee house that became a popular haunt of ship owners, merchants, and ships' captains, and thereby a reliable source of the latest shipping news. It became the meeting place for parties wishing to insure cargoes and ships, and those willing to underwrite such ventures. Today, Lloyd's of London remains the leading market for marine and other specialist types of insurance, but it works rather differently than the more familiar kinds of insurance.

Fire of London

The fire would have started in Pudding Lane in the king's appointed baker's shop. His maid failed to put out the ovens at the end of the night, and ignited the wooden home of Farriner. The maid failed to escape the fire, and was one of its few victims. Once it started, however, the fire spread quickly. The city was basically made out of wood and during September very dry. Strong winds fanned the flames.

The fire gutted the medieval City of London inside the old Roman City Wall. It consumed 13,200 houses, 87 parish churches, St. Paul's Cathedral, and most of the buildings of the City authorities. It is estimated that it destroyed the homes of 70,000 of the City's 80,000 inhabitants. The death toll from the fire is unknown and has traditionally been thought to have been small, as only a few verified deaths are recorded.

The Great Fire cost London an estimated £10 million, at a time when its annual income was just £12,000. Not surprisingly, this expense focused minds on the idea of insuring against fire.

By the end of the 17th century, three London societies were actively engaged in the business – Nicholas Barbon's "Fire Office" was established in 1680, the "Friendly Society" established in 1683, and the "Hand-in-Hand" Office. The first insurance company in the United States underwrote fire insurance and was formed in Charles-Town, South Carolina, in 1732.

Benjamin Franklin helped to popularize the practice of insurance in North America - particularly against fire – and in 1752, he founded the Philadelphia Contribution-ship for the Insurance of Houses from Loss by Fire. Franklin's company was the first to make contributions toward fire

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prevention. Not only did his company advise/warn against certain fire hazards, it refused to insure certain buildings where the risk of fire was too great, such as “all-wooden” houses.

As other needs for insurance arose in the 1830s, the practice of classifying risks had begun. The insurance companies had a rude awakening in 1835 when the New York fire struck. The losses were unexpectedly high and they had no reserves prepared for such a situation. As a result of this, Massachusetts leads the states in 1837 by passing a law that required insurance companies to maintain such reserves. The great Chicago fire in 1871 reiterated the need for these reserves, especially in large, dense cities.



Did u know?

- A South African soap maker insured Princess Diana for two months back in the early 1990s, but she probably never knew anything about it. The soap maker invested R400,000.00 into an eight-week ad campaign that used a Diana look-alike. If anything would have happened to the real Diana, the company worried it would have to pull its ads and would lose its investment, and such risk was insured.
- In 1901, the first car insured at Lloyd’s was covered by a marine policy. Cars were such a novelty that specific policies did not yet exist, so the marine underwriter wrote a normal marine policy for the car on the basis that it was a ship navigating on dry land.
- Insurers basically earn their profit from – (a) underwriting (the process by which insurers select risks to insure and decide how much in premiums to charge for accepting those risks), and (b) investing premiums collected from policyholders. The investment component (albeit risky in itself) is a major component of the business of insurance, and often more profitable (and absolutely necessary in times of volatile claim-periods) than underwriting.

The industry was growing into massive scale, carrying equally massive risk, and – although competitors – to find a solution to the challenge of large losses they worked together to create systems that could be used throughout the industry. Reinsurance – whereby losses can be distributed among many carriers – was devised, a plan not unlike the Chinese farmers’ solution a thousand years earlier. This system is now commonly used in all types of insurance.

The first American life insurance association was sponsored by a church – the Presbyterian Synod of Philadelphia – and set up for the benefit of their ministers and their dependents. Although there was initial religious objection against the practice of insurance by a church, after 1840 life assurance simply boomed as people used the opportunity to protect themselves against major losses. Insurance had become accepted practice. Farmers wanted crop insurance. Travellers wanted travel insurance. Everybody turned to insurers to buy peace of mind.

Mechanically propelled vehicles were not used on the roads of the UK to any great extent before the beginning of the 20th Century and, consequently, car insurance is of more recent origin than fire, theft and general liability insurance.

The early underwriters tended to adapt the practices of these existing insurance departments to the requirements of car insurance, and placed more emphasis on the car for rating purposes, than they did upon the driver. The increase in road traffic after 1918 and the rise in the number of occasions when members of the public were injured, led to the introduction of the Road Traffic Act 1930. This Act was imposed for the first time in the U.K. a statutory obligation on the users of all cars to provide security against their legal liability for death of or bodily injury caused to third parties.

To make a long story short, insurance is being conducted over a vast array of “lines of business” that encompass personal, commercial, marine, aviation, agriculture, life, health, financial and engineering insurance. Virtually, anything from the mundane to the bizarre can be insured, as Lloyd’s is famous for insuring the life, health, legs or even noses of actors, actresses and/or sports figures.

Self Assessment

Fill in the blanks:

1. Insurance is simply the equitable transfer of a risk of a loss, from one entity to another, in exchange for a
2. These new insurance contracts allowed insurance to be separated from

1.2 Definition of Insurance

Let’s read some of the great sayings related to insurance.

Man on earth always had an eye on the avoidance of ill-luck and has tried in all ages somehow to ensure himself and to take out a policy of some sort on which he paid a regular premium in some form of social denial and sacrifice.

– Summer and Keller

It existed in some form of mutual or communal protection in the Aryan tribes some 3000 years back.

– Stone and Cox

The word “Bima” was derived from the Persian word “Bim” meaning “Fear” and “Bima” means “expense” incurred to get rid of fear.

– Persian Dictionary

From the beginning, human societies have tried to find ways to soften the shocks of existence. Our ancestors were very much aware that no individual could do it alone, only by pooling the resources of the many; the unfortunate few could be helped.

This simple idea of mutual cooperation persists like a welcome footpath through the incredible tangle of human history.



Example: In ancient times, enterprising merchants used to send caravans and ships to trade with all parts of the known world: with Egypt, Phoenicia, India and China.

Traders in olden times devised a system of contracts in which the supplier of the capital of business would agree to cancel the loan if the trader was robbed of his goods. The trader who borrowed the capital paid an extra sum (a premium) for this kind of protection over and above the usual interest. As for the lender, collecting these premiums from many traders made it possible for him to absorb the losses of the unfortunate few, who really suffered the loss.

Above arrangement proved to be more sensible and appealing than the earlier one whereby the trader’s ship and other tangible property as well as his life and those of his family as well was pledged (as a slave).

Accordingly, the practice was sensibly legalized in the code of Hammurabi in 2100 B.C. The Phoenicians and the Greeks applied a similar kind of system to their sea-born commerce. The

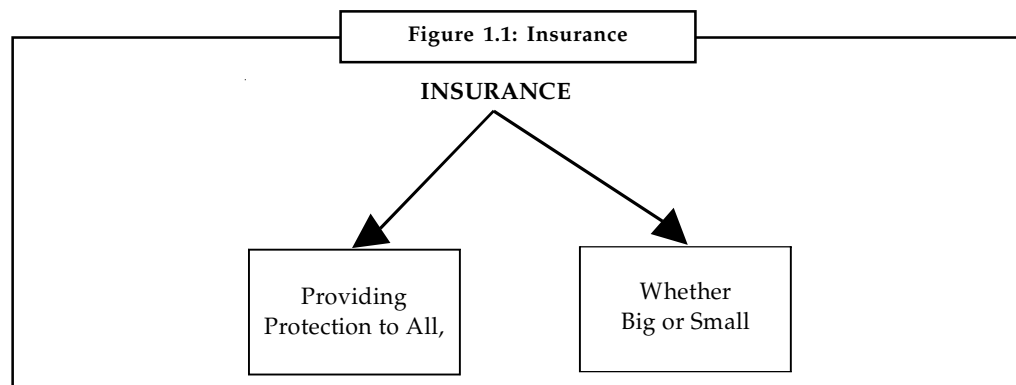
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Romans used burial clubs as a form of life insurance, providing funeral expenses for members and later on, for payments to the survivors for their future subsistence.


With the growth of towns and trade in Europe, the medieval guilds undertook to protect their guild members from losses by fire and shipwreck, provide ransom to get free from the captivity of pirates, and support in sickness and poverty and to provide decent burial. By the middle of the 14th centuries as evidenced by the earliest known insurance contract (Genoa, 1347), marine insurance was practically universal among the maritime nations of Europe.

The first kind of formal insurance business was marine insurance. Traders who met in the Lloyd’s coffee house in London agreed to share the losses of their goods carried by ships while on voyage to various countries. The losses normally occurred due to attack of pirates who robbed on the high seas or because of bad weather, which spoiled and destroyed the goods or sinking of the ship. The first insurance policy was issued in England in 1583.

Insurance may be defined in two ways:

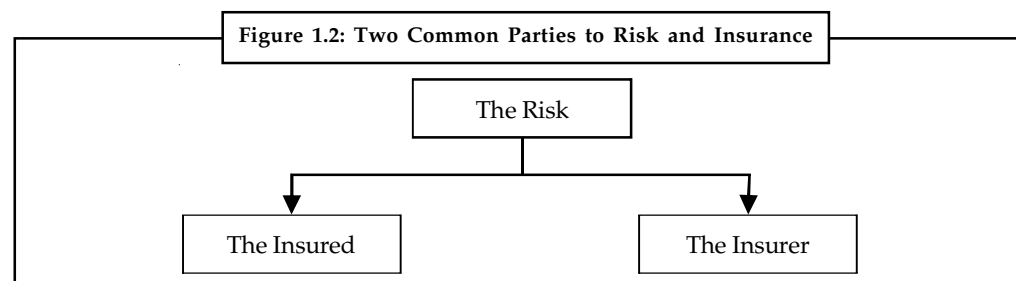


Risk is the uncertainty of a financial risk. Insurance primarily creates counter part of the risk, which is security.



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1. Insurance is defined as a cooperative device to spread the loss caused by a particular risk over a number of persons who are exposed to it and
2. It does not reduce the risk,
3. It does not alter the probability of risk, but
4. It only reduces/spreads the financial losses.



Thus, insurance is a financial arrangement that spreads the costs of losses among the members of an insurance pool.

Self Assessment

Notes

Fill in the blanks:

3. The first kind of formal insurance business was insurance.
4. The Romans used clubs as a form of life insurance, providing funeral expenses for members.

1.3 Meaning of Insurance

Now, let's find out what exactly is meant by insurance.

Encarta Encyclopaedia explains insurance as–

Insurance is a contractual arrangement that provides for compensation by an insurer to an insured party if a specific set of circumstances occurs. These circumstances could be death, personal injury, accident, loss or damage to property or any other number of occurrences that can be compensated for an economic value.

The insurance company operates by collecting small contributions from many people who are exposed to risks. The money thus collected in the form of contributions is used to settle the claims of those people who fall victim of such risks. The contributions thus collected by the insurance company are known as premium.

Insurance is seen as an investment, to some individuals. But here the question arises, is insurance an investment? The answer would be, no, insurance is not an investment. Insurance is a way through which people share their risks with others. It is a way of getting protection against the damages associated with some mishaps. No matter how careful one may be, he/she must need one or other type of insurance.

It is well understood by now that when you buy insurance, it means that you are sharing your risks with others. Basically, the insurance firm is a risk management firm that can help anyone to minimize the risks associated with an individual's day to day activities. Man is vulnerable to dangers and by virtue of this need insurance to help him cope in an unfriendly world.

Another thing one has to know when buying insurance is "insurance policy". The insurance policy is the guideline of the insurance company. Insurance policy will assist you in choosing a better option for your insurance needs.

Examples of Insurance

Some readers may already have used insurance to reduce economic risk. You may purchase collision insurance for your car, which will pay toward having your car repaired or replaced in case of an accident. You can also buy coverage that will pay for damage to your car from causes other than collision, for example, damage from hailstones or vandalism.



Caution In many places, to drive a car legally, you must have liability insurance, which will pay benefits to a person that you might injure or for property damage from a car accident.

Insurance on your residence will pay toward repairing or replacing your home in case of damage from a covered peril. The contents of your house will also be covered in case of damage or theft. However, some perils may not be covered.

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Example: Flood damage may not be covered if your house is in a floodplain.

At some point, you will probably consider the purchase of life insurance to provide your family with additional economic security should you die unexpectedly. Generally, life insurance provides for a fixed benefit at death. However, the benefit may vary over time. In addition, the length of the premium payment period and the period during which a death is eligible for a benefit may each vary. Many combinations and variations exist.

When it is time to retire, you may wish to purchase an annuity that will provide regular income to meet your expenses. A basic form of an annuity is called a life annuity, which pays a regular amount for as long as you live. Annuities are the complement of life insurance. Since payments are made until death, the peril is survival and the risk you have shifted to the insurer is the risk of living longer than your savings would last. There are also annuities that combine the basic life annuity with a benefit payable upon death. There are many different forms of death benefits that can be combined with annuities.

Disability income insurance replaces all or a portion of your income should you become disabled. Health insurance pays benefits to help offset the costs of medical care, hospitalization, dental care, and so on. Employers may provide many of the insurance covers listed above to their employees.

Self Assessment

Fill in the blanks:

- 5. The insurance company operates by collecting small contributions from many people who are exposed to
- 6. The insurance policy is the of the insurance company.
- 7. Life insurance provides for a fixed benefit at
- 8. A basic form of an annuity is called a annuity, which pays a regular amount for as long as you live.

1.4 How Insurance Works?

You need to know that insurance is an agreement where, for a stipulated payment called the premium, one party (the insurer) agrees to pay to the other (the policyholder or his designated beneficiary) a defined amount (the claim payment or benefit) upon the occurrence of a specific loss. This defined claim payment amount can be a fixed amount or can reimburse all or a part of the loss that occurred.

The insurer considers the losses expected for the insurance pool and the potential for variation in order to charge premiums that, in total, will be sufficient to cover all of the projected claim payments for the insurance pool. The premium charged to each of the pool participants is that participant's share of the total premium for the pool. Each premium may be adjusted to reflect any special characteristics of the particular policy.

Normally, only a small percentage of policyholders suffer losses. Their losses are paid out of the premiums collected from the pool of policyholders. Thus, the entire pool compensates the unfortunate few. Each policyholder exchanges an unknown loss for the payment of a known premium.

Under the formal arrangement, the party agreeing to make the claim payments is the insurance company or the insurer. The pool participant is the policyholder. The payments that the

policyholder makes to the insurer are premiums. The insurance contract is the policy. The risk of any unanticipated losses is transferred from the policyholder to the insurer who has the right to specify the rules and conditions for participating in the insurance pool.

The insurer may restrict the particular kinds of losses covered. For example, a peril is a potential cause of a loss. Perils may include fires, hurricanes, theft, and heart attack. The insurance policy may define specific perils that are covered, or it may cover all perils with certain named exclusions, for example, loss as a result of war or loss of life due to suicide. Hazards are conditions that increase the probability or expected magnitude of a loss.



Example: Smoking increases the probability of potential healthcare losses, poor wiring in a house increases the probability of losses due to fire, or a California residence increases the probability of earthquake damage.

In summary, an insurance contract covers a policyholder for economic loss caused by a peril named in the policy. The policyholder pays a known premium to have the insurer guarantee payment for the unknown loss. In this manner, the policyholder transfers the economic risk to the insurance company. Risk is the variation in potential economic outcomes. It is measured by the variation between possible outcomes and the expected outcome: the greater the standard deviation, the greater the risk.

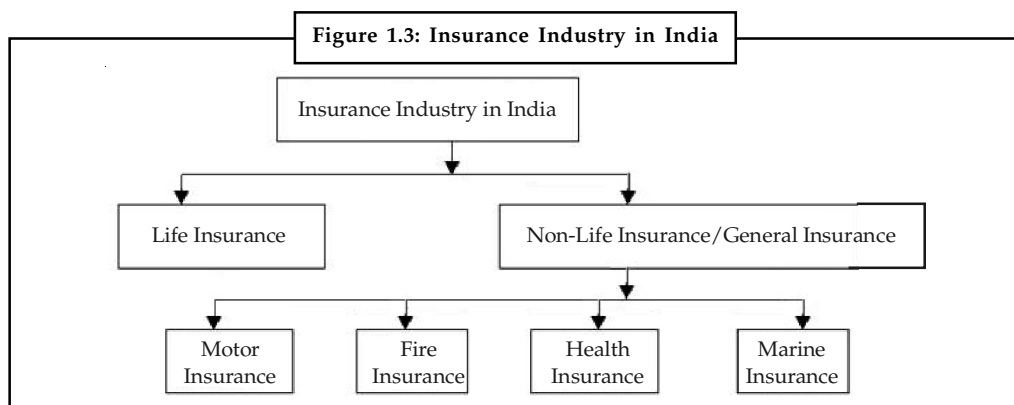
Self Assessment

Fill in the blanks:

9. The considers the losses expected for the insurance pool.
10. are paid out of the premiums collected from the pool of policyholders.
11. The risk of any unanticipated losses is transferred from the to the insurer.

1.5 Indian Insurance Industry

You must be aware that India insurance is a flourishing industry, with several national and international players competing and growing at rapid rates.



Source: <http://www.medindia.net/patients/insurance/images/insurance-Industry-India.jpg>

Thanks to reforms and the easing of policy regulations, the Indian insurance sector has been allowed to flourish, and as Indians become more familiar with different insurance products, this

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growth can only increase, with the period from 2010–2015 projected to be the ‘Golden Age’ for the Indian insurance industry.

Indian Insurance Policies at a Glance

You need to know that Indian insurance companies offer a comprehensive range of insurance plans, a range that is growing as the economy matures and the wealth of the middle classes increases. The most common types include: term life policies, endowment policies, joint life policies, whole life policies, loan cover term assurance policies, unit-linked insurance plans, group insurance policies, pension plans, and annuities. General insurance plans are also available to cover motor insurance, home insurance, travel insurance and health insurance.



Figure 1.4: Various Indian Insurance Companies

Source: <http://www.indianmirror.com/indian-industries/images/insurance-top-img.jpg>

Due to the growing demand for insurance, more and more insurance companies are now emerging in the Indian insurance sector. With the opening up of the economy, several international leaders in the insurance sector are trying to venture into the India insurance industry.

Indian Insurance: History

You must remember that the history of the Indian insurance sector dates back to 1818, when the Oriental Life Insurance Company was formed in Kolkata. A new era began in the India insurance sector, with the passing of the Life Insurance Act of 1912.

The Indian Insurance Companies Act was passed in 1928. This Act empowered the government of India to gather necessary information about the life insurance and non-life insurance organizations operating in the Indian financial markets.

The Triton Insurance Company Ltd. formed in 1850 and was the first of its kind in the general insurance sector in India. Established in 1907, Indian Mercantile Insurance Limited was the first company to handle all forms of India insurance.

Indian Insurance: Sector Reform

You will find out that the formation of the Malhotra Committee in 1993 initiated reforms in the Indian insurance sector. The aim of the Malhotra Committee was to assess the functionality of

the Indian insurance sector. This committee was also in charge of recommending the future path of insurance in India.

The Malhotra Committee attempted to improve various aspects of the insurance sector, making them more appropriate and effective for the Indian market.



Task Visit an old insurance firm and collect some data on the changes it has seen since its infancy and prepare a slideshow on the same.

The recommendations of the committee put stress on offering operational autonomy to the insurance service providers and also suggested forming an independent regulatory body.

The Insurance Regulatory and Development Authority Act of 1999 brought about several crucial policy changes in the insurance sector of India. It led to the formation of the Insurance Regulatory and Development Authority (IRDA) in 2000.

The goals of the IRDA are to safeguard the interests of insurance policyholders, as well as to initiate different policy measures to help sustain growth in the Indian insurance sector.

The Authority has notified 27 Regulations on various issues which include Registration of Insurers, Regulation on insurance agents, Solvency Margin, Reinsurance, Obligation of Insurers to Rural and Social sector, Investment and Accounting Procedure, Protection of policy holders' interest etc. Applications were invited by the Authority with effect from 15th August, 2000 for issue of the Certificate of Registration to both life and non-life insurers. The Authority has its Head Quarter at Hyderabad.



Caselet

Insurance Companies introduce Premium Payment Plans

Limited premium payment policies seem to be the rage currently. Many insurance companies have already introduced limited premium payment products, while many more are on the anvil, according to industry sources.

Conventional life insurance policies require investors to pay their premiums till the year of maturity, whereas in limited premium payment products, the premium is paid for a far shorter period of time. Of course, the amount paid would be far higher in the latter case than in the former. For investors, there is also the matter of falling value of the currency in the future years that needs to be kept in mind while shelving out such huge amounts.

SBI Life Insurance announced a new limited premium payment product last week, named Sanjeevan Supreme. This product comes with the twin aspects of limited premium payment and money back. Investors pay a premium for a period of 6 to 10 years. In return, they get guaranteed money back in equal instalments at regular intervals and accumulated bonuses while remaining fully covered for life insurance during the policy term. The policy is open to persons from the age of 18 to 75. The sum assured (SA) begins from a minimum of ₹ 50,000 to a maximum of ₹ 5 crore.

There are four options to the plan. Under Plan A, the term of the policy is 15 years. For the first 6 years of the policy, investors pay the premium. Then there is a 4-year period when investors do not pay any premium (technically known as growth/deferment period).

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At the end of this period (6 years + 4 years = 10 years), investors will get 20% of the SA every year for 5 years.

Source: http://articles.economictimes.indiatimes.com/2004-03-01/news/27377588_1_premium-sbi-life-insurance-policy

Protection of the interest of policy holders

You need to know that IRDA has the responsibility of protecting the interest of insurance policyholders. Towards achieving this objective, the Authority has taken the following steps:

IRDA has notified Protection of Policyholders Interest Regulations 2001 to provide for: policy proposal documents in easily understandable language; claims procedure in both life and non-life; setting up of grievance redressal machinery; speedy settlement of claims; and policyholders' servicing. The Regulation also provides for payment of interest by insurers for the delay in settlement of claim.

The insurers are required to maintain solvency margins so that they are in a position to meet their obligations towards policyholders with regard to payment of claims.

It is obligatory on the part of the insurance companies to disclose clearly the benefits, terms and conditions under the policy.



Caution The advertisements issued by the insurers should not mislead the insuring public.

All insurers are required to set up proper grievance redress machinery in their head office and at their other offices.

The Authority takes up with the insurers any complaint received from the policyholders in connection with services provided by them under the insurance contract.

Self Assessment

Fill in the blanks:

- 12. Several international leaders in the insurance sector are trying to into the India insurance industry.
- 13. It is obligatory on the part of the insurance companies to clearly the benefits, terms and conditions under the policy.

1.6 Role of Insurance in Financial System

You will find it interesting to note that insurance is a part of financial system. Financial system may be defined as set of institutions, instruments and markets, which gather savings and channel them to their most efficient use.

The system consists of individuals (savers), intermediaries, markets and users of savings. Economic activity and growth are greatly facilitated by the existence of the market in mobilizing the saving and allocating them among competing users.

An economy needs institutions that impartially enforce property rights and contracts. Economic growth of a country depends on the existence of a well-functioning financial infrastructure. It is essential that the financial infrastructure be developed sufficiently so that the market operates in an efficient manner.

Insurance as a part of the financial system provides valuable services to those affected by various risks or contingencies.

It takes care of the financial consequences of certain specific contingencies but in insurance terminology, such contingencies are called risks and they cause losses when they occur.

The effect of these losses on financial system is not only negative but may be disastrous and catastrophic also. It results in substantial burden on the financial well-being of those affected.

The insurance sector supports the financial system in several ways. A few have been enumerated below:

1. It accepts the risk from people and corporate bodies who are exposed to them.
2. It collects small amounts of premium, which are pooled together to be called an insurance fund. This fund is used for investment purpose.
3. It organizes compulsory insurance in certain areas as per the provisions of the law.
4. It sells voluntary insurance covers through its sales force.
5. It settles claims arising out of insured losses. Neither the insurance company nor the insured are allowed to make profits out of insurance. If insurance company gets a surplus.

Self Assessment

Fill in the blanks:

14. growth of a country depends on the existence of a well-functioning financial infrastructure.
15. Insurance as a part of the system provides valuable services to those affected by various risks or contingencies.



Case Study

Should an Insurance Claim be paid to Insured or Financier?

Inder Singh Chauhan had purchased a bus by taking a loan from Swami Financiers. The bus was being used as a private service vehicle, and not as a public transport one. It was insured under a comprehensive insurance policy issued by United India Insurance. The bus met with an accident, for which insurance was claimed. The insurance company appointed its surveyor, who assessed the loss at ₹ 1,26,500. However, the company deducted ₹ 33,125 from the assessed amount, on the ground that the driver did not have an endorsement on his licence to drive a transport vehicle. Even this amount was not paid to Chauhan, but was directly paid to the financier.

Aggrieved, Chauhan filed a consumer complaint that ultimately reached the National Commission. It was held that once a person had a licence to drive a heavy goods carriage vehicle, it would mean that he/she was entitled to drive a transport vehicle, including a public service vehicle. Accordingly, the insurance company was directed to pay the balance amount, along with 12 per cent interest and costs of ₹ 5,000.

The commission also ruled that the practice adopted by insurance companies of directly paying to the financier, without informing the insured or without his consent, cannot be

Contd...

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justified. If the insurance policy is taken in the name of the vehicle purchaser, there is no question of paying the amount straightaway to the financier. [United India Insurance Co Ltd v/s Inder Singh Chauhan – IV (2006) CPJ 15 (NC)]

Question

Discuss the decisions taken by the National Commission in a group of three members.

Source: http://www.business-standard.com/article/pf/case-studies-on-insurance-claims-111050500049_1.html

1.7 Summary

- Insurance is a form of risk management, primarily used to hedge against the risk of a contingent or an uncertain loss.
- Insurance is defined as the equitable transfer of the risk of a loss, from one entity to another, in exchange for payment.
- An insurer is a company selling the insurance; an insured or policyholder is the person or entity buying the insurance policy.
- At some point, you will probably consider the purchase of life insurance to provide your family with additional economic security should you die unexpectedly. Generally, life insurance provides for a fixed benefit at death.
- The insurer considers the losses expected for the insurance pool and the potential for variation in order to charge premiums that, in total, will be sufficient to cover all of the projected claim payments for the insurance pool.
- The risk of any unanticipated losses is transferred from the policyholder to the insurer who has the right to specify the rules and conditions for participating in the insurance pool.
- Indian insurance companies offer a comprehensive range of insurance plans, a range that is growing as the economy matures and the wealth of the middle classes increases.
- The Insurance Regulatory and Development Authority Act of 1999 brought about several crucial policy changes in the insurance sector of India. It led to the formation of the Insurance Regulatory and Development Authority (IRDA) in 2000.
- IRDA has the responsibility of protecting the interest of insurance policyholders.
- The Authority takes up with the insurers any complaint received from the policyholders in connection with services provided by them under the insurance contract.
- Economic activity and growth are greatly facilitated by the existence of the market in mobilizing the saving and allocating them among competing users.
- Insurance as a part of the financial system provides valuable services to those affected by various risks or contingencies.

1.8 Keywords

Accident: An event definite in time and place and is unintended, unforeseen, unexpected and one time is called as an accident.

Financial System: Financial system may be defined as set of institutions, instruments and markets, which gather savings and channel them to their most efficient use.

Insurance Company: Any corporation is said to be an insurance company which is primarily engaged in the business of furnishing insurance protection to the public.

Insurance Policy: The printed form, which serves as the contract between an insurer and an insured.

Insurance: It is contract (policy) in which an individual or entity receives financial protection or reimbursement against losses from an insurance company.

Insured: Insured is a person or organization covered by an insurance policy.

Insurer: Insurer is the party who promises to pay losses or benefits to the insured under the insurance contract.

Lloyd's of London: It is an insurance marketplace situated in London.

1.9 Review Questions

1. Explain the evolution of insurance.
2. Define the term insurance.
3. What are the two common parties to risk and insurance? Give examples of each.
4. "Insurance is a risk coverage device". Explain.
5. Why only a small percentage of policyholders suffer losses? Explain briefly.
6. Briefly explain which period is projected to be the 'Golden Age' for the Indian insurance industry.
7. Discuss the history of Indian insurance.
8. What is the role of insurance in a financial system?

Answers: Self Assessment

- | | |
|------------------|---------------|
| 1. Premium | 2. Investment |
| 3. Marine | 4. Burial |
| 5. Risks | 6. Guideline |
| 7. Death | 8. Life |
| 9. Insurer | 10. Losses |
| 11. Policyholder | 12. Venture |
| 13. Disclose | 14. Economic |
| 15. Financial | |

1.10 Further Readings



Books

Gulati, Neelam. C. (2011), *Banking and Insurance*, Excel Books.

Gulati, Neelam. C. (2013), *Principles of Risk Management and Insurance*, Excel Books.

Krishnaswamy, G. (2009), *Principles and Practice of Life Insurance*, Excel Books.

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Misra, M.N. and Mishra, S.B. (2009), *Insurance Principles and Practices*, S. Chand Publication.

Sahoo and Das (2009), *Insurance Management: Text and Case*, Himalaya Publication.



Online links

<http://www.soa.org/files/pdf/P-21-05.pdf>

<http://support.sas.com/publishing/pubcat/chaps/62823.pdf>

http://www.randmark40.com/index.php?option=com_content&view=article&id=33&Itemid=56

Unit 2: Risk and Insurance

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Objectives

After studying this unit, you will be able to:

- Discuss insurable risk
- Explain the various types of risk
- Explain the need for insurance
- Discuss the importance of insurance in business
- Explain the requirements of an insurable risk

Introduction

In the previous unit, you have studied about the evolution of insurance and you have learnt to define insurance. The unit also dealt with the meaning of insurance and mechanism of insurance about how it works. You have learnt about the Indian insurance industry and about the role of insurance in financial system.

In this unit, you will study about risk and insurance. You need to know that an insurable risk refers to a potential situation in which an insurance company evaluates the risk and determines insurability. This typically requires that the risk have a few basic elements, including the fact that the risk must be random or due to chance and not something someone can control. The potential loss for an insurable risk also must be something predictable and it must be measurable so that it can be proven in a definite way. In order for a risk to be insurable, it is also important that an insurer be able to charge enough for premiums covering it to pay for loss that may result from a claim being filed.

Just remember that the idea of an insurable risk is the basic concept behind all of insurance. Insurance is typically offered by a company, called the insurer, for payments of a fee called a

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premium. These payments are intended as fairly small fees, which over time can add up to a significant amount. The total value of the premiums is meant to compensate the insurer and provide enough funding to cover potential costs if an insurance claim is filed by the insured.

In the next unit you will study about the nature and functions of insurance including the scope of insurance. The unit will guide you through the difference between insurance, gambling and hedging and will help you to understand some of the related terms of insurance. It will also explain the role of insurance in economic development.

2.1 Insurable Risks

You must remember that insurable risks have certain common features. They are enumerated below:

1. **Insurance is concerned only with pure risks:** Speculative risks, where there is the possibility of some gain, cannot be insured. This is generally the case, although certain modern developments may lead us to alter this statement in due course. Speculative risks are normally taken in the hope of a gain. All pure risks are insurable but speculative risks, on the whole, are not.
2. **Homogeneous exposures:** If there are thousands of people/properties having similar exposures then the contributions could be comparatively small as the percentage of losses on the whole will decrease.
3. **Financial value:** The risk must involve a loss that is capable of financial quantification. Insurance is concerned only with situations where monetary compensation is given following a loss. Loss or damage of property may lead to a loss, which is quantifiable.



Example: In life assurance, the financial loss suffered by a wife on the death of her husband is difficult to quantify, still a specific sum of money is decided prior to taking out the policy.

4. **Not against public policy:** It is a common principle in law that contracts must not be contrary to what the society considers the right and moral thing to do. This applies to insurance contracts also. Something against public policy is not insurable, E.g. risk of loss of goods while smuggling.
5. **Risk of being fined by the police:** A fine is intended to penalize the person and while insurance may be available to meet the losses following, say, a motor accident. It is not possible to provide insurance to pay the fine of the driver who was found guilty of some offence.
6. **Insurable interest:** The risk that is to be insured must result in some form of financial loss to the person taking insurance. Otherwise any person could insure some other person's house or car so that when the house or car was damaged he, in addition to the owner of the property, would receive compensation from the insurance company. This is not allowed.



Caution One of the basic doctrines of insurance is that the person insuring must be the one who stands to suffer some financial loss if the risk materializes.

7. **Fortuitous (by fortune):** The loss must be entirely fortuitous as far as the person seeking insurance is concerned. It is not possible to insure against an event that will occur with certainty, as in such a case, there would be no risk, no uncertainty of loss.



Notes The frequency and severity of any risk must be completely beyond the control of the person taking the insurance.

But in life assurance some could argue that there is no uncertainty about death: it is one of the few certainties we have. Life assurance is, however, still involved with fortuitous events as it is the timing of death that is beyond the control of the person affecting the policy.

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Caselet

At ₹ 50 crore, Mahabharat is the Highest Insured Film

Karan Johar's My Name Is Khan, starring Shah Rukh Khan and Kajol, was the highest insured Bollywood production at 46 crore so far. Now, the animation film Mahabharat has surpassed its record, with an insurance cover of 50 crore. If that's not enough, the insurance for the Amaan Khan – directed film was renewed thrice as it took seven years to make.

Presenter-producer Jayantilal Gada says, "We had to make a presentation for Amitabh Bachchan (who has lent his voice for Bheeshma in the film) after he had expressed reservations about being 'cartoonised' for an animation film. The idea was to show him what we were planning to make."

Gada adds, "For that, we had to create other characters as per our imagination... around 100 people worked on it. If anything related to our concept leaked out, our project would have been in jeopardy, and hence we bought such a high insurance cover for it."

However, it wasn't that easy as there were various aspects — the concept, stars lending voices for it and someone filing litigation against the makers — to be considered. He says, "Finally, an Indian company tied up with six foreign companies before the policy materialised. While the Indian company covered 10 per cent, the foreign companies covered the remaining 90 per cent. And it was only after we started working that we realised that the insurance was valid for only two years, the time it took to make the presentation for Amitji. By the end of the film, we had renewed the policy thrice as it took seven years to reach the finishing line."

Source: http://articles.timesofindia.indiatimes.com/2013-12-17/news-interviews/45256951_1_insurance-cover-mahabharat-bheeshma

The classes of risk and their insurability:

- (a) **Static and Dynamic Risks:** Changes in the prices of essential commodities consumer tastes and technology are dynamic risks. All these risks have financial consequences, but are still not considered insurable as they are unpredictable.



Did u know? Static risks have nothing to do with changes in the economy but arise due to perils of nature, dishonesty or infidelity. The property may be ruined or dispossessed and there is a financial loss from such risks and they are predictable and hence insurable.

- (b) **Pure and Speculative Risks:** Risks that produce only loss but no gain are pure risks but speculative risks involve possibility of gain and are almost similar to wagering or gambling.

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- (c) **Financial and Non-financial Risks:** There are several risks in life, which have little or no financial consequences. But insurance is concerned with indemnifying only losses arising from financial risks.
- (d) **Fundamental and Particular Risks:** These are a group of risks which are caused by economic, social and political factors. They affect large segments of the population. Some examples are floods, war, inflation, earthquake, etc.

They are uncontrollable and are considered to come under social insurance. However, some risks like earthquake are covered by commercial insurance companies.

Particular risks involve losses that happen to individuals and may be dynamic or static. Destruction of a house by fire and robbery of a bank are particular risks and hence, are insurable.

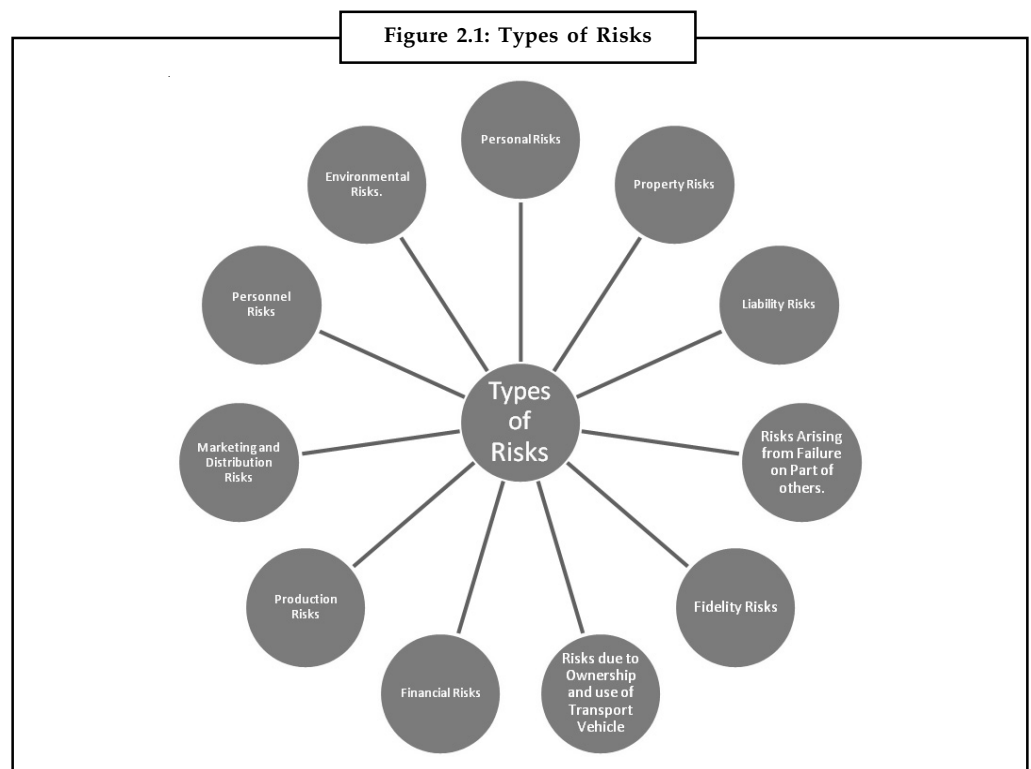
Self Assessment

Fill in the blanks:

1. The risk must involve a loss that is capable of financial
2. The and of any risk must be completely beyond the control of the person taking the insurance.
3. All pure risks are insurable but risks.
4. risks have nothing to do with changes in the economy.

2.2 Types of Risk

You need to know how the risks affect individuals and the different types of risks which a person and his organization face. Risks can be further classified in the following manner also:



Personal Risks

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Remember, there are four basic types of risks, which a person faces. A person may or may not have any property or assets but he has to manage the below mentioned risks, and hence, there is a vast market for insuring such risks like:

- Premature death (Dying too early),
- Dependent old age (Dying too late),
- Sickness or disability (Resulting in loss of income and earning power, involving additional expenses and extra needs), and
- Unemployment (Loss of income may be temporary/permanent, but routine living expenses continue. Fixed liabilities like loan repayments have still to be paid, hence, further multiplying the difficulties).

Property Risks

Direct and consequential losses (arising from usage of various kinds of property), which may take different forms:

- Loss/damage to property,
- Loss of use of property, and
- Additional expenses occasioned by the loss of property.

Liability Risks

They arise out of human mistakes often termed as civil wrongs committed by a person resulting in injury and/or death to another person, and/or loss of or damage to property. In either case, he attracts liability for damages by way of compensation under common law, statutory law or both.

Risk Arising from Failure on Part of Others

Risk arising due to failure on part of another person to meet a specified obligation, e.g. guarantee bonds and sureties.

Fidelity Risks

Risks arising due to dishonesty of employees and others in course of performance of their duties causing loss of money and stocks to the owner.

Risks Due to Ownership and use of Transport Vehicle

Use of transport vehicles opens scope for two types of risks – own damage or loss to the vehicle due to a variety of pure risks including negligence. The second risk is death/injury to third parties and loss/damage to their property.

Production Risks

A firm may fail to produce its decided output at the desired and planned unit cost due to uncertain event(s). Production may be disturbed or stopped by, for example:

- Fire, flood, or strikes.

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- Management may exceed its limit of technical abilities especially in case of firms seeking to develop new products or introduce new processes.
- The plant layout may prove to be badly planned.
- Plant may fail to operate efficiently and effectively.
- Change in market conditions may have adverse impact on the availability of materials / parts.
- Cost of materials and parts may go up.

Marketing and Distribution Risks

You must understand that in order to succeed, a firm must be able to sell all its products at the planned price, and then deliver those products to its customers properly, i.e., right product in right time, place and price. It may fail to do so due to reasons like:

- Competitors undercut the price or introduce better products;
- Fashions/tastes of consumers change;
- General economic conditions at home or abroad may react adversely on sales;
- Export sales may be lost because of political moves, such as changes in exchange controls, tariffs, or import quotas.

Despite of a firm's best efforts to minimize such risks (by undertaking extensive market research) particularly new products may fail to sell in the numbers planned due to one or other reason.

Financial Risks

A firm may find itself in difficulty due to financial factors such as:

- An increase in the cost of borrowing caused by a rise in market interest rates.
- Lesser availability of bank credit.
- High-gearing – A heavy dependence upon loan capital relative to equity capital (known as a high capital gearing) increases the risks for creditors and shareholders both.
- Return on investment lower than interest payments.
- Hike (increase) in interest rates more than provided for.
- The failure of debtors to settle their debts can be another source of financial loss.
- Inability of debtor(s) to pay arises particularly in overseas trade where goods may be sold on extended credit, thus, the buyer, even though willing and able to pay, may be prevented from doing so because of exchange control regulations or their restrictions imposed by the government.

Personnel Risks

The success or failure of business depends on the ability, integrity, zeal and passion of its directors, managers, and employees.

- The loss of a key man due to injury, sickness, or death may endanger the success of a project or negotiation of a major sales contract.

- Heavy losses due to embezzlement and fraud by employees.
- Passing of trade secrets to competitors.
- Poor industrial relations leading to frequent stoppages of work.

Environmental Risks

You will find it interesting to note that firms run risks of legal, social, political, and economic environment in which they operate. Changing social norms can interrupt a firm's operations in many ways; for example, bad and complacent attitudes to work, pilferage, and wage differentials. Political changes may result into increased government intervention in employment, marketing, investment and other policies, and also sometime may lead to nationalization or the expropriation (acquire without compensation) of business assets.

Also society and government are becoming increasingly aware of the damage and injury caused by the release of pollutants into the air and the disposal of industrial wastes on land and into water bodies. Today, industrial firms run the risk of heavy fines if they violate pollution laws, even accidentally.

Thus, occurrence of some environmental events may result in either gain or loss, whereas others cause only loss. Some events are the result of human behaviour, others are beyond human control.

Changes in the Above Classifications

Unemployment, once upon a time, was looked upon as the fault of the individual concerned. It may have arisen out of his laziness, lack of training or a number of other reasons and it was very much a particular risk. With the passage of time, the view of society has changed and today, most people would agree that unemployment arises out of some malfunctioning of the economic system.

In this way, the risk is claimed to be one of a fundamental nature, not due to any one individual and it is also widespread in its consequences.

When a risk is identified as being of a fundamental nature, the Government normally has to take note of it and has to step in with some scheme to provide compensation for victims.



Example: By means of unemployment benefit or generation of employment/ self-employment through various schemes.

Classification by Size of Loss

You will find out that losses can be classified according to severity of potential loss for the individual or firm exposed to loss. Losses can be classified as follows:

- **Class I:** Losses that do not disturb a firm's basic finances;
- **Class II:** Losses that necessitate raising additional finance by borrowing or a share issue;
- **Class III:** Larger losses which might bankrupt the firm.

Whereas it may be possible for a firm to handle internally Class I and even Class II risks, normally Class III losses can only be handled by transferring them, usually to an insurer.

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Self Assessment

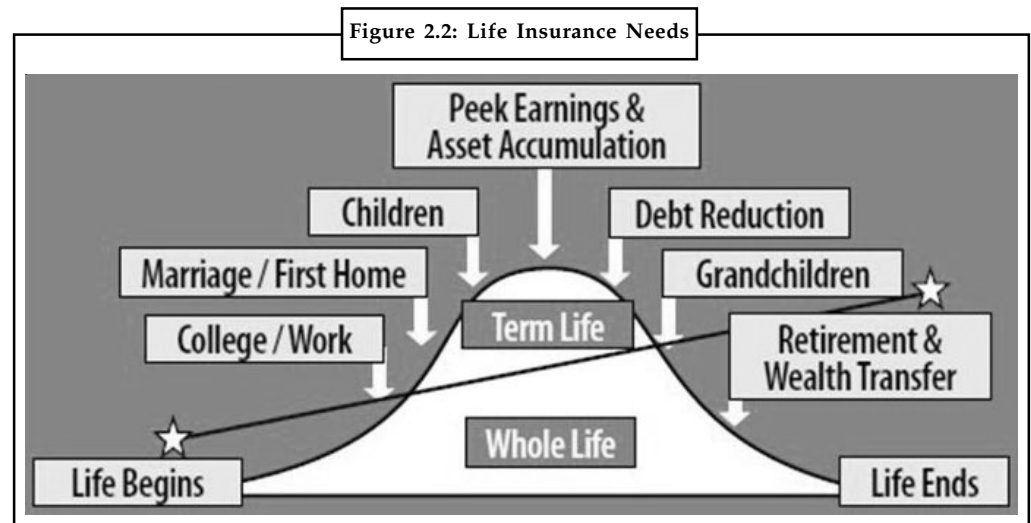
Fill in the blanks:

5. A firm must be able to sell all its products at the price.
6. A heavy dependence upon loan capital relative to capital increases the risks for creditors and shareholders both.
7. Occurrence of some events may result in either gain or loss, whereas others cause only loss.
8. Most people would agree that arises out of some malfunctioning of the economic system.

2.3 Need for Insurance

You need to know that the concept of insurance was sparked by the idea of pooling risk. People with families and valuable property have always faced the possibility of loss; even the possibility of such loss has caused individuals so much concern that they have ultimately refused to live without having options for replacement of their loss. Thus, the practice of insuring property for its replacement value has evolved. Even more importantly, the practice of replacing of the economic value of a human life has also grown out of this thought process.

The following figure gives you a peek into the need for life insurance.



Source: <http://www.mylifeinsurancequotes101.com/wp-content/uploads/2012/12/LI-Life-Insurance-Needs.jpg>

Insurance allows you to transfer the financial risk of certain types of losses to another entity, usually an insurance company that is organized according to stringent federal and state regulations specifically for the purpose of protecting you against losses. By transferring the financial risk to such an entity and paying the required premiums, you can receive compensation for loss in the form of either a lump sum or an annual amount of financial resources. This compensation can maintain or replace your income stream. In this way, insurance helps you and your family maintain financial stability if you get sick or become unable to work because of disability, injury, or death.



Task Conduct a survey among 20 people and ask them what they think, why there is a need of insurance and prepare a small report based on your survey.

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If you have insurance but do not incur a loss for which you had coverage, you lose only the premium you paid, although some insurance policies do have a return-of-premium feature. And even though a particular loss may not occur, you still receive value from the premium paid in the form of peace of mind and the knowledge that you are being obedient to commandments that instruct you to care for your family. However, if you do not have insurance and you are sued, get sick, or even die, you and your family may suffer serious consequences: your family may have to rely on only one income or a reduced income to get by, and your children may not be able to achieve important goals.

If you do not have insurance and you suffer great loss, it is likely that you will not be able to take care of your family as you should. You may be unable to work, and you may lose your earning capacity: you may lose everything you have ever saved.



Notes Insurance allows you to transfer the financial responsibility for risks like illness, disability, and death to an institution capable of handling these risks.

Following points will give you more clarity about the need for insurance:

1. **Removal of uncertainties:** Insurance company takes the risks of large but uncertain losses in exchange for small premium. So it gives a sense of security, which is real gift to the business man. If all uncertainty could be removed from business, income would be sure. Insurance removed many uncertainties and to that extent is profitable.
2. **Stimulant of business enterprise:** Insurance facilitates to maintain the large size commercial and industrial organizations. No large scale industrial undertaking could function in the modern world without the transfer of many of its risks to insurer. It safeguards capital and at the same time it avoids the necessity on the part of industrialists. They are therefore free to use their capital as may seem best.
3. **Promotion of saving:** Saving is a device of preparing for the bad consequences of the future. Insurance policy is often very suitable way of providing for the future. This type of policy is found particularly in life assurance. It promotes savings by making it compulsory which has a beneficial effect both for the individual and nation.
4. **Correct distribution of cost:** Insurance helps to maintain correct distribution of cost. Every business man tries to pass on to the consumer all types of costs including accidental and losses also. In the various fields of Insurance such losses are correctly estimated keeping in view a vast number of factors bearing on them. In the absence of insurance these losses and costs would be assessed and distributed only by guess work.
5. **Source of credit:** Modern business depends largely on credit; insurance has contributed 'a lot in this regard. A life insurance policy increases the credit worthiness of the assured person because it can provide funds for repayment if he dies. Credit extension is also obtained by means of various kinds of property insurance. A businessman who stock of goods has been properly insured can get credit easily. Similarly marine insurance is an essential requirement for every transaction of import and export.
6. **Reduction of the chances of loss:** Insurance companies spend large sums of money with a view to finding out the reasons of fire accidents, theft and robbery and suggest some

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- measures to prevent them. They also support several medical programs in order to make the public safety minded. Without such losses preventive activities of insurance companies, the chances of loss would have been greater than they are at present days.
7. **Solution of social problems:** Insurance serves as a useful device for solving complex social problems e.g. compensation is available to victims of Industrial injuries and road accident while the financial difficulties arising from old age, disability or death are minimized. It thus enables many families and business units to continue intact even after a loss.
 8. **Productive utilization of fund:** Insurer accumulates large resources from the various insurance funds. Such resources are generally invested in the country, either in the public or private sector. This facilitates considerably in overall development of the economy.
 9. **Insurance as an investment:** A life policy is a combination of protection and investment which serves a useful purpose. The premium that is paid by insured goes on accumulating in a fund every year. The sum so accumulated by the insurance company earns interest. Under life assurance a person may also invest his capital in an annuity which will pay him an income every year till death. Therefore, insurance may be regarded as an investment.
 10. **Promotion of international trade:** The growth of the international trade of the country has been greatly helped by shifting of risk to insurance company. A ship sailing in the sea faces some miss-fortune. A fire breaks out and burns to ashes all the merchandise of a business man. But insurance is one of the devices by which these risks may be reduced or eliminated. So industrialists and exporter may devote their full attention toward the promotion of business which may increase the export activities.
 11. **Removing fear:** Insurance helps to remove various types of fear from the mind of the people. The insured is secured in the knowledge that the protection of the insurance fund is behind him if some sad event happens. It thus creates confidence and eliminates worries which are difficult to evaluate, but the benefit is very real.
 12. **Favourable allocation of factors of production:** Insurance also helps in achieving favourable allocation of the factors of production. Capital is usually shy in the risky business. People hesitate to invest their capital where financial losses are great. If protection is provided against these risks by means of insurance, several investors will become ready to invest their funds in those fields.
 13. **Growth of Business competition:** Insurance enables the small business units to compete upon more equal terms with the bigger organization. Without insurance it would have been impossible to undertake the risks themselves. On the other side bigger organization could absorb, their losses due to great financial strength. Moreover insurance removes uncertainty of financial losses arising out of the certain causes. It thus increases knowledge which is one of the most important preconditions of perfect competition.
 14. **Employment opportunity:** Insurance provides employment opportunity to jobless persons which is helpful for the improvement and progress of social condition
 15. **Miscellaneous benefits:** Following are some other miscellaneous benefits offered by insurance:
 - (a) It establishes the relation between the employed and employer by providing various facilities i.e. group life insurance, social security scheme, retirement income plan, and workman's compensation insurance.
 - (b) Insurance creates the confidence and sense of security among the policy holder.
 - (c) Insurance company provides valuable services of skilled and expert persons to industries and business in order to eliminate various risks.

- (d) It promotes economic growth and development. This would be impossible in the absence of insurance.
- (e) It contributes to the efficiency of business and also industrial and commercial executives.
- (f) Security of dependents is made possible through life assurance. It gives relief to helpless families after the death of the earning member of the family.

Notes

Self Assessment

Fill in the blanks:

9. The concept of insurance was sparked by the idea of risk.
10. The practice of replacing of the value of a human life has also grown out of this thought process.
11. is a device of preparing for the bad consequences of the future.
12. Insurance helps in achieving favourable allocation of the factors of

2.4 Importance of Insurance in Business

You must be aware that many business owners feel business insurance is an expense they cannot afford, or is a luxury for more established businesses. Although it is true business insurance can be expensive, it is an expense every business, regardless of the industry, size or length of time in existence, needs to include in its budget.

1. **Theft:** A new business is a big target for thieves. New computers, furniture and other office equipment are worth more at a pawn or chop shop than older equipment. Even older businesses that have just undergone renovations and upgrades are a target. Replacement insurance protects a business in the event of stolen equipment, replacing the missing items and paying for repairs from damage caused by the invasion.
2. **Liability:** If a customer slips and falls while on your business premises or your product has a defect that injures a customer and you do not have insurance, this could spell the end of your business. If a company car is involved in an accident and someone is injured, that could be disastrous as well. Business liability insurance covers accidents that occur on the business premises, product defects and mishaps that occur during normal business operations on and off premises.
3. **Level of Coverage:** How much insurance to carry will depend on your industry, the business structure and the amount of assets your business has.



Example: A law firm partnership that owns the building in which it is housed might need more insurance than a jewellery designer operating out of her home.

4. **Litigation:** We live in a litigious society. Even with the Texas tort reform legislation passed in 2003, which capped judgments and sought to eliminate frivolous lawsuits, businesses are sued by individuals and other businesses for a variety of reasons, legitimate and otherwise. Even the most frivolous lawsuit can be costly to defend; and in the event business ends up on the losing end of a lawsuit, the awarded damages could exceed the business's capabilities to pay. Depending on the business entity structure, not only the business assets, but also the owner's personal assets could be at risk. Business liability insurance, malpractice insurance or professional liability insurance will cover at least part, if not all, of any damages.

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5. **Catastrophic Loss:** Business insurance protects a business from closing due to a catastrophic loss. Fires, floods, hurricanes and tornadoes have been the end of many businesses in Texas, as elsewhere. When a company carries insurance against these types of losses, closure and loss are only temporary instead of permanent. Companies should always consider business interruption insurance, a rider on their business insurance policy, to ensure continued cash flow for the duration of a closure due to a natural disaster.
6. **Personal Injury or Illness:** Business owners should have personal insurance as well. Medical insurance will ensure medical bills incurred due to an illness or injury will not wipe out a business's assets.

Self Assessment

Fill in the blanks:

13. Business liability insurance covers accidents that occur on the business premises, product defects and mishaps that occur during normal business on and off premises.
14. Depending on the business entity not only the business assets, but also the owner's personal assets could be at risk.

2.5 Managing Risk

You must remember that the steps to management in general, include—plan, organise, delegate, motivate, training, control, course corrections and achieving the goals. Management of risks is also concerned with direction of purposeful activities towards the achievement of individual or organizational goals.

Risk Management may be defined as “the identification, analysis and economic control of those risks, which can threaten the assets or earning capacity of an enterprise.”

Risk Management evaluates which risks identified in the risk assessment process require management. It then selects and implements the plans or actions that are required to ensure that those risks are controlled.

Mark Dorfman says “risk management is the logical development and execution of a plan to deal with potential losses”. The risk can include both positive aspect (upside) and negative (downside) aspect. Risk management often refers to reducing downside likelihood and enhances the returns on topside.

Risks that a business faces include:

- Environmental risks: legal, social, economic, financial risks
- Speculative risks
- Technological changes
- Pure risks
- Fundamental risks.

Risk Management helps a business to face risks in a better and prepared manner. Thus, risk management is a process, which assures that:

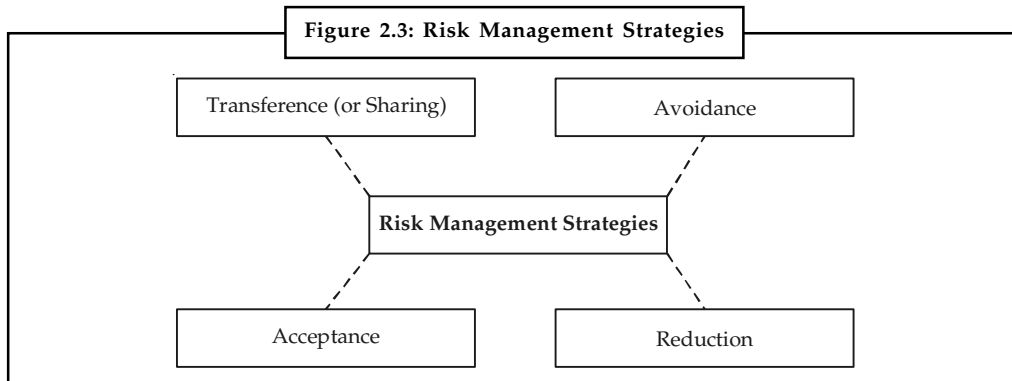
- Achievement of aims is more likely;
- Harmful things do not happen or are less likely to happen;

- Advantageous things will be or are more likely to be achieved.

Notes

An important part of determining the right level of insurance that you should have is understanding risk. Risk, in terms of insurance, is uncertainty concerning the occurrence of a loss.

There is risk in all areas of your life: there are risks involved in your lifestyle, your career, your environment, and so on. You can manage risk in four ways: you can avoid risk, reduce risk, assume risk, or transfer risk as shown in the figure below:



Source: http://dl.groovygecko.net/anon.groovy/clients/kaplan/AlexILS/ACCAWIKI/ACCA_P1_HTML/Images/P1_Ch12_Tara_S5.gif

1. **Avoid risk:** You can avoid some risks, such as risks to your health, by taking care of yourself, eating well, and exercising. You can avoid some financial risks by avoiding high-risk occupations and diversifying your investments.
2. **Reduce risk:** You can reduce some risks by adding fire extinguishers and burglar alarms to your home, adding airbags to your car, or getting regular medical check-ups. By taking these precautions, you can reduce the potential damage of some risks.
3. **Assume risk:** You can assume some types of risk through self-insurance.



Example: A used to own a 1973 Ford Pinto. Instead of carrying full-coverage insurance, which would have allowed him to get the car fixed if it were in an accident, he carried only liability insurance. If he had been in an accident, he would have had to pay to have the car fixed himself.

If the costs are not too high, you can assume some risks by assuming the potential for additional costs.

4. **Transfer risk:** You can transfer risk to others by purchasing insurance. You pay premiums to transfer the risk to an insurance company. Buying insurance is the process of transferring financial responsibility for a specific risk—death, disability, liability, and so on from yourself to an insurance company.

Once you understand how to manage risk, you can determine which risks you can avoid, reduce, or assume, and which risks you should transfer to an insurance company or other entity.

Self Assessment

Fill in the blanks:

15. Risk Management evaluates which risks identified in the risk process require management.

Notes

16. If the costs are not too high, you can assume some risks by assuming the potential for costs.

2.6 Requirements of an Insurable Risk

You need to know that insurers normally insure only pure risks. However, all pure risks are also not insurable. Certain requirements usually must be satisfied before a pure risk can be insured. There are six requirements of an insurable risk.

1. **Large Number of Exposure Units:** The first and foremost requirement of an insurable risk is presence of large number of exposure units to be given insurance protection. Ideally, there should be a large group of nearly similar exposure units that are subject to the same peril or group of perils.



Example: A large number of houses in a city can be grouped together for purposes of providing property insurance.

The purpose of this, first requirement is to enable the insurer, i.e., the insurance company to predict loss based on the law of large numbers. Loss data can be compiled over a period of time, and losses for the group as a whole can be predicted and estimated. The loss costs can then be spread over all insured individuals. This is how premium is determined.

2. **Accidental and Unintentional Loss:** The second requirement is that the loss should be accidental and unintentional. Ideally the loss should be by chance and outside the insured's control. Thus, if a person intentionally causes a loss, he or she should not be indemnified for the loss.

The above condition is necessary due to two reasons:

- (a) If intentional losses are paid, moral hazard would be substantially increased, and premiums would rise as a result. This would result in substantial increase in premiums and fewer persons will purchase the insurance. Thus, insurer might not have a sufficient number of exposure units to forecast future losses.
 - (b) The loss should be accidental because the law of large numbers is based on the random happening of events. A deliberately caused loss is not a chance event, as the insured knows when the loss will take place. Thus, forecast of future occurrences may be very inaccurate if a large number of intentional or non-random losses occur.
3. **Determinable and Measurable (Calculable) Loss:** The loss should be both determinable and calculable. This means the loss should be definite as to cause, time, place, and amount. But some losses are difficult to determine and measure. For example, under a disability-income policy, the insurer promises to pay a monthly benefit to the disabled person if the definition of disability stated in the policy is satisfied.

Some dishonest claimants may deliberately fake sickness or injury to collect from the insurer.



Caution Even if the claim is legitimate, the insurer must still determine whether the insured satisfies the definition of disability stated in the policy.

Sickness and disability are highly subjective, and the same event can affect two persons quite differently.



Example: Two accountants who are insured under separate disability-income contracts may be injured in an auto accident, and both may be classified as totally disabled. One accountant, however, may be stronger willed and more determined to return to work. If that accountant undergoes rehabilitation and returns to work, the disability-income benefits will terminate. Meanwhile, other accountant would still continue to receive disability income benefits according to the terms of the policy. In short, it is difficult to determine when a person is actually disabled. However, all losses ideally should be both determinable and measurable.

4. **The Loss should not be Catastrophic:** This means that a large proportion of exposure units should not incur losses at the same time. As we stated earlier, pooling is the essence of insurance. If most or all of the exposure units in a certain class simultaneously incur a loss, then the pooling technique breaks down and becomes unworkable. Premiums must be increased to prohibitive levels, and the insurance technique is no longer a viable arrangement by which losses of the few are spread over the entire group.

Insurers ideally wish to avoid all catastrophic losses. In the real world, this is impossible, because catastrophic losses periodically result from floods, hurricanes, tornadoes, earthquakes, forest fires, and other natural disasters. Fortunately, several approaches are available for meeting the problem of a catastrophic loss.

Firstly, reinsurance can be used by which insurance companies are indemnified by reinsurer for catastrophic losses. Reinsurance is the shifting of part or all of the insurance originally written by one insurer to another insurer. The reinsurer is then responsible for the payment of its share of the loss.

Secondly, insurers can avoid the concentration of risk by dispersing their coverage over a large geographical area. The concentration of loss exposures in a geographical area exposed to frequent floods, tornadoes, hurricanes, or other natural disasters can result in periodic catastrophic losses. If the loss exposures are geographically dispersed (isolated), the possibility of a catastrophic loss is reduced.

Finally, new financial instruments are now available for dealing with catastrophic losses. These instruments include catastrophic bonds and options sold on the Chicago board of trade.

5. **Calculable Chance of Loss:** Another important requirement is that the chance of loss should be calculable. The insurer must be able to calculate both the average frequency and the average severity of future losses with some accuracy. This requirement is necessary so that a proper premium can be charged that is sufficient to pay all claims and expenses and yield a profit during the policy period.

Certain losses, however, are difficult to insure because the chance of loss cannot be accurately estimated, and the potential for a catastrophic loss is present. For example, floods, wars, and cyclical unemployment occur on an irregular basis, and prediction of the average frequency and the severity of losses are difficult. Thus, without government assistance, these losses are difficult for private carriers to insure.

6. **Economically Feasible Premium:** A final requirement is that the premium should be economically feasible. The insured must be able to afford to pay the premium. In addition, for the insurance to be an attractive purchase, the premiums paid must be substantially less than the face value, or amount, of the policy.



Notes To have an economically feasible premium, the chance of loss must be relatively low.

Notes

One view is that if the chance of loss exceeds 40 per cent, the cost of the policy will exceed the amount that the insurer must pay under the contract. For example, an insurer could issue ₹ .100000 life insurance policy on a man of age 99, but the pure premium would be about ₹ .98000, and an additional amount for expenses would have to be added. The total premium would exceed the face amount of the insurance.

Based on these requirements, personal risks, property risks, and liability risks can be privately insured, because the requirements of an insurable risk generally can be met. By contrast, most market risks, financial risks, production risks, and political risks are usually uninsurable by private insurers. These risks are uninsurable for several reasons. First, they are speculative and so are difficult to insure privately. Second, the potential of each to produce a catastrophic loss is great; this is particularly true for political risks, such as the risk of war.

Finally, calculation of the proper premium for such risks may be difficult as the chance of loss cannot be correctly estimated. For example, insurance that protects a trader against loss because of a change in consumer tastes, such as a style change, generally is not available. Accurate loss data are not available, and there is no accurate way to calculate a premium. The premium charged may or may not be adequate to pay all losses and expenses. Since private insurers are in business to make a profit, certain risks are uninsurable because of the likelihood of large losses.

Self Assessment

Fill in the blanks:

- 17. If a person intentionally causes a loss, he or she should not be indemnified for the
- 18. Forecast of future may be inaccurate if a large number of intentional or non-random losses occur.



Case Study

Govt. Plans Insurance Scheme for Girl Child

Under the special scheme of conditional cash transfer, the government will provide cash on certain conditions, such as at birth and registration of the girl; at the time of enrolling in school, updation of immunisation cards and at completion of primary school, elementary school and secondary education. The remaining sum would be given at the age of 18 years if the girl is unmarried.

Under the scheme, the girl will receive a lump sum when she turns 18. Women and child development minister Renuka Chowdhury said the ministry had proposed the conditional cash transfer scheme during the 11th Plan.

“The move is to reward parents that will help in checking declining sex ratio and discourage female foeticide and infanticide,” said an official.

Question

Explain the steps taken by government in case of providing insurance cover to girl child.

Source: http://articles.timesofindia.indiatimes.com/2007-12-27/india/27995371_1_girl-child-special-scheme-conditional-cash-transfer

2.7 Summary

Notes

- All pure risks are insurable but speculative risks, on the whole, are not.
- Insurance is concerned only with situations where monetary compensation is given following a loss. Loss or damage of property may lead to a loss, which is quantifiable.
- The risk that is to be insured must result in some form of financial loss to the person taking insurance.
- Liability risks arise out of human mistakes often termed as civil wrongs committed by a person resulting in injury and/or death to another person, and/or loss of or damage to property.
- Firms run risks of legal, social, political, and economic environment in which they operate. Changing social norms can interrupt a firm's operations in many ways; for example, bad and complacent attitudes to work, pilferage, and wage differentials.
- Today, industrial firms run the risk of heavy fines if they violate pollution laws, even accidentally.
- Insurance allows you to transfer the financial risk of certain types of losses to another entity, usually an insurance company that is organized according to stringent federal and state regulations specifically for the purpose of protecting you against losses.
- Insurance helps to maintain correct distribution of cost. Every business man tries to pass on to the consumer all types of costs including accidental and losses also.
- A life insurance policy increases the credit worthiness of the assured person because it can provide funds for repayment if he dies.
- Insurance companies spend large sums of money with a view to finding out the reasons of fire accidents, theft and robbery and suggest some measures to prevent them.
- People hesitate to invest their capital where financial losses are great. If protection is provided against these risks by means of insurance, several investors will become ready to invest their funds in those fields.
- Risk Management evaluates which risks identified in the risk assessment process require management. It then selects and implements the plans or actions that are required to ensure that those risks are controlled.

2.8 Keywords

Business liability insurance: Business liability insurance covers accidents that occur on the business premises, product defects and mishaps that occur during normal business operations on and off premises.

Fidelity Risks: Risks arising due to dishonesty of employees and others in course of performance of their duties causing loss of money and stocks to the owner.

High-gearing: A heavy dependence upon loan capital relative to equity capital is known as a high capital gearing which increases the risks for creditors and shareholders both.

Insurable Risk: A risk which can be insured by an insurer. The conditions that make a risk insurable may be probability of occurrence of loss, loss not in control of insured, capability of loss to be calculable, etc.

Liability Risks: They arise out of human mistakes often termed as civil wrongs committed by a person resulting in injury and/or death to another person, and/or loss of or damage to property.

Production Risks: A firm may fail to produce its decided output at the desired and planned unit cost due to uncertain event is known as the production risk.

Notes

Risk Management: It is defined as the identification, analysis and economic control of those risks, which can threaten the assets or earning capacity of an enterprise.

2.9 Review Questions

1. Define insurable risks. What are the classes of risk and also discuss their insurability?
2. Explain the main features of insurable risks.
3. What are the different kinds of risks? Explain with the help of a diagram.
4. What is the need for insurance? Explain in detail with relevant examples.
5. Discuss the importance of insurance in business.
6. Define and explain risk management.
7. Discuss the ways of managing risk.
8. Describe the requirements of an insurable risk.

Answers: Self Assessment

- | | |
|-------------------|------------------------|
| 1. Quantification | 2. Frequency, severity |
| 3. Speculative | 4. Static |
| 5. Planned | 6. Equity |
| 7. Environmental | 8. Unemployment |
| 9. Pooling | 10. Economic |
| 11. Saving | 12. Production |
| 13. Operations | 14. Structure |
| 15. Assessment | 16. Additional |
| 17. Loss | 18. Occurrences |

2.10 Further Readings



Books

- Gulati, Neelam. C. (2011), *Banking and Insurance*, Excel Books.
- Gulati, Neelam. C. (2013), *Principles of Risk Management and Insurance*, Excel Books.
- Krishnaswamy, G. (2009), *Principles and Practice of Life Insurance*, Excel Books.
- Misra, M.N. and Mishra, S.B. (2009), *Insurance Principles and Practices*, S. Chand Publication.
- Sahoo and Das (2009), *Insurance Management: Text and Case*, Himalaya Publication.



Online links

- <http://nilum.hubpages.com/hub/Importance-of-Insurance>
- <http://smallbusiness.chron.com/importance-insurance-business-271.html>

Unit 3: Nature and Scope of Insurance

Notes

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Objectives

After studying this unit, you will be able to:

- Discuss the nature of insurance
- Explain the functions of insurance
- Discuss the scope of insurance
- Differentiate between insurance, gambling and hedging
- Describe the role of insurance in economic development

Introduction

In the previous unit, you have studied about the need and importance of risk as well as got an insight about the insurable risk. It also dealt with the types of risks. It has also summarized the requirements of an Insurable Risk.

This unit will provide you an insight on the nature and scope of insurance as well as the various functions of insurance. You will be able to differentiate between insurance, gambling and hedging

Notes

after studying this unit. The unit will throw some light on the role of insurance in economic development.

In the next unit, you will study about the meaning of insurance contract. You will study about the various types of insurance contracts prevailing in the market today. Besides this, the next unit will update you about the documents of insurance. The next unit will also explain the term partial insurance.

3.1 Nature of Insurance

Following characteristics will help you to understand the nature of insurance, which are generally, observed in the case of all kinds of insurance contracts whether life, marine, fire, or miscellaneous insurance:

1. **Risk Sharing and Risk Transfer:** Insurance is a device to share the financial losses, which might occur to an individual or his family on the happening of a specified event. The event may be death of the earning member of the family in the case of life insurance, marine-perils in marine insurance, fire in fire insurance and other certain events in miscellaneous insurance, e.g., theft in burglary insurance, accidents in motor insurance, etc. The loss arising from these events are shared by all the insured in the form of premium which they have already paid in advance. Hence, the risk is transferred from one individual to a group.
2. **Co-operative Device:** A group of persons who agree to share the financial loss may be brought together voluntarily or through publicity or through solicitations of the agents. An insurer, by insuring a large number of persons, is able to pay the amount of loss. Like all co-operative devices, there is no compulsion here on anybody to purchase the insurance policy (third party liability insurance in case of a vehicle owner is an exception).
3. **Calculates Risk in Advance:** The risk is evaluated on the basis of probability theory before insuring since the premium payable on a policy is to be determined. Probability theory is that body of knowledge, which is concerned with measuring the likelihood that something will happen and making estimates on the basis of this likelihood.



Notes The likelihood of an event is assigned a numerical value between 0 and 1. Those events that are impossible are assigned a value of 0 and those that are inevitable are assigned a value of 1. The higher values (between 0 and 1) are assigned to those events estimated to have a greater likelihood or probability of occurrence.

4. **Payment of Claim at the Occurrence of Contingency:** The payment is made on happening of a certain insured contingency. It is true for all non-life insurances that payment will be made on the happening of the specified contingency only.

The life insurance claim is a certainty, because the contingency of death or the expiry of term will certainly occur and the payment is certain.

Similarly, in certain types of life policies, payment is not certain due to uncertainty of a particular contingency within a particular period.



Example: In term-insurance the payment is made only when death of the assured occurs within the specified term, may be one or two years.

Similarly, in pure endowment, payment is made only at the survival of the insured at the expiry of the period.

5. **Amount of Payment:** The amount of payment depends upon the value of loss suffered due to the happening of that particular insured risk, provided insurance is there up to that amount. In life insurance, the purpose is not to make good the financial loss suffered. Moreover, one cannot estimate the value of a human being. A person is no doubt precious to his/her family. The insurer promises to pay a fixed sum on the happening of an event i.e. death or permanent disability.

The amount of loss at the time of contingency is immaterial in life insurance. But in the property and general insurances, the amount of loss, as well as the happening of loss, is required to be proved.

6. **Larger Number of Insured Persons:** The price of insurance is basically linked to the cost of claims, which is only known subsequently. In the beginning, it is an unknown factor and an estimate is made on the basis of past claims experience or empirical data about the longevity of human beings, accidents and their financial consequences.

Generally, the past claims experience is repeated with minor variations if a large number of risks are collected. This once again operates by the law of large numbers and is one reason why insurance companies want to do as much business as possible.



Caution The ultimate objective is to keep the insurance cost as low as possible.

7. **Insurance must not be confused with Charity or Gambling:** The uncertainty is changed into certainty by insuring property and life because the insurer promises to pay a definite sum at damage or death. In the absence of insurance, the property owner could at the best, practice only some form of self-insurance, which may not give him absolute certainty.

A family is protected against losses on death and damage with the help of insurance. From the point of view of an insurance company, the insurance contract is essentially non-speculative. In fact, no other business operates with greater certainties. From the insured's point of view, too, insurance is also not gambling. Failure of taking insurance, however, amounts to gambling because the uncertainty of loss is always looming on the head.

One could also say that the insurance is just the opposite of gambling. In gambling, by bidding, the person exposes himself to risk of losing, but the insured safeguards himself through insurance, and may suffer loss only if he is not insured.

Self Assessment

Fill in the blanks:

- The risk is evaluated on the basis of theory before insuring.
- In pure, payment is made only at the survival of the insured at the expiry of the period.
- The amount of loss at the time of contingency is in life insurance.

3.2 Functions of Insurance

In this section, we will discuss about the functions of insurance. The functions of insurance can be studied into two parts: (i) Primary Functions (ii) Secondary Functions.

3.2.1 Primary Functions

Following are the primary functions of insurance:

1. **Insurance provides certainty:** Insurance provides certainty of payment at the uncertainty of loss. The uncertainty of loss can be reduced by better planning and administration. But, the insurance relieves the person from such difficult task. Moreover, if the subject matters are not adequate, the self-provision may prove costlier. There are different types of uncertainty in a risk. The risk will occur or not, when will occur, how much loss will be there.

In other words, there are uncertainty of happening of time and amount of loss. Insurance removes all these uncertainty and the assured is given certainty of payment of loss. The insurer charges premium for providing the said certainty.

2. **Insurance provides protection:** The main function of the insurance is to provide protection against the probable chances of loss. The time and amount of loss are uncertain and at the happening of risk, the person will suffer loss in absence of insurance. The insurance guarantees the payment of loss and thus protects the assured from sufferings.



Caution The insurance cannot check the happening of risk but can provide for losses at the happening of the risk.

3. **Risk-Sharing:** The risk is uncertain, and therefore, the loss arising from the risk is also uncertain. When risk takes place, the loss is shared by all the persons who are exposed to the risk. The risk sharing in ancient time was done only at time of damage or death, but today, on the basis of probability of risk, the share is obtained from each and every insured in the shape of premium without which protection is not guaranteed by the insurer.

3.2.2 Secondary Functions

Besides the above primary functions, you need to know that the insurance works for the following functions:

1. **Prevention of loss:** The insurance joins hands with those institutions which are engaged in preventing the losses of the assured and so more saving is possible which will assist in reducing the premium. Lesser premium invites more business and more business cause lesser share to the assured. So again premium is reduced to, which will stimulate more business and more protection to the masses. Therefore, the insurance assist financially to the health organization, fire brigade, educational institution and other organizations which are engaged in preventing the losses of the masses from death or damage.
2. **It provides Capital:** The insurance provides capital to the society. The accumulated funds are invested in productive channel. The dearth of capital of the society is minimized to a greater extent with the help of investment of insurance. The industry, the business and the individual are benefited by the investment and loans of the insurers.
3. **It improves Efficiency:** The insurance eliminates worries and miseries of losses at death and destruction of property. The care-free person can devote his body and soul together for better achievement. It improves not only his efficiency, but the efficiencies of the masses are also advanced.

4. **It helps Economic Progress:** The insurance helps in economic progress by protecting the society from huge losses of damage, destruction and death. Provides an initiative to work hard for the betterment of the masses. The next factor of economic progress, the capital, is also immensely provided by the masses. The property, the valuable assets, men, machine & the society cannot lose much at the disaster.

Self Assessment

Fill in the blanks:

4. Insurance provides certainty of payment at the of loss.
5. The insurance the payment of loss and thus protects the assured from sufferings.
6. The insurance helps in progress by protecting the society from huge losses of damage, destruction and death.

3.3 Scope of Insurance

You must be aware that insurance is a protection against financial hammering arising on the happening of an unexpected event. Insurance policy helps in not only mitigating risks but also provides a financial militate against adverse financial loads suffered. Insurance is a contract between two parties, the insurer or the insurance company, and the insured, the person seeking the cover. Within this contract, the insurer agrees to pay the insurer for financial losses arising out of any unforeseen events or risk in return for a regular payment of premium. Therefore, these insurance plans are also called as a Risk Cover Plans, which means to financially compensate for losses that occur uncertainly through accident, illness, theft, natural disaster.

3.3.1 Insurance Scope in India

You must remember that insurance is a nice-looking option for investment but most people are not aware of its advantages as an investment option. Remember that foremost and first, insurance is about risk cover and protection. By buying life insurance, you buy peace of mind.



Notes Insurance also serves as an excellent tax saving mechanism.

The Government of India has provided tax incentives to life insurance products in order to facilitate the flow of funds into productive assets.

The insurance sector has opened up for private insurance companies with the enactment of IRDA Act, 1999. A large number of companies are competing under both general and life Insurance. The FDI cap/equity in this sector is 26% and the proposals have to be cleared by Insurance Regulatory and Development Authority (IRDA) established to protect the interest of holder of Insurance policy and act as a regulator and facilitator in the industry.

Some of the major players in this sector are LIC, Max New York Life Insurance, Bajaj Allianz, ICICI Prudential, HDFC Standard Life, Metlife Insurance, Birla Sun Life Insurance, etc.

Various types of instruments and policies are coming up in the market to attract more clients. Most of the population of India is not insured, hence there is a lot of scope in this sector and a number of companies are planning to enter the sector.

Notes



Caselet

Evaluate the Role of Investment-cum-Insurance Policies in Your Portfolio

Amruta Patel, a 45-year old professional, has realised that she owns too many insurance policies. When she bought them, they looked like the right way to save money and taxes. There was also the comfort of getting a periodic pay-out as bonus or as redemptions. However, now she is not sure what she should do going forward. How should Amruta go about her review?

Amruta must understand that insurance is primarily a protection against unexpected loss in the value of an asset or the income it can generate. The core insurance product that every investor should have is a term cover, which protects the income on which a family depends.

She may be one of the many insurance buyers who do not like insurance policies that do not make any pay-out. Insurance companies have therefore modified this basic product in several ways and structured products where some pay-out is made to the investor. In such products, the insurance and investment components can differ.

The simplest way to evaluate is to ask what she is paying and what she would get. If she is able to work out the return on her premium payments, treating them like an investment, she would know whether the return she is getting is worthwhile or not. If Amruta wants to invest in avenues where the money can be kept safe, she should consider investing in bank deposits, debt funds and bonds.

The amount of insurance a person needs is based on their value as a human asset and the value of other economic assets they like to protect. Amruta's evaluation of her insurance need should be based on this logic, and should be adjusted for other assets and wealth she may have already created.

Source: http://articles.economicstimes.indiatimes.com/2013-11-11/news/43930174_1_policies-structured-products-insurance-need

3.3.2 Scope of Insurance Professionals in India

You must be well aware that insurance is a booming sector in India. Its growth potential can be gauged by the fact that it has registered over 100 per cent growth in the past two years. And the scope remains phenomenal. For instance, barely 8 million people are presently covered under health insurance in the country. Even LIC's new business crossed ₹ 1,00,000 crore by the end of the third fiscal.

The 19 joint ventures between international giants and Indian companies that are presently operating in India have got an additional shot in the arm with the 49 per cent foreign direct investment or FDI provision in the recent budget. Several other global players are ready to jump on the bandwagon.

While the industry presently employs over 5 lakh people, the anticipated demand for insurance professionals is pegged at an additional ₹ 1 lakh in the next two years. Even a quarter of that is not to be scoffed at. Some head-hunters are already pitting the insurance industry against IT, in terms of sheer attractiveness and spread.

The insurance market is projected to hit \$ 25 bn by 2010. While that remains to be seen, one thing is for sure: the industry requires professionals in diverse disciplines such as marketing and

sales, distribution, operations, claims, financial experts specializing in investment, banking and mutual funds, accountants, business analysts, HR professionals, software programmers & analysts, technical and medical experts, agents, actuaries, valuers, underwriters, risk managers and surveyors, to name a few. While some of these, such as programmers, marketing and HR professionals are common to other industries, the rest are exclusive to the insurance sector.

Some key slots are traditional. New ones are those of actuaries, business development officers, business analysts, insurance agents, valuers, surveyors, underwriters, and even process associates for insurance underwriting, in the ITES sector such as in GE Capital, among others.

Self Assessment

Fill in the blanks:

7. Insurance is a between two parties, the insurer or the insurance company, and the insured, the person seeking the cover.
8. Insurance also serves as an excellent saving mechanism.
9. Most of the population of India is not, hence there is a lot of scope in this sector and a number of companies are planning to enter the sector.

3.4 Insurance, Gambling and Hedging

Following section will give you an insight on the difference between insurance, gambling and hedging:

3.4.1 Comparing Insurance & Gambling

You will find that insurance is often compared to betting or gambling, with insurers and bookmakers taking a similar position and applying probability theory in respectively setting rates and odds.

The underlying principles are the same. A bookmaker will convert prices or odds to percentages.



Example: In simplistic terms, taking a horse race, if the sum total of all the percentages is less than 100%, it means that a punter could back every horse in the race and make a profit – the bookmaker would lose. If however, as is customary, the sum total of all percentages is more than 100%, a bookmaker could lay every horse in the race and make a profit – the punter would lose. By virtue of the sum total of the percentages always being greater than 100%, overall, the bookmaker will win. Insurers benefit similarly from this pooling effect, and protect themselves against catastrophes or abnormal losses by arranging reinsurance.

Gambling transactions offer the possibility of either a loss or a gain. Gambling creates losers and winners. Insurance transactions do not present the possibility of gain. Insurance offers financial support sufficient to replace loss, not to create pure gain.



Did u know? The pooling effect means that some punters will win, some will lose.


Gamblers can continue spending, buying more risk than they can afford to pay for. Insurance buyers can only spend up to the limit of what carriers would accept to insure; their loss is limited to the amount of the premium.

Notes

Gamblers, by creating new risk transfer, are risk seekers. Insurance buyers are risk avoiders, creating risk transfer in terms of their need to reduce exposure to large losses.

Gambling or gaming is designed at the start so that the odds are not affected by the players' conduct or behaviour and not required to conduct risk mitigation practices. But players can prepare and increase their odds of winning in certain games such as poker or blackjack. In contrast to gambling or gaming, to obtain certain types of insurance, such as fire insurance, policyholders can be required to conduct risk mitigation practices, such as installing sprinklers and using fireproof building materials to reduce the odds of loss due to fire. In addition, after a proven loss, insurers specialise in providing rehabilitation to minimise the total loss.

Insurance, the avoiding, mitigating and transferring of risk, creates greater predictability for individuals and organisations.

 <i>Notes</i> Both gambling and insurance transfer risk and reward.

3.4.2 Insurance and Hedging Compared

In this section, we will compare and contrast between insurance and hedging. The concept of hedging refers to transferring the risk to the speculator through purchase of future contracts. An insurance contract, however, is not the same thing as hedging. Although both techniques are similar in that risk is transferred by a contract, and no new risk is created, there are some important differences between them.

First, an insurance transaction involves the transfer of insurable risks, because the requirement of an insurable risk generally can be met. However, hedging is a technique for handling risks that are typically uninsurable, such as protection against a decline in the price agriculture products and raw materials.

A second difference between insurance and hedging is that insurance and hedging is that insurance can reduce the objective risk of an insurer by application of the law of large numbers. As the number of exposure units increases, the insurer's prediction of future losses improves, because the relative variation of actual loss from expected loss will decline thus, many insurance transactions reduce objective risk.

In contract, hedging typically involves only risk transfer, not risk reduction .The risk of adverse price fluctuation is transferred because of superior knowledge of market conditions. The risk is transferred, not reduced, and prediction of loss generally is not based on the law of large numbers.

Self Assessment

Fill in the blanks:

10. Insurance buyers can only spend up to the limit of what carriers would accept to insure; their loss is limited to the amount of the
11. The concept of hedging is to transferring the risk to the speculator through purchase of contracts.
12. The risk of adverse price is transferred because of superior knowledge of market conditions.

3.5 Insurance and some Related Terms

You will be surprised to know that insurance is associated with the terms such as loss, chance of loss, peril, hazard and risk. These words take on particular meaning when used to describe insurance:

1. **Loss:** Loss is commonly used term which means being without something previously possessed. Insurable losses are categorized as direct or indirect losses. Direct losses are the immediate, or first, result of an insured peril. Indirect losses are a secondary result of an insured peril.



Example: If fire destroys a home, the loss of the home is the direct loss. The expenses of living in a hotel while the home is being rebuilt are an indirect loss.

There must be a direct loss before there can be an indirect loss.

2. **Chance of Loss:** The concept of chance of loss refers to a fraction. The numerator is either the actual or the expected number of losses; the denominator represents the number exposed to loss. The chance of loss is the probability of loss that creates the need for insurance.
3. **Peril and Hazard:** Peril is defined as the cause of the loss. Insurance policies provide financial protection against losses caused by perils. Insurers call policies that specifically identify a list of covered perils as specified perils contracts. Those not specified comes under open perils contract.

Hazards are conditions that increase the frequency or the severity of losses. If an individual causes or exaggerates a loss to collect insurance proceeds, this is insurance fraud, and the loss results from the moral hazard. If a person remains unnecessarily in a hospital to collect health insurance benefits rather than returning to work is a morale hazard. Morale hazard is responsible for the increased severity of the loss.



Task With the help of the internet, find out more terms related to insurance and prepare a chart.

Insurers try to eliminate the moral hazard and minimize morale hazard by carefully selecting the insurers and by including contractual provisions causing the insured to regret the loss, despite the insurance coverage.

4. **Risk:** Risk has been the subject of study by scholars for many centuries and a great deal of thought and effort has gone into defining the concept. It is defined as the variation in possible outcomes of an event based on chance. That is the greater the number of different outcomes that may occur the greater the risk. Another definition of risk is the uncertainty concerning a possible loss. This definition of risk helps to explain why people purchase insurance. The insurance company will pay for such uncertain losses.

Self Assessment

Fill in the blanks:

13. is commonly used term which means being without something previously possessed.

Notes

- 14. The concept of chance of loss refers to a
- 15. hazard is responsible for the increased severity of the loss.

3.6 Role of Insurance in Economic Development

You need to know that from its early inception as predominantly a maritime instrument until the present day, insurance has grown significantly in scope, purpose, and availability. Today the insurance industry contributes to economic growth and national prosperity in various ways. At the macro level, the industry helps strengthen the efficiency and resilience of the economy by facilitating the transfer of risk. At the micro level, it brings benefits in all areas of day-to-day life. Insurance helps individuals minimise the financial impact of unexpected and unwelcome future events, and help them organise their businesses and their lives with greater certainty. Risk-averse individuals are able to enjoy greater utility from their most important assets via the purchase of insurance products. Almost every conceivable asset or activity can be insured through familiar product types, such as motor, travel, and home content insurance, and by business through professional and product liability insurance, cover for business interruption, and many other contingencies.

As a vital tool for the management of risk by both individuals and organizations, whether private or public, insurance plays an important role in the economic, social, and political life of all countries. Quantifying the contribution of insurance to economic growth is, however, far from simple.



Did u know? One such attempt was made in 1990 by J. Francois Outreville, who investigated the economic significance of insurance in developing countries. By comparing 45 developed and developing countries, he was able to show that there is a positive but non-linear relationship between insurance premiums per capita and gross domestic product per capita, demonstrating that the development of insurance as a financial instrument clearly plays an important role in assisting a nation's economic growth.

An example of how insurance supports economic growth can be demonstrated by its impact on the private residential homes market. Without home insurance (i.e., structure and contents insurance), households would be unwilling to invest most of their wealth in a single property and would have to rent properties from commercial landlords. Hence, insurance enables members of the general public to be homeowners and supports the private housing market. It could even be argued, in fact, that insurance directly influenced the growth of democracy in the United Kingdom, since the vote was initially limited to homeowners.

Another illustration of how insurance supports risk taking and economic growth is that of the North Sea oil industry from the 1970s. The oil drilling platforms required to operate in the North Sea were not only extremely expensive to construct, but also had to work at depths and contend with conditions not previously experienced in the industry. The financial capacity of the London insurance market, and moreover its willingness to insure new and costly technologies, supported the successful development of the North Sea oil industry and the subsequent economic growth of several northern European countries.

The insurance industry also provides mechanisms that enable individuals to pool their savings to meet financial objectives, such as providing for retirement. Individuals benefit from economies of scale in accessing capital markets, reducing transaction and information costs, thereby improving the trade-off they face between risk and expected return. As a result, insurance companies are a key link in the investment chain that enables firms to finance investment and savers to smooth income over their lifetimes.



Caution The operation of the investment chain is critical to the efficient allocation of capital across the economy and therefore to improving productivity and competitiveness.

Today, in the rare instance in which commercial insurance is not available to business, alternative risk-sharing mechanisms soon arise to fill the gap. For example, in the mid-1980s, a crisis in the U.S. liability insurance market dramatically reduced the levels of cover available, particularly to large industrial companies, and a sharp increase in premium levels ensued. The response by the U.S. manufacturing industry was immediate, and new mutually owned insurance groups were quickly set up in Bermuda and other tax-haven countries to replace the missing insurance cover.

Self Assessment

Fill in the blanks:

16. Today the insurance industry contributes to economic growth and national in various ways.
17. Insurance enables members of the general public to be homeowners and supports the private market.
18. Individuals benefit from of scale in accessing capital markets.



Case Study

Reliance General Insurance to focus on fire, Engineering and Marine

Reliance General Insurance is focusing more on fire, engineering and marine insurance segments as part of its plan to diversify product basket and achieve profitable growth, a top company official said.

“We are focusing on commercial lines, fire, engineering and marine insurance, which are still untapped and more profitable than traditional segments. We are trying to grow these portfolios this fiscal,” Reliance General Insurance Chief Executive Rakesh Jain said.

As per the company, while fire insurance accounts for 8 per cent of its total business, engineering segment contributes around 4 per cent, marine 2 per cent and others including commercial lines account for 6 per cent.

Jain also said the company is reducing its dependence on motor insurance segment and plans to bring it down to below 60 per cent by the end of this financial year.

“Our aim is to expand our presence in fire and engineering segments and increase their business contributions in the next couple of years,” he said, adding the company plans to increase health insurance contribution to 20 per cent from present 16 per cent.

The general insurer also aims to come up with sector specific insurance products. “We are planning to devise sector-wise insurance schemes. We are in touch with people in cement, IT and power sectors and are working to create a more risk-based approach for different sectors,” Jain said.

Contd...

Notes

Reliance General, which is part of Reliance Capital, has posted 25 per cent increase in gross written premium to ₹ 706 crore in the June quarter.

Question

Discuss the widening scope of insurance in Reliance General Insurance.

Source: http://articles.economictimes.indiatimes.com/2013-08-30/news/41619016_1_reliance-general-insurance-fire-insurance-commercial-lines

3.7 Summary

- A group of persons who agree to share the financial loss may be brought together voluntarily or through publicity or through solicitations of the agents.
- The risk is evaluated on the basis of probability theory before insuring since the premium payable on a policy is to be determined. Probability theory is that body of knowledge, which is concerned with measuring the likelihood that something will happen and making estimates on the basis of this likelihood.
- The life insurance claim is a certainty, because the contingency of death or the expiry of term will certainly occur and the payment is certain.
- The amount of payment depends upon the value of loss suffered due to the happening of that particular insured risk, provided insurance is there up to that amount.
- The price of insurance is basically linked to the cost of claims, which is only known subsequently.
- Failure of taking insurance, however, amounts to gambling because the uncertainty of loss is always looming on the head. Insurance removes all these uncertainty and the assured is given certainty of payment of loss.
- The main function of the insurance is to provide protection against the probable chances of loss.
- The insurance assist financially to the health organization, fire brigade, educational institution and other organizations which are engaged in preventing the losses of the masses from death or damage.
- The insurance sector has opened up for private insurance companies with the enactment of IRDA Act, 1999. A large number of companies are competing under both general and life Insurance.
- Insurance buyers can only spend up to the limit of what carriers would accept to insure; their loss is limited to the amount of the premium.

3.8 Keywords

Chance of Loss: The concept of chance of loss refers to a fraction. The numerator is either the actual or the expected number of losses; the denominator represents the number exposed to loss.

Hazards: Hazards are conditions that increase the frequency or the severity of losses.

Hedging: The concept of hedging is refers to transferring the risk to the speculator through purchase of future contracts.

Loss: Loss is commonly used term which means being without something previously possessed.

Peril: Peril is defined as the cause of the loss.

Notes

Risk: It is defined as the variation in possible outcomes of an event based on chance.

3.9 Review Questions

1. "Insurance is a device to share the financial losses." Explain.
2. Discuss the nature of insurance.
3. Explain the primary functions of insurance.
4. "Lesser premium invites more business and more business cause lesser share to the assured". Discuss briefly.
5. How does insurance eliminate worries and miseries of losses?
6. What is the scope of insurance? Also, discuss the scope of insurance professionals in India.
7. Compare and contrast insurance, gambling and hedging with suitable examples.
8. Discuss the role of insurance in economic development.

Answers: Self Assessment

- | | |
|----------------|-----------------|
| 1. Probability | 2. Endowment |
| 3. Immaterial | 4. Uncertainty |
| 5. Guarantees | 6. Economic |
| 7. Contract | 8. Tax |
| 9. Insured | 10. Premium |
| 11. Future | 12. Fluctuation |
| 13. Loss | 14. Fraction |
| 15. Morale | 16. Prosperity |
| 17. Housing | 18. Economies |

3.10 Further Readings



Books

- Gulati, Neelam. C. (2011), *Banking and Insurance*, Excel Books.
- Gulati, Neelam. C. (2013), *Principles of Risk Management and Insurance*, Excel Books.
- Krishnaswamy, G. (2009), *Principles and Practice of Life Insurance*, Excel Books.
- Misra, M.N. and Mishra, S.B. (2009), *Insurance Principles and Practices*, S. Chand Publication.
- Sahoo and Das (2009), *Insurance Management: Text and Case*, Himalaya Publication.



Online links

- <http://insurancewindows.blogspot.in/2012/06/functions-of-insurance.html>
- <http://business.tm-india.com/insurance/>
- <http://support.sas.com/publishing/pubcat/chaps/62823.pdf>

Unit 4: Contract of Insurance

CONTENTS

Objectives

Introduction

- 4.1 Meaning of Insurance Contract
- 4.2 Types of Insurance Contract
 - 4.2.1 Life Insurance
 - 4.2.2 Types of Non-Life Insurance
- 4.3 Conditions Necessary for Contract
 - 4.3.1 Offer and Acceptance
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- 4.6 Summary
- 4.7 Keywords
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Objectives

After studying this unit, you will be able to:

- Explain the meaning of insurance contract
- Discuss the types of insurance contract
- Describe insurance documents
- Discuss partial insurance

Introduction

In the previous unit, you have studied about the nature and scope of insurance along with the various functions of insurance. You have learned about the difference between insurance, gambling and hedging. It also summarized some of the related terms of insurance such as risk, loss etc. The unit also explained about the role of insurance in the development of economy.

In this unit, you are going to study about the contract of insurance. Insurance is a contract. A contract of insurance is a contingent contract. The general principles of law of contract must be complied with for a contract of insurance to be valid. Contract of insurance comes into existence

where there is an offer (from the person facing the risk) and the underwriter or the insurer accepts it by issuing the policy. The contract of insurance (in order to be a valid contract) can be entered into only by person(s) competent to contract.

A contract of insurance other than life insurance contract is a contract of indemnity. The insurer undertakes to indemnify the insured for loss or damage arising as a result of risk specified. In case of life insurance, if a person dies the insurance company can only give a specified claim amount as compensation to the survivors; it cannot indemnify the loss of lost life as the person who is dead cannot be brought back.

In the next unit, you will study about the various principles of insurance such as principle of utmost good faith, principle of insurable interest, principle of indemnity, principle of contribution, principle of subrogation and principle of causa proxima (nearest cause).

4.1 Meaning of Insurance Contract

Let's discuss what exactly is meant by an insurance contract.

An insurance contract is whereby, for specified consideration, one party undertakes to compensate the other for a loss relating to a particular subject as a result of the occurrence of designated hazards.

The normal activities of daily life carry the risk of enormous financial loss. Many persons are willing to pay a small amount for protection against certain risks because that protection provides valuable peace of mind. The term insurance describes any measure taken for protection against risks. When insurance takes the form of a contract in an insurance policy, it is subject to requirements in statutes, administrative agency regulations, and court decisions.

In an insurance contract, one party, the insured, pays a specified amount of money, called a premium, to another party, the insurer. The insurer, in turn, agrees to compensate the insured for specific future losses. The losses covered are listed in the contract, and the contract is called a policy.

When an insured suffers a loss or damage that is covered in the policy, the insured can collect on the proceeds of the policy by filing a claim, or request for coverage, with the insurance company. The company then decides whether or not to pay the claim.



Notes The recipient of any proceeds from the policy is called the beneficiary. The beneficiary can be the insured person or other persons designated by the insured.

A contract is considered to be insurance if it distributes risk among a large number of persons through an enterprise that is engaged primarily in the business of insurance.



Example: Warranties or service contracts for merchandise do not constitute insurance. They are not issued by insurance companies, and the risk distribution in the transaction is incidental to the purchase of the merchandise. Warranties and service contracts are thus exempt from strict insurance laws and regulations.

The business of insurance is sustained by a complex system of risk analysis. Generally, this analysis involves anticipating the likelihood of a particular loss and charging enough in premiums to guarantee that insured losses can be paid. Insurance companies collect the premiums for a certain type of insurance policy and use them to pay the few individuals who suffer losses that are insured by that type of policy.

Notes

Self Assessment

Fill in the blanks:

1. The term describes any measure taken for protection against risks.
2. The insurer agrees to compensate the for specific future losses.
3. The business of insurance is sustained by a complex system of
4. A contract is considered to be insurance if it distributes risk among a large number of persons through an enterprise that is engaged primarily in the business of

4.2 Types of Insurance Contract

Let's discuss about the various types of insurance contract. Insurance contracts can be broadly classified into life insurance contract and non-life insurance contracts:

4.2.1 Life Insurance

You must be aware that life insurance is insurance of human life and is a long-term business while general insurance is an annual business with some exceptions. General insurance covers all other categories of insurance other than life. In some cases like engineering (general insurance), the policy period for dwellings and contents is more than one year.



Caution Under the IRDA Act, 1999, life and non-life business have to be done under separate companies. A company is not allowed to do both businesses simultaneously.

Types of Life Insurance

Life insurance includes ordinary life, annuities and pensions. The risks of death due to any reason both natural and unnatural are covered during the policy period. There are two main life insurance products namely, term insurance and pure endowment. All other policies are variations of these two basic policies. Term insurance is insurance taken for a particular period. If death takes place during the term, the claim is paid. If death does not take place, nothing is paid to the insured.

In India, most of the products are endowment-type where the savings component is predominant. Under this, every policy will result in a claim either by maturity or by death claims. If death does not occur, the policy expires on a specified date, i.e., date of maturity. Premium, rates are based on three variables – mortality rate, interest rate and expenses. Interest earned on premiums help to reduce the periodical premium, which is normally the same during the insurance period and is known as level premium.

Since these policies are long-term; as long as for 15, 20 or 25 years, the premium amounts are invested by the insurance company in the long-term income yielding securities as per the IRDA regulations. Claims settlement is easy in case of these policies since they are only benefit policies and not indemnity policies. In case of maturity and instalment claims, the person insured collects the claim. Otherwise if he/she is no more, the assignees/nominees collect the claim amount.

Several options like different types of accident benefits, coverage for major illnesses, payment in instalments for specific needs like children's education and last survivor benefits are also available.



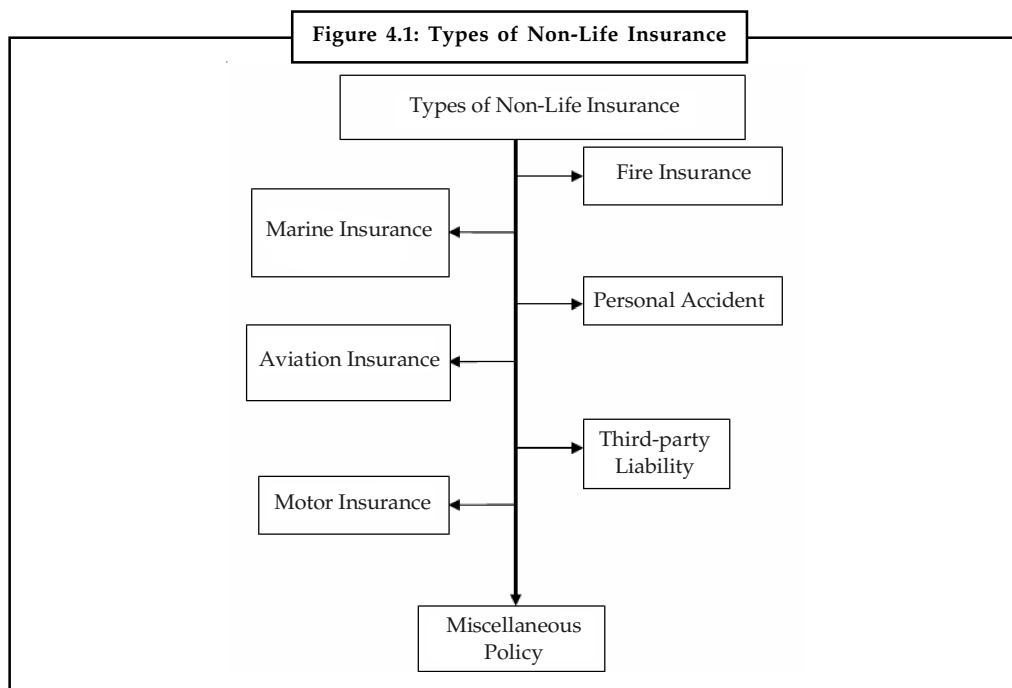
Notes The major goal of insurance business is earning the maximum income out of the life fund and matching the assets with liabilities.

The surplus as stated above is distributed among the policyholders in form of bonus or in case of some policies may be offered as a reduction to the premium payable.

Group Insurance: Group insurance is nothing but insuring a group of individuals together. This may be done due to their working in specific group, e.g., being partners, being employees of same organization or being members of a particular organization formed for a specific purpose. These products are similar to individual policies but are managed differently.

4.2.2 Types of Non-Life Insurance

As you can see in the figure below, there are various types of non-life insurance.



In non-life insurance category, the following types of insurance exists:

1. **Marine Insurance:** It covers cargo, hull and freight, both ocean and inland transits. Even oil rigs and drilling platforms are covered under this category.
2. **Fire Insurance:** It covers the movable and immovable assets against fire and allied perils. Business stoppage due to occurrence of the peril and consequential loss of profit policies are issued in this category and a number of add-on perils are covered in this insurance e.g. engineering machinery breakdown, loss of profits and project insurance, liability including employer's liability, Workmen's Compensation Act policy, public liability, product and professional indemnity policy are a few examples.

Notes

3. **Aviation Insurance:** It covers the cargo and passengers liability travelling by air.
4. **Personal Accident:** It includes health and overseas Medical insurance.
5. **Motor Insurance:** It covers the private and commercial vehicles against damages and destruction.
6. **Third Party Liability:** It is insurance of third party against suffering caused to them due to mistakes of person driving the vehicle. This insurance is compulsorily provided with other kind of insurances related to vehicles to safeguard the interest of people on road.
7. **Miscellaneous Policies:** These policies include insurance like plate glass, burglary, cash in transit, fidelity guarantee, etc.

Some non-life insurance policies issued in modern times are as follows:

1. **Property Insurance:** Fire, theft, engineering and miscellaneous accidents.
2. **Personal Insurance:** Personal accident, health insurance.
3. **Motor/Vehicle Insurance:** All types.
4. **Liability Insurance:** All types – public, product, professional and employers.
5. **Pecuniary Insurance:** Fidelity guarantee, credit insurance.
6. **Interruption Insurance:** Arising out of fire and engineering risks.
7. **Rural Insurance:** Non-traditional policies.

General insurance contracts are yearly contracts and are based on the indemnity principle. This makes a difference in the premium rating, which is also complicated as more variables are taken into account than in life insurance. In general insurance also, some policies insuring the life and health of person are issued but they are all annual contracts. They are benefit policies unlike other general insurance products, which are based on indemnity.

The reason for general insurance contracts being annual is that the subject matter insured, is subject to change. It may undergo visible wear and tear and may depreciate, even may suffer from loss of value, become obsolete, out-of-fashion or difficult to service, etc. So the calculations are preferably on annual basis. This makes the contract easier to make and to implement.



Caution In case of general insurance is that the premium paid gets expired once the year has passed. Meaning that there is no return of the premium or a part thereof if the peril insured against does not occur. No damages, no claim. This is reverse to life insurance where the claim is paid on maturity if death does not occur within the policy period.

Other Classifications of Insurance

You need to know that there are various insurance policies cover a wide variety of approaches to share and transfer risks. Types of insurance can be divided and subdivided according to the perils insured against a particular event. It can be broadly divided into personal insurance, property insurance, liability insurance, casualty insurance, marine insurance, aviation and motor coverage.

Personal Insurance: The risk of individuals and families are covered under personal insurance. Examples are life insurance, pensions, accidents, sickness, old age coverage, etc. Personal insurance is designed to protect against two distinct risks—premature death and living too long. People

are worried about these two aspects. If one dies pre-maturely, who will take care of the dependents? If a person lives longer than his working age then who will support him? These problems are solved by various policies offered under the head of personal insurance. Life insurance, endowments and annuities protect the individual and his or her dependents against the undesirable financial consequences of premature death and superannuation.

A pension fund provides regular income to the individual after his retirement. A fund which covers the loss of income from unemployment after accident and sickness is defined as "insurance against loss by sickness or accidental body injury". The loss incurred may be the loss of income caused by sickness, accident or the expenses towards doctor's bills, medicines, etc. Insurance provides lump sum or periodic payments in the event of loss occasioned by sickness or accident.

Property Insurance: As the name suggests, this type of insurance covers the risk of loss of property. It is designed to protect against losses resulting from damage to or loss of property and losses arising from legal liability arising by use of vehicle/asset. It is distinguished from personal insurance in the sense that while personal insurance covers perils that may prevent one from earning money which can be used to accumulate property in the future, property insurance covers property which is already accumulated.



Did u know? Property insurance includes fire insurance, marine insurance, liability insurance, causality insurance and surety insurance. These are termed in India as general insurance.

Fire Insurance: Fire Insurance covers are designed to indemnify the insured for loss of or damage to furniture, fixtures, buildings and other personal property as a result of fire, explosion, lighting, windstorm, etc. Originally only fire was an insured peril, but the numbers of perils insured against are gradually being expanded over the years. Nowadays, two basic covers are considered with respect to perils. First coverage is called peril coverage. Under peril coverage, some specific coverage is listed in the policy and the coverage applies only to damage arising out of listed perils.

The second coverage is the open coverage. In this coverage, perils for which coverage is not provided are specified, rest all are covered. Therefore, the loss from any peril, not mentioned in the policy is covered. Coverage may be provided for both direct and indirect loss.

Marine Insurance: Marine insurance, indemnifies the financial loss resulting from damage to property due to the perils that are primarily those associated with water transportation. Marine insurance is divided into ocean marine insurance and inland marine insurance.

- **Ocean Marine Insurance:** It is designed to protect all types of ocean going ships and vessels, but cargo is covered by insurance only after it is loaded on the ship. Nowadays, policies are designed in such a way that they cover the cargo from "warehouse to warehouse", i.e., they protect the risk on land as well as during ocean transportation.
- **Inland Marine Insurance:** It covers the goods being transported by different types of carriers like trains, trucks, ships or barges on the inland waterways.

This insurance extends cover to wide areas of transportation and communication such as bridges, tunnels, power transmission lines and radio and television and communication equipment. Hence, it is widely used to cover different types of in-transit property.

Liability Insurance: Liability insurance may cover a wide range of risks arising under various branches of motor, marine and aviation insurances and also under the liability of employers and public ownership of property, manufacturing and construction operations, the sale and distribution of products and many other exposures.

Notes



Example: When an employer is liable to pay damage to an injured employee or a dependent of the injured employee, he can claim the employers' liability insurance policy. This will provide for the employees consultation with the doctors and lawyers fees, etc. This insurance is taken to cover the financial loss of the employer brought about by paying the injured employee. This type of insurance is compulsory for all employers so that the insured employee gets compensation in the event of an injury.

Fidelity Insurance: This is a special type of risk transfer device. Fidelity guarantee covers the risk of the employers in the event of fraud by an employee. This risk arises due to the dishonesty of employees who hold a position of trust. This policy covers loss caused by employees in the business.

Casualty Insurance: This is a residual class of insurance mainly related to health, accident, liability insurance, automobile insurance, workers compensation insurance, burglary robbery and the insurance credit insurance, etc. Some of the types of casualty insurance are discussed below:

Automobile Insurance: This covers the values types of losses like ownership, liability losses, medical expense losses due to accident, etc. It also covers damage of property due to accident and theft.

Workmen's Compensation Insurance: The Indian Workmen's Compensation Act 1923 provides for the payment of compensation by the employer to his employees (for their dependents in the event of fatal accidents) if personal injury is caused to them by accidents arising out of and in the course of their employment. The maximum compensation payable is as per the scale given by Workmen's Compensation Amendment Act 2000. This covers the losses incurred by employers in the business due to accident or injury of employees.

Liability Insurance: This covers a wide range of losses or hazards. It covers automobile and non-automobile liability. Examples of non-automobile liability are ownership of property, manufacturing and construction operations, sale and distribution of products, etc.

Burglary, Robbery and Theft Insurance: These products cover the losses arising from the criminal acts of others. If employees commit such act the loss is covered by fidelity bond, whereas burglary, robbery and theft insurance cover the loss of property from criminal act of those other than the employees of the business.

Credit Insurance: This is a special type of coverage offered to the manufacturers of wholesalers against their losses resulting from the inability to collect their dues from the debtors or customers. This type of insurance protects the loss of bad debts of the insured person.

Health and Accident Insurance: This protects the insured against loss due to sickness or injury. It covers the loss of remunerations caused by sickness or medical expenses resulting from injury of the insured person.



Caselet

Govt. brings more area under Insurance

The state government has extended the insurance coverage areas for pilgrims during the Rath Yatra festivity in Puri. The state-run Jagannath temple administration has insured the ring road around the 12th century shrine and all streets connecting to the Grand Road for a fortnight, to help pilgrims get insurance in case of death.

Contd...

Notes

The insurance coverage period started from Friday and will end on July 14, public relations officer of Jagannath temple, Laxmidhar Pujapanda said. "The insurance period included the nine-day Rath Yatra festival and Niladri Bije that is on July 14," Pujapanda said.

Kins of those, who die at the insured locations during the fortnight, are eligible for ₹ one lakh from the temple. Earlier the Jagannath temple had insurance coverage facility on the three-km Grand Road alone. Moreover, pilgrims were insured inside the Jagannath temple few years ago. "While insurance coverage is available round the year inside the temple premises, the facility is given on Grand Road during Rath Yatra only," Pujapanda said.

The government had introduced insurance benefit inside the shrine and on the Grand Road following a stampede near the sanctum sanctorum in 2006. Four pilgrims were trampled to death during the month of Kartika. The temple insured the by-lanes connecting to Grand Road after a woman died in a stampede near Dolabedi Kona (a narrow lane) on Rath Yatra last year.

Sources said the temple has so far disbursed insurance to six pilgrims, who died in a stampede in front of chariots on Rath Yatra day in 2008.

Source: http://articles.timesofindia.indiatimes.com/2011-07-01/bhubaneswar/29730923_1_jagannath-temple-12th-century-shrine-rath-yatra

Self Assessment

Fill in the blanks:

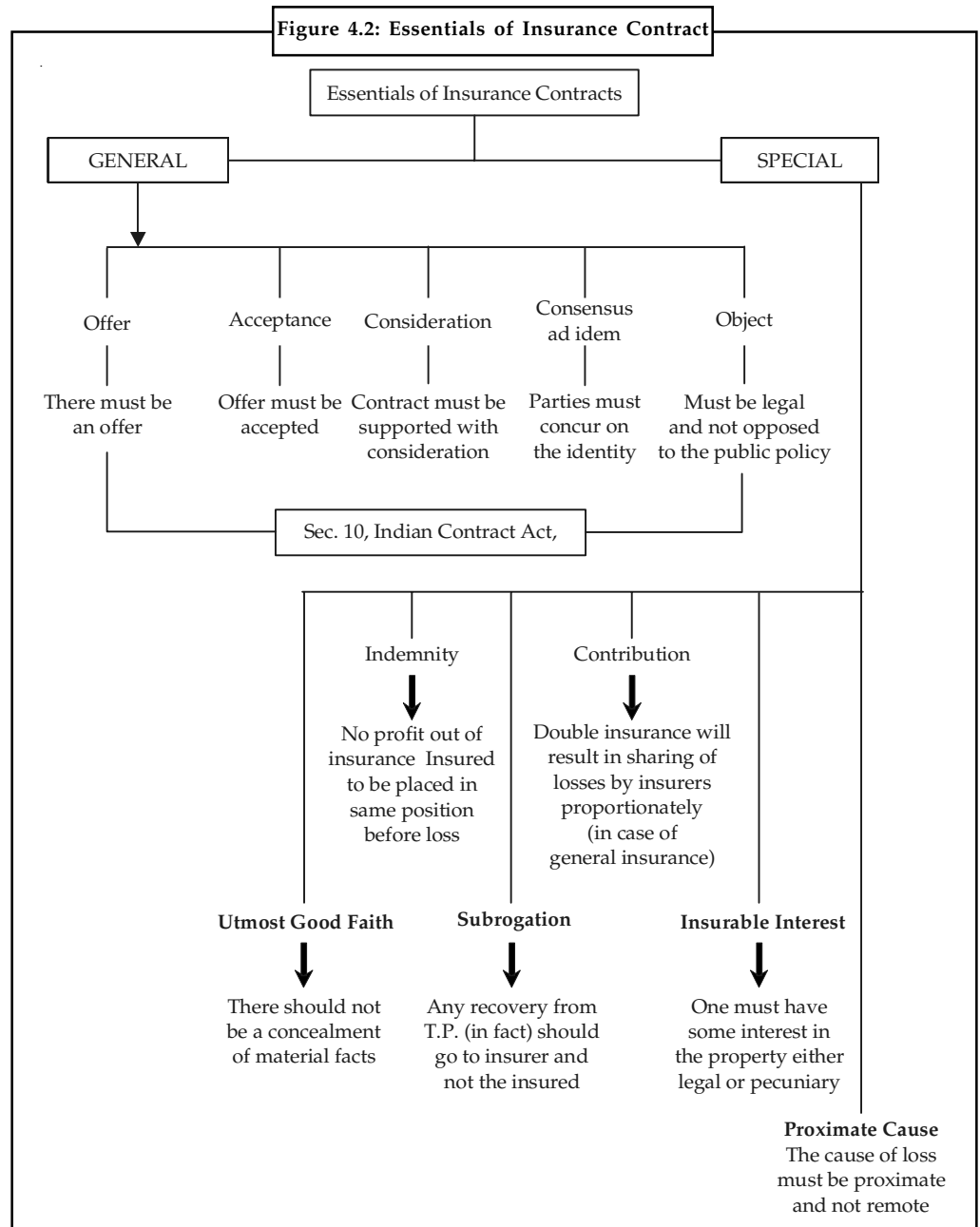
5. General insurance covers all other categories of insurance other than
6. insurance is insurance taken for a particular period.
7. General insurance contracts are yearly contracts and are based on the principle.
8. Marine insurance is divided into marine insurance and marine insurance.
9. Fidelity guarantee covers the risk of the employers in the event of by an employee.

4.3 Conditions Necessary for Contract

You need to know that Section 10 of the Indian Contract Act, 1872 says a contract to be valid must have the following elements:

1. Agreement (offer and acceptance).
2. Legal consideration
3. Parties must be competent to contract
4. Free consent
5. Legal object.

Notes



Is Insurance a Contract?

The contract of insurance is a legal agreement between two or more parties and has to comply with the provisions of the Indian Contract Act, 1872.

Insurance can be defined as “a contract between an insurer and insured, in consideration of a sum to make good the financial loss of the insured, subject to limit of the insured property by specified perils insured against and during the stated time period”. All insurance contracts must have the above five essential elements in order to be enforceable at law:

4.3.1 Offer and Acceptance

Notes

Just remember, the person who wants to take cover against particular perils offers his risk through a proposal form to the insurance company. Insurance company may or may not accept the risk. Thus, offer for entering into contract may generally come from the insured. The insurer may also propose to make the contract but whether the offer comes from insurer or insured, the main fact is acceptance.



Did u know? Any act that precedes an acceptance is an offer or a counter-offer. All that precedes the offer or counter-offer is an invitation to offer. In insurance, the publication of prospectus, the canvassing of agents are invitations to offer to the public.

When the prospect (the potential policy-holder) proposes to enter the contract of insurance, it is an offer and if there is any alteration in the offer (suggested by either party) that would be a counter-offer.

If this alteration or change (counter-offer) is accepted by the proposer; it would be an acceptance. Immediately the notice of acceptance is given to other party and it would become a valid acceptance.

4.3.2 Legal Consideration

You must remember that the promisor (insurer) promises to pay a fixed sum at a given contingency. So the insurer must have some return/consideration for his promise. The premium paid is the consideration and on receipt of the premium by the insurance company, the contract comes into force.

Hence, premium being the valuable consideration must be given for starting the insurance contract. The fact is that without payment of premium, the insurance contract will not come into force.

4.3.3 Parties Competent to Contract

You will find it interesting to note that both the parties must be legally competent to enter into an agreement. An agreement with a mentally unsound person does not form a valid contract. So also an agreement with a minor, insolvent and foreigner is not a valid contract.

Every person is competent to contract:

- Who has attained the age of majority according to the law
- Who is of a sound mind
- Who is not disqualified from contracting by any law to which he is subject to

A minor is not competent to contract. A contract by a minor is void excepting contracts for necessities. A person is said to be of sound mind for the purpose of making a contract if at the time when he makes it, he is capable of understanding it and of forming a rational judgment as to its effect upon his interest. An alien enemy, an insolvent and criminals cannot enter into contract. Thus contract made by incompetent party/parties will be void.

4.3.4 Free Consent

You should remember that there should be a complete and unbiased agreement between the insurer and insured regarding the terms of contract. The intention of the insured and insurer

Notes

should be clearly understood by each of them. Parties entering into the contract should enter into it by their free consent. The consent will be free when it is not caused by any of these:

- Coercion
- Undue influence
- Fraud
- Misrepresentation
- Mistake.

When free consent is not there, the contract becomes voidable at the option of the party whose consent was not free. In case of fraud, the contract would be void.

4.3.5 Legal Object

You must note that the purpose for which the agreement is entered into should not be illegal. It should not be against the public policy, e.g., insuring contraband goods, insuring dacoits and smugglers.

To make a valid contract, the object of the agreement should be lawful.

An object that is

- Not forbidden by law, or
- Not immoral, or
- This does not defeat the provisions of any law.

If the object of Insurance like the consideration is found to be unlawful, the policy is void.

Self Assessment

Fill in the blanks:

10. An agreement with a mentally person does not form a valid contract.
11. A contract by a is void excepting contracts for necessities.
12. When free consent is not there, the contract becomes at the option of the party whose consent was not free.

4.4 Insurance Documents

You must be aware that there are various insurance documents used for different types of insurance, which are essential for all classes of insurance business. The object of insurance documents is given to the insurer full particulars of the risk against which insurance protection is desired. It also provides evidence of contract into which the parties have entered.

Proposal Form

The company's printed proposal form is normally used for making an application for the required insurance cover. The proposal form contains questions designed to elicit all material information about the particular risk proposed for insurance. The number and nature of questions vary according to the particular class of insurance covered.

Notes

In Marine Cargo Insurance, Insurance document is not the practice to use a proposal form, although sometimes it is usual to obtain a questionnaire or a declaration form duly completed. Proposal forms are used for hull insurance.

In Fire Insurance, the practice varies among the companies, proposal forms are not generally used for large industrial risks where inspection of the risk is arranged before acceptance of the risk. Forms are used for simple risks. Proposal forms are used in respect of risks which are normally declined but have to be accommodated to retain the goodwill of the client.

In Miscellaneous Insurance, proposal forms are invariably required and they incorporate a declaration which extends the common law duty of good faith. Fire proposal forms may or may not have the declarations. The following items may be considered as common to all proposal forms.

1. Proposer's name in full
2. Proposer's address
3. Proposer's profession, occupation or business
4. Previous and present insurance
5. Loss experience
6. Sum insured
7. Other Sections – Signature, date, place, etc.

Policy Form

Policy forms, like proposal forms, vary within wide limits as between different classes of insurance but they have certain features in common. The policy is a document which provides evidence of the contract of insurance. This document has to be stamped in accordance with provisions of the Indian Stamp Act 1899. Where the insurance is governed by a Tariff or a market agreement, the policy wording is prescribed therein and it is obligatory for insurers to use these wordings. In fire and miscellaneous insurance, the policy form used is on a scheduled basis i.e. all individual details relating to a particular insurance are grouped together in a schedule. Generally speaking policies are divisible into certain well defined sections and these are as follows:

1. Recital Clause or Preamble
2. Operative Clause
3. Attestation Clause
4. Conditions
5. Schedule

Cover Notes

A cover note is a document issued in advance of the policy. It is issued when the policy cannot for some reason or the other, be issued straight away. Cover notes are issued when the negotiations for insurance are in progress and it is necessary to provide cover on a provisional basis or when the premises are being inspected for determining the actual rate applicable. Pending the preparation of the policy, the cover note is issued as evidence of protection for a temporary period of time and to prove that cover is in force. Here is a brief detail of cover.

Notes

In Marine Insurance, marine cover notes are normally issued when details required for the issue of policy such as name of the steamer, number of packages or exact value etc. are not known. In Fire Insurance, the operative clause of a fire cover note is issued in consideration of the proposer named in the schedule having proposed the effect of an insurance against fire for the period mentioned, on the usual terms and conditions of the company's policy. In Motor Vehicle Insurance, motor cover notes are to be issued in the form prescribed by the Motor Tariff.

Certificate of Insurance

A certificate of insurance is a document that is issued by an insurance company, at the request and on behalf of, an insured policyholder. The document serves as proof of insurance coverage to persons, companies or organizations that request the certificate. Generally speaking, there are three major types of certificates of insurance.

Certificate of Car Insurance

A certificate of car insurance may be in the form of an insurance identification card (such as the one you are required to keep in your vehicle) or the document may actually be full sized form that has been issued by the car insurance company at the request of the policy holder for a specific purpose.

A certificate of car insurance may be requested by a bank or lender that financed the purchase of a vehicle in some circumstances. For example, when financing a vehicle, the lender will usually require that full coverage insurance be maintained on the vehicle until the loan has been completely paid off. In addition, the lender will usually be required that it be named an additional insured party on the policy so that they can be paid in the event the vehicle is totalled in an accident.

If the lender ever has reason to suspect that you are not maintaining adequate insurance coverage, the company may request a certificate of car insurance. Most of the time, if the lender requests a certificate of car insurance, it will not accept the insurance ID card carried inside the vehicle and will require a signed document from the agent or insurance company.

Certificate of Liability Insurance

There are many situations when one or both companies involved in a business transaction or relationship will require a certificate of liability insurance. For example, if you own a business and need to lease a building or space from a landlord or rental management company, the renter of the property may require that you supply them with a certificate of liability insurance. The landlord or renter of the property may require this in order to be assured that they are protected from liability in the event someone is injured while at your place of business.

Other times a certificate of liability insurance may be required when contractors or vendors need to visit a client location and perform certain types of work. Many times the client organization purchasing goods or services from the contractor or vendor will require a certificate of insurance. This is due help protect the client organization in the event that the contractor vendor causes damage or injury while on the premises of the client. It also helps to ensure that property of the client is protected in the event it is damaged by the contractor vendor while working at the client site.

Certificate of Workers Compensation Insurance

For many types of construction jobs or other large projects, there is usually a project management company or general contractor responsible for the overall completion of the project. Most the

time, companies responsible for the completion of the project will use contractors or vendors to perform certain aspects of the work.

Because most states require that many businesses maintain some sort of workers compensation insurance for employees, general contractors or project management companies may require certificates of workers compensation insurance from subcontractors and vendors working on the project. They will require this in order to protect themselves from liability in the event a subcontractor or vendor employee is injured while on the job.



Task Prepare a pro-forma of certificate of insurance.

Endorsements

It is the practice of insurers to issue policies in a standard form, covering certain perils and excluding certain others. If it is intended, at the time of issuing the policy to modify the terms and conditions of the policy, it is done by setting out the alteration in a memorandum which is attached to the policy and forms part of it. The memorandum is called an endorsement.

Self Assessment

Fill in the blanks:

13. Proposal forms are used for insurance.
14. The policy is a document which provides of the content of insurance.

4.5 Partial Insurance

Let's find out what exactly is meant by partial insurance. Partial insurance can refer to any type of insurance that omits certain risks or only covers costs in specific circumstances. In more common use, partial insurance refers to incomplete health insurance coverage. Partial insurance in the field of health leaves patients unable to file claims for certain types of care despite having coverage in other areas. Health care analysts and professionals discuss partial insurance along with the uninsured when advocating health insurance policy changes.

Patients may have partial insurance for one of two reasons. The first reason is cost, as when a given patient can only afford partial insurance, or was uninsured and qualifies for subsidized or free insurance that only offers partial coverage. The other reason for partial insurance is because a patient chooses to fracture risk with more than one insurance policy. Each policy offers partial coverage, but together they provide more comprehensive coverage.



Example: In a country with a national health plan, a resident may choose to purchase private partial health insurance to add coverage in one or more areas where public health insurance is lacking.

Partial insurance has a number of effects throughout the health care field. For patients, it makes certain types of care, or venues for care, more affordable than others.



Example: Patients who don't have standard health insurance policies can still seek care in emergency rooms, where government and health care provider subsidies may cover the cost

Notes

of care, creating a form of de facto partial insurance. This means fewer uninsured patients have reasons to seek insurance or see doctors regularly, leading to emergency room overcrowding and late treatment for medical conditions.

Health care policymakers need to consider the impact of partial insurance. Hospitals and doctors' offices make treatment decisions based in part on what types of insurance patients have, which can conflict with the best medical practices. Federal health care reform legislation from 2010, which goes into full effect in 2014, seeks to address partial insurance by making comprehensive policies mandatory and more affordable.

Self Assessment

Fill in the blanks:

- 15. Partial insurance refers to health insurance coverage.
- 16. Health care analysts and professionals discuss partial insurance along with the when advocating health insurance policy changes.



Case Study

Future Generali insures Falguni Pathak's Garba

MUMBAI: Future Generali has bagged the deal to insure dandiya queen Falguni Pathak's prestigious garba event at Ghatkopar this year. The nine-day festival of Navratri begins Saturday, October 5.

This year Falguni's Ta Thaiya group will perform at the Mangal Navratri 2013 at the police parade grounds from October 5-13. The event is organised by Mangal Entertainment Pvt Ltd.

Falguni's event has been covered for cancellation due to various perils including terrorism and non-appearance of artistes owing to accident or critical illness.

Future Generali has also insured the rival Ghatkopar Samaj's Versatile Navratri 2013 to be held at Somaiya Grounds in Ghatkopar east.

The company did not divulge details of total cover or premium paid but said that normally event insurance rates range from 0.30% to 0.65% or more, depending upon location, type of event and coverage required. Easwara Narayanan, chief operating officer, Future Generali India, said, "Festivals like Ganesh Chaturthi and Navratri are assuming a grand scale owing to large pandals and celebrity performances. The risk perspectives are too vast to be ignored from an insurance viewpoint, and the organisers understand this as well."

Future Generali offers insurance for films, television serials and live events across India.

Question

Examine the presence of elements of contract of insurance in the above mentioned case.

Source: http://articles.timesofindia.indiatimes.com/2013-10-05/india-business/42745604_1_falguni-pathak-future-general-India-garba

4.6 Summary

- In an insurance contract, one party, the insured, pays a specified amount of money, called a premium, to another party, the insurer. The insurer, in turn, agrees to compensate the insured for specific future losses.

- The business of insurance is sustained by a complex system of risk analysis.
- Life insurance is insurance of human life and is a long-term business while general insurance is an annual business with some exceptions.
- Various insurance policies cover a wide variety of approaches to share and transfer risks.
- Liability insurance may cover a wide range of risks arising under various branches of motor, marine and aviation insurances and also under the liability of employers and public ownership of property, manufacturing and construction operations, the sale and distribution of products and many other exposures.
- When the prospect proposes to enter the contract of insurance, it is an offer and if there is any alteration in the offer that would be a counter-offer.
- A person is said to be of sound mind for the purpose of making a contract if at the time when he makes it, he is capable of understanding it and of forming a rational judgment as to its effect upon his interest.
- The company's printed proposal form is normally used for making an application for the required insurance cover.
- Policy forms, like proposal forms, vary within wide limits as between different classes of insurance but they have certain features in common. The policy is a document which provides evidence of the contract of insurance.
- Cover notes are issued when the negotiations for insurance are in progress and it is necessary to provide cover on a provisional basis or when the premises are being inspected for determining the actual rate applicable.
- A certificate of car insurance may be requested by a bank or lender that financed the purchase of a vehicle in some circumstances.
- Partial insurance in the field of health leaves patients unable to file claims for certain types of care despite having coverage in other areas.

4.7 Keywords

Certificate of Insurance: A certificate of insurance is a document that is issued by an insurance company, at the request and on behalf of, an insured policyholder.

Cover Notes: A cover note is a document issued in advance of the policy. It is issued when the policy cannot for some reason or the other, be issued straight away.

Group Insurance: Group insurance is nothing but insuring a group of individuals together.

Insurance Contract: An insurance contract is whereby, for specified consideration, one party undertakes to compensate the other for a loss relating to a particular subject as a result of the occurrence of designated hazards.

Life Insurance: Life insurance is insurance of human life and is a long-term business while general insurance is an annual business with some exceptions.

Marine insurance: Marine insurance, indemnifies the financial loss resulting from damage to property due to the perils that are primarily those associated with water transportation.

Partial insurance: Partial insurance can refer to any type of insurance that omits certain risks or only covers costs in specific circumstances.

Policy Form: The policy is a document which provides evidence of the contract of insurance. This document has to be stamped in accordance with provisions of the Indian Stamp Act 1899.

Notes

4.8 Review Questions

1. Is insurance a contract? Explain in detail.
2. Define life insurance.
3. What are the different types of life insurance?
4. What are the different types of non-life insurance?
5. Briefly explain the other classifications of insurance.
6. What is proposal form? Explain the purpose of proposal form.
7. Briefly discuss policy form and cover notes.
8. What is certificate of insurance? Explain the major types of certificates of insurance.

Answers: Self Assessment

- | | |
|------------------|------------------|
| 1. Insurance | 2. Insured |
| 3. Risk analysis | 4. Insurance |
| 5. Life | 6. Term |
| 7. Indemnity | 8. Ocean, inland |
| 9. Fraud | 10. Unsound |
| 11. Minor | 12. Voidable |
| 13. Hull | 14. Evidence |
| 15. Incomplete | 16. Uninsured |

4.9 Further Readings



Books

- Gulati, Neelam. C. (2011), *Banking and Insurance*, Excel Books.
- Gulati, Neelam. C. (2013), *Principles of Risk Management and Insurance*, Excel Books.
- Krishnaswamy, G. (2009), *Principles and Practice of Life Insurance*, Excel Books.
- Misra, M.N. and Mishra, S.B. (2009), *Insurance Principles and Practices*, S. Chand Publication.
- Sahoo and Das (2009), *Insurance Management: Text and Case*, Himalaya Publication.



Online link

<http://onlinemoneymaking-bna.blogspot.in/2009/08/insurance-documents.html>

Unit 5: Principles of Insurance

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Objectives

After studying this unit, you will be able to:

- Explain the principle of utmost good faith
- Discuss the principle of insurable interest
- Describe the principle of indemnity
- Define the principle of subrogation
- Explain the principle of contribution
- Describe the principle of causa proxima (nearest cause)

Introduction

In this unit, we will cover various aspect of General Insurance such as Principles of Utmost Good Faith material fact, Principle of Insurable Interest and Principle of Indemnity.

Notes

General Insurance comprises insurance of property against fire, burglary etc., personal insurance such as Accident and Health Insurance, and liability insurance which covers legal liabilities. Suitable general Insurance covers are necessary for every family. It is important to protect one's property, which one might have acquired from one's hard earned income. Losses created to catastrophes such as the tsunami, earthquakes, cyclones etc. have left many homeless and penniless. Such losses can be devastating but insurance could help mitigate them. Property can be covered, so also the people against Personal Accident. A Health Insurance policy can provide financial relief to a person undergoing medical treatment whether due to a disease or an injury.

In the next unit, you will study about the Insurance Act, 1938 such as various definitions contained in it and the main provisions of the Act. It will also deal with registration of principal agents, chief agents and special agents, regulation of employment of principal agents as well as renewal of registration and capital requirements.

5.1 Principles of Utmost Good Faith

You need to know that both the parties to a commercial contract are by law required to observe good faith. Let us say that you go to a shop to buy an electrical appliance. You simply will not enter, pay and pick up any sample piece but will check two, three or even more pieces. You may be even ask the shopkeeper to give a demonstration to ensure that it is in working condition and also ask several questions to satisfy yourself about what you are buying. Then when you go home you find it does not work or is not what you were looking for exactly so you decide to return the item but the shopkeeper may well refuse to take it back saying that before purchasing you had satisfied yourself; and he is possibly right.

The common law principle "Caveat Emptor" or let the buyer beware is applicable to commercial contracts and the buyer must satisfy himself that the contract is good because he has no legal redress later on if he has made a bad bargain. The seller cannot misrepresent the item he has sold or deceive the buyer by giving wrong or misleading information but he is under no obligation to disclose all the information to the buyer and only selective information in reply to the buyers queries is required to be given. But in Insurance contracts the principles of "Uberrima fides", i.e. of Utmost Good Faith is observed and simple good faith is not enough. Why this difference in Insurance contracts?

Firstly, in Insurance contracts the seller is the insurer and he has no knowledge about the property to be insured. The proposer on the other hand knows or is supposed to know everything about the property. The condition is reverse of ordinary commercial contracts and the seller is entirely dependent upon the buyer to provide the information about the property and hence the need for Utmost Good Faith on the part of the proposer. It may be said here that the insurer has the option of getting the subject matter of Insurance examined before covering the risk. This is true that he can conduct an examination in the case of a property being insured for fire risk or of getting a medical examination done in the case of a health policy. But even then there will be facts which only the insured can know e.g., the history of Insurance of the property whether it has been refused earlier for Insurance by another company or whether it is also already insured with another company and the previous claim experience. Similarly, a medical examination may not reveal the previous history i.e. details of past illness, accidents etc. Therefore Insurance contracts insist on the practice of Utmost Good Faith on the part of the Insured.

Secondly, Insurance is an intangible product. It cannot be seen or felt. It is simply a promise on the part of Insurer to make good the loss incurred by the Insured if and when it occurs. Thus, the Insurer is also obliged to practice Utmost Good Faith in his dealings with the Insured. He cannot and should not make false promises during negotiations. He should not withhold information from the Insured such as the discounts available for good features e.g., fire extinguishing.

Appliances discount in fire policies or that Earthquake risk is not covered under the standard fire policy but can be covered on payment of additional premium. In the recent Earthquake disaster in Gujarat, a number of insured failed to get any relief from Insurance Companies as Earthquake risk was not covered.

Utmost Good Faith can be defined as *“A positive duty to voluntarily disclose, accurately and fully all facts material to the risk being proposed whether requested for or not”*. In Insurance contracts Utmost Good Faith means that *“each party to the proposed contract is legally obliged to disclose to the other all information which can influence the others decision to enter the contract”*.

The following can be inferred from the above two definitions:

1. Each party is required to tell the other, the truth, the whole truth and nothing but the truth.
2. Unlike normal contract such an obligation is not limited to any questions asked.
3. Failure to reveal information even if not asked for gives the aggrieved party the right to regard the contract as void.

How is this duty of Utmost Good Faith to be practiced? And what are the facts that the proposer has to disclose? The answer to both the question is simply the proposer must disclose to the insurer all material facts in respect of the subject matter of Insurance.

5.1.1 What is a material fact?

Material fact is every circumstance or information, which would influence the judgement of a prudent insurer in assessing the risk.

Or

Those circumstances which influence the insurer decision to accept or refuse the risk or which effect the fixing of the premium or the terms and conditions of the contract must be disclosed.

Following are the facts, which must be disclosed:

- (i) Facts, which show that a risk represents a greater exposure than would be expected from its nature e.g., the fact that a part of the building is being used for storage of inflammable materials.
- (ii) External factors that make the risk greater than normal e.g. the building is located next to a warehouse storing explosive material.
- (iii) Facts, which would make the amount of loss greater than that normally expected e.g. there is no segregation of hazardous goods from non-hazardous goods in the storage facility.
- (iv) History of Insurance (a) Details of previous losses and claims (b) if any other Insurance Company has earlier declined to insure the property and the special condition imposed by the other insurers; if any.
- (v) The existence of other insurances.
- (vi) Full facts relating to the description of the subject matter of Insurance.

Some examples of Material facts are:

- (a) **In Fire Insurance:** The construction of the building, the nature of its use, i.e. whether it is of concrete or kucha having thatched roofing and whether it is being used for residential purposes or as a godown, whether fire fighting equipment is available or not.
- (b) **In Motor Insurance:** The type of vehicle, the purpose of its use, its age (Model), Cubic capacity and the fact that the driver has a consistently bad driving record.

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- (c) *In Marine Insurance:* Type of packing, mode of carriage, name of carrier, nature of goods, the route.
- (d) *In Personal Accident Insurance:* Age, height, weight, occupation, previous medical history if it is likely to increase the choice of an accident, Bad habits such as drinking etc.
- (e) *Burglary Insurance:* Nature of stock, value of stock, type of security precautions taken.

As mentioned, this is not an exhaustive list but only a few examples.

Details of previous losses are a material fact which is relevant to all policies.

Following are the facts which need not be disclosed:

1. *Facts of Law:* Everyone is deemed to know the law. Overloading of goods carrying vehicles is legally banned. The transporter cannot take excuse that he was not aware of this provision.
2. *Facts which lessen the Risk:* The existence of a good fire fighting system in the building.
3. *Facts of Common Knowledge:* The insurer is expected to know the areas of strife and areas susceptible to riots and of the process followed in a particular trade or Industry.
4. *Facts which could be reasonably discovered:* For example, the previous history of claims which the Insurer is supposed to have in his record.
5. *Facts which the insurers' representative fails to notice:* In burglary and fire Insurance it is often the practice of Insurance companies to depute surveyors to inspect the premises and in case the surveyor fails to notice hazardous features and provided the details are not withheld by the Insured or concealed by him then the Insured cannot be penalized.
6. *Facts covered by policy condition:* Warranties applied to Insurance policies i.e. there is a warranty that a watchman be deployed during night hours then this circumstance need not be disclosed.

Duration of Duty of Disclosure

The duty of disclosure remains in force throughout the entire negotiation stage and till the contract is finalized. Once the contract is finalized, then the contract is subject to ordinary simple good faith. However when an alteration is to be made in an existing contract then this duty of full disclosure recovers in respect of the proposed alteration. The duty of disclosure also revives at the time of renewal of contract since legally renewal is regarded as a fresh contract.



Example: A landlord at the time of proposal has disclosed that the building is rented out and is being used as an office. If during the continuation of the policy the tenants vacate the building and the landlord subsequently rents it out to a person using it as a godown then he is required to disclose this fact to the Insurer as this is a change in material facts and effects the risks.



Notes Please note that in long term Insurance Business, the Insurer is obliged to accept the renewal premium if the Insured wishes to continue the contract and there is no duty of disclosure operating at the time of renewal. Normally, Insurer arranges inspection on each renewal.

5.1.2 Breaches of Utmost Good Faith

Notes

You must remember that breaches of Utmost Good Faith occur in either of 2 ways:

- (1) Misrepresentation, which again may be either innocent or intentional. If intentional then they are fraudulent.
- (2) Non-Disclosure, which may be innocent or fraudulent. If fraudulent then it is called concealment.

It is important to distinguish between the two: Misrepresentation and Non-Disclosure.

Misrepresentation

Innocent: This occurs when a person states a fact in the belief or expectation that it is right but it turns out to be wrong. While taking out a Marine Insurance Policy the owner states that the ship will leave on a specific date but in fact the ship leaves on a different date.

Intentional: Deliberate misrepresentation arises when the proposer intentionally distorts the known information to defraud the insurer. The selfish objective is somehow to enter the contract or to get a reduction in the premium e.g., If an applicant for motor Insurance stated that no one under 18 would drive the vehicle when in fact his 17 years old son drives frequently. Such a misrepresentation would be material as it would affect the decision of the insurer.

Non-Disclosure

Innocent: This arises when a person is not aware of the facts or when even though being aware of fact does not appreciate its significance e.g. A proposer at the time of effecting the contract has undetected cancer therefore does not disclose it, or A proposer had suffered from Rheumatic fever in his childhood but he does not disclose this not knowing that people who have this are susceptible to heart diseases at a later age.

Deliberate: This is done with a deliberate intention to defraud the insurer entering into a contract, which he would not have done had he been aware of that fact.

A proposer for fire Insurance hides the fact knowingly by not disclosing that he has an outhouse next to his building, which is used as a store for highly inflammable material.

How to Deal With Breaches

How breaches are dealt with depends upon whether the breaches are:

- (1) Innocent
 - (2) Deliberate
 - (3) Material to the risk
 - (4) Immaterial to the risk
1. When Breach of Utmost Good Faith occurs the aggrieved party gets the right to avoid the contract. The contract does not become automatically void and it must decide on the course to be taken. The options available are on case-to-case basis like:
 2. The contract becomes void from the very beginning if deliberate misrepresentation or non-disclosure is resorted to with the intention of misleading the insurer to enter into a contract.

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3. To consider the contract void, the bereaved party must notify the offending party that breach has been noticed and as per the conditions of the contract he is no longer governed with the terms of the contract agreed upon in covering the risk. In case the breach is discovered at the time of claim he will refuse to honour his promise and will not pay the claim. This again occurs when there has been a deliberate breach.
4. When the breach is innocent but it is material to the fact then the insurer may impose a penalty in the form of additional Premium.
5. Where the breach is found to be innocent and is not material the insurer can choose to ignore the breach or waive off the breach.

Self Assessment

Fill in the blanks:

1. Insurance contracts insist on the practice of on the part of the insured.
2. Material fact is every circumstance or information, which would influence the of a prudent insurer in assessing the risk.

5.2 Principle of Insurable Interest

Remember, one of the essential ingredients of an Insurance contract is that the insured must have an insurable interest in the subject matter of the contract. Insurance without insurable interest would be a mere wager and as such unenforceable in the eyes of law.

The subject matter of the Insurance contract may be a property or an event that may create a liability but it is not the property or the potential liability which is insured but it is the pecuniary interest of the insured in that property or liability which is insured.



Example: The concept is the basis of the doctrine of insurable interest and was cleared in the case of *Castellain v/s Priston* in 1883 as follows:

“What is it that is insured in a fire policy? Not the bricks and materials used in building the house but the interest of the Insured in the subject matter of Insurance.”

The subject matter of the contract is the name given to the financial interest, which a person has in the subject matter and it is this interest, which is insured.

Insurable Interest is defined as:

“The legal right to insure arising out of a financial relationship recognized under the law between the insured and the subject matter of Insurance.”



Example: The owner of a taxicab has insurable interest in the taxicab because he is getting income from it. But, if he sells it, he will not have an insurable interest left in that taxicab.

From above example, we can conclude that, ownership plays a very crucial role in evaluating insurable interest. Every person has an insurable interest in his own life. A merchant has insurable interest in his business of trading. Similarly, a creditor has insurable interest in his debtor.

There are four essential components of Insurable Interests:

1. There must be some property, right, interest, life, limb or potential liability capable of being insured.

2. Any of these above i.e. property, right, interest etc. must be the subject matter of Insurance.
3. The insured must stand in a formal or legal relationship with the subject matter of the Insurance. Whereby he benefits from its safety, well-being or freedom from liability and would be adversely affected by its loss, damage existence of liability.
4. The relationship between the insured and the subject matter must be recognized by law.

5.2.1 How is Insurable Interest Created?

You will be surprised to know that there are a number of ways by which Insurable Interest arises or is restricted:

- (a) **By Common Law:** Cases where the essential elements are automatically present can be described as insurable interest having arisen by common law. Ownership of a building, car etc., gives the owner the right to insure the property.
- (b) **By Contract:** In some cases a person will agree to be liable for something which he would not be ordinarily for. A lease deed for a house for example may make the tenant responsible for the repair and maintenance of the building. Such a contract places the tenant in a legally recognized relationship with the house or the potential liability and this gives him the insurable interest.
- (c) **By Statute:** Sometimes an Act of the Parliament may create an insurable interest by granting some benefit or imposing a duty and at times removing a liability may restrict the Insurable Interest.

Insurable Interest is applicable in the Insurance of property, life and liability.

In case of property Insurance, insurable interest arises out of ownership where the owner is the insured but it can arise due to other situations & financial interests which give a person who is not an owner, insurable interest in the property and some of the situations are listed below:

- (i) **Mortgagee and Mortgagers:** The practice of Mortgage is common in the area of house & vehicle purchase. The mortgagee is the lender normally a bank or a financial institution, and the mortgager is the purchaser. Both have an insurable interest; the mortgager because he is the owner and the mortgagee as a creditor with insurable interest limited to the extent of the loan.
- (ii) **Bailee:** Bailee is person legally holding the goods of another, may be for payment or other reason. Motors garages and watch repairers have a responsibility to take care of the items in their custody and this gives them an insurable interest even though he is not owner.
- (iii) **Trustees:** They are legally responsible for the property under their charge and it is this responsibility which gives rise to insurable interest.
- (iv) **Part Ownership:** Even though a person may have only part interest in a property he can insure the entire property. He shall be treated as a trustee or the co-owners; and in the event of a claim he will hold the money received by him in excess of his financial interest in trust for the others.
- (v) **Agents:** When the principal has an insurable interest then his agent can insure the property.
- (vi) **Husband & Wife:** Each has unlimited interest in each other's life and hence they have an insurable interest in each other's property. These parties can insure each other's lives as they stand to lose in the event of death of any of them.
- (vii) **Creditor:** Similarly a creditor may lose financially if a debtor dies before paying the loan so the creditor gets an Insurable Interest in the life of the debtor to the extent of the loan amount.

Notes

- (viii) **Liability:** In liability Insurance a person has insurable interest to the extent of any potential liability which may be incurred due to damages and other costs. It is not possible to foretell how much liability or how often a person may incur liability and in what form or shape it arises. In this way Insurable Interest in Liability Insurance is different than Insurable Interest in life and property – where it is possible to predetermine the extent of Insurable Interest.

Therefore in liability assurance the insured is asked to choose the amount of sum insured as the maximum figure that he estimates is ever likely to be required to settle the liability claims.

5.2.2 When Should Insurable Interest Exist

You need to know that this can happen in the following cases:

- (i) In Life Insurance Insurable Interest must exist at the time of inception of Insurance and it is not required at the time of claim.
- (ii) In Marine Insurance Insurable Interest must exist at the time of loss/claim and it is not required at the time of inception.
- (iii) In Property and other Insurance Insurable Interest must exist at the time of inception as well as at the time of loss/claims.

Other Salient Features of Insurable Interest

Let's learn about the salient features of insurable interest:

1. **Insurable Interest of Insurers:** Once the Insurers have accepted the liability they derive an insurable interest, which arises from that liability thus they are free to insure a part or whole of the risk with another insurer. This is done by reinsurance.
2. **Legally Enforceable:** The Insurable Interest must be legally enforceable. The mere expectation that one may acquire insurable interest in the future is not sufficient to create insurable interest.
3. **Possession:** Lawful possession of property together with its responsibility creates an insurable interest.
4. **Criminal Acts:** A person cannot avail benefits from insurance to cover penalties because of a criminal act but insurance to take care of civil consequences arising out of his criminal act can be done. This is applicable in the case of motor Insurance where a driver found guilty of an offence which is involved in an accident receives the claim for damage to his own car and also liability incurred due to damage to another's property but he shall not be insured for the amount of penalty that was imposed for his offense.
5. **Financial Value:** Insurable interest must be capable of financial evaluation. In the case of property and liability incurred it is easily evaluated but in life it is difficult to put a value on the life of a person or his spouse and this depends on the amount of premium the individual can bear. However in cases where lives of others are involved a value on life can be placed i.e. creditor can put a value on the life of debtor restricted to the extent of the loan.

Employers have an insurable interest in the lives of their employees because if the employee dies there will be cost on training of the replacement and in the case of death of a key employee there may be loss of income as well. The amount of insurable interest cannot be exactly determined but it should be reasonable and proportionally related with salary of an employee; contribution level of a key personal or equity contribution in case of partners.



Task Prepare a presentation on the salient features of the principles of insurable interest of insurance.

Notes

Assignment of policies is possible but normally not without the permission of the Insurer because it can mean a change in the underwriting consideration as the new policyholder may not have the same insurable interest.

Fire and other Misc. policies are not freely assignable as the Insurer at the time of underwriting has satisfied himself about the insured's attitude or treatment of the subject matter and its loss causing capability. This would however change in the case of an assignee and it is reasonable to give the insurer a chance to consider the credentials of the new proposer. When the Insurer gives his consent to the assignment of the policy a new contract is in fact being entered into and this is called NOVATION.

Marine cargo policies are however freely assignable without the knowledge or the consent of the Insurer. The reason being that the ownership of the goods insured frequently change when the goods are still in transit and it is necessary that the benefit of the policy passes to the new owner.

In some cases only the proceeds of the policy are assigned. There is normally no objection to such assignments as the assured is still a party to the contract with the insurer and he has to continue to comply with all the terms and conditions of the policy with the only difference being that in event of a claim the insurer is directed to pay the amount to the Assignee.

Insurers protect themselves by taking a receipt from the person receiving the amount discharging the Insurer from any further liability. This condition arises often in motor claims when bills of repair are directly paid to the garage and not the owner of the vehicle. In these cases the garage owners obtain a letter of satisfaction from the owner and submit his bills to the Insurer directly for payment.

Self Assessment

Fill in the blanks:

3. The subject matter of the insurance contract may be a property or an event that may create a
4. is person legally holding the goods of another, may be for payment or other reason.

5.3 Principle of Indemnity

You must learn what exactly is meant by indemnity. Well, indemnity according to the Cambridge International Dictionary is "Protection against possible damage or loss" and the Collins Thesaurus suggests the words "Guarantee", "Protection", "Security", "Compensation", "Restitution" and "Reimbursement" amongst others as suitable substitute for the word "Indemnity". The words protection, security, compensation etc. are all suited to the subject of Insurance but the dictionary meaning or the alternate words suggested do not convey the exact meaning of Indemnity as applicable in Insurance Contracts.

In Insurance, the word indemnity is defined as "financial compensation sufficient to place the insured in the same financial position after a loss as he enjoyed immediately before the loss occurred."

Notes

Indemnity thus prevents the insured from recovering more than the amount of his pecuniary loss. It is undesirable that an insured should make a profit out of an event like a fire or a motor accident because if he was able to make a profit there might well be more fires and more vehicle accidents.



Did u know? As in the case of Insurable Interest, the principle of indemnity also relies heavily on the financial evaluation of the loss but in the case of life and disablement it is not possible to be precise in terms of money.

Insurance may be for less than a complete indemnity but it may not be for more than it. To illustrate let us take the example of a person who insures his car for ₹ 4 lakh and it meets with an accident and is a total loss. It is not certain that he will get ₹ 4 lakh. He may have over valued the car or may be the prices of cars have fallen since the policy was taken.

The Insurer will only pay an amount equal to the value of the car at the time of loss. If he finds that a car of the same make and model is available in the market for ₹ 3 lakh then he is not liable to pay more than this sum and payment of ₹ 3 lakh will indemnify the Insured.

Similarly in the case of partial loss if some part of the car needs to be replaced the Insurer will not pay the full value of the new part. He shall assess how much the old part had run and after deduction of a proportionate sum he shall pay the balance amount. An insured is not entitled to new for old as otherwise he would be making a profit from the accident.

However there are two modern types of policy where there is a deviation from the application of this principle. One is the agreed value policy where the insurer agrees at the outset that they will accept the value of the insured property stated in the policy (sum insured) as the true value and will indemnify the insured to this extent in case of total loss. Such policies are obtained on valuable pieces of Art, Curious, Jewellery, Antiques, Vintage cars, etc.

The other type of policy where the principle of strict indemnity is not applied is the Reinstatement policy issued in Fire Insurance. Here the Insured is required to insure the property for its current replacement value and the Insurer agrees that in the event of a total loss he shall replace the damaged property with a new one or shall pay for the replacement in full.

Other than these there are Life and Personal Accident policies where no financial evaluation can be made. All other Insurance policies are subjected to the principle of strict Indemnity. In most policy documents, the word indemnity may not be used but the courts follow this principle in case of any dispute coming before them.

5.3.1 How is Indemnity Provided?

The Insurers normally provide indemnity in the following manner and the choice is entirely of the insurer:

1. Cash Payment
2. Repairs
3. Replacement
4. Reinstatement

Cash Payment

In majority of the cases the claims will be settled by cash payment (through cheques) to the assured. In liability claims the cheques are made directly in the name of the third party thus

avoiding the cumbersome process of the Insurer first paying the Insured and he in turn paying to the third party.

Repair

This is a method of Indemnity used frequently by insurer to settle claims. Motor Insurance is the best example of this where garages are authorized to carry out the repairs of damaged vehicles. In some countries Insurance companies even own garages and Insurance companies spend a lot on Research on motor repair to arrive at better methods of repair to bring down the costs.

Replacement

This method of Indemnity is normally not preferred by Insurance companies and is mostly used in glass Insurance where the insurers get the glass replaced by firms with whom they have arrangements and because of the volume of business they get considerable discounts. In some cases of jewellery loss, this system is used especially when there is no agreement on the true value of the lost item.

Reinstatement

This method of Indemnity applies to Property Insurance where an insurer undertakes to restore the building or the machinery damaged substantially to the same condition as before the loss. Sometimes the policy specifically gives the right to the insurer to pay money instead of restoration of building or machinery.

Reinstatement as a method of Indemnity is rarely used because of its inherent difficulties e.g., if the property after restoration fails to meet the specifications of the original in any material way or performance level then the Insurer will be liable to pay damages. Secondly, the expenditure involved in restoration may be much more than the sum Insured as once they have agreed to reinstate they have to do so irrespective of the cost.

Limitations on Insurers Liability

1. The maximum amount recoverable under any policy is the sum insured, which is mentioned on the policy. The amount is not the agreed value of the property (except in Valued policies) nor is it the amount, which will be paid automatically on occurrence of loss. What will be paid is the actual loss or sum insured whichever is less.
2. Property Insurance is subjected to the Condition of Average. The underlying principle behind this condition is that Insurers are the trustees of a pool of premiums from which they meet the losses of the few who suffer damage, so it is reasonable to conclude that every Insured should bring a proper contribution to the pool by way of premium. Therefore if an insured deliberately or otherwise underinsures his property thus making a lower contribution to the pool, he is not entitled to receive the full benefits.

The application of this principle makes the insured his own Insurer to the extent of under-insurance i.e. the pro-rata difference between the Actual Value and the sum insured.

The amount of loss will be shared between the Insurer and the insured in the proportion of sum insured and the amount underinsured. The formula applicable for arriving at the amount to be paid by the Insurance Co. is:

$$\text{Claim} = \text{Loss} \times (\text{Sum Insured} / \text{Market Value})$$

Notes



Example: Mr Sudhir Kumar has insured his house for ₹ 5 lakh and suffers a loss of ₹ 1 lakh due to fire. At the time of loss the surveyor finds that the actual market value of the house is ₹ 10 lakh. In this case applying the above formula the claim will be as under:

Loss	= 1 lakh
Sum insured	= 5 lakh
Market Value	= 10 lakh
Therefore, 1 lakh × 5 lakh /10 lakh	= 50,000/-
Claim	= ₹ 50,000/-

Self Assessment

Fill in the blanks:

5. An is not entitled to new for old as otherwise he would be making a profit from the accident.
6. as a method of Indemnity is rarely used because of its inherent difficulties.

5.4 Principle of Subrogation

Subrogation means substituting one creditor for another. Principle of Subrogation is an extension and another corollary of the principle of indemnity. It also applies to all contracts of indemnity.

It has already been established that the purpose of Indemnity is to ensure that the Insured does not make a profit or gain in any way as a consequence of an accident. He is placed in the same financial position, which he had occupied immediately before the loss occurred.

As an off shoot of the above it is also fair that the insurer having indemnified the insured for damage caused by another (A Third Party) should have the right to recover from that party the amount of damages or part of the amount he has paid as indemnity.

This right to recover damages usually lies with the bereaved or injured party but the law recognises that if another has already paid the bereaved or injured party then the person who has paid the compensation has the right to recover damages.

In case the insured after having received indemnity also recovers losses from another then he shall be in a position of gain which is not correct and this amount recovered from another shall be held in trust for the insurer who have already given indemnity. Subrogation may be defined as the transfer of legal rights of the insured to recover, to the Insurer.

Subrogation can arise in 4 ways:

- (i) Tort
- (ii) Contract
- (iii) Statute
- (iv) Subject matter of Insurance

Tort: When an insured has suffered a loss due to a negligent act of another then the Insurer having indemnified the loss is entitled to recover the amount of indemnity paid from the wrongdoer.

The Insured has a right in Tort to recover the damages from the individuals involved. The Insurers assume these rights and take action in the name of the insured and take his permission before starting legal proceedings.

Another reason for seeking permission of the insured is that the Insured may be having another claim which was not insured arising from the same incident which he may wish to include because the law allows one to sue a person only once for any single event.

Contract: This can arise when a person has a contractual right to compensation regardless of a fault then the Insurer will assume the benefits of this right.

Statute: Where the Act or Law permits, the insurer can recover the damages from Government agencies like the Risk (Damage) Act 1886 (UK) gives the right to insurers to recover damages from the District Police Authorities in respect of the property damaged in Riots which has been indemnified by them.

Subject matter of Insurance: When the Insured has been indemnified and the property treated as lost he cannot claim salvage as this would give him more than indemnity. Therefore, when insurers sell the salvage as in the case of damaged cars, it can be said that they are exercising their right of subrogation.

Subrogation – When?

According to common law the right of subrogation arises once the Insurers have admitted the claim and paid it. This can create problems for the Insurers as delay in taking action could at times hamper their chance of recovering the damages from the wrongdoer or it could be adversely affected due to any action taken by the Insured. To safeguard their rights and to ensure that they are in control of the situation from the beginning Insurers place a condition in the policy giving themselves subrogation rights before the claim is paid. The limitation is that they cannot recover from the third party unless they have indemnified the insured but this express condition allows the insurer to hold the third party liable pending indemnity being granted.



Caution This principle is applicable only when the damaged property has any value after the event causing the damage. The insurer can benefit out of subrogation rights only to the extent of the amount he has paid to the insured as compensation.

Many individuals having received indemnity from the Insurer lose interest in pursuing the recovery rights they may have. Subrogation ensures that the negligent do not get away scot free because there is Insurance. The rights which subrogation gives to the Insurers are the rights of the Insured and it places certain obligations on the Insured to assist the Insurers in enforcing their claims and not to do anything which would harm the Insurers chances to recover losses.

Self Assessment

Fill in the blanks:

7. Subrogation means substituting onefor another.
8. The Insured has a right in to recover the damages from the individuals involved.

5.5 Principle of Contribution

You must remember that contribution is the second corollary of Indemnity. An individual may have more than one policy on the same property and in case there was a loss and he were to claim from all the Insurers then he would be obviously making a profit out of the loss which is against the principle of Indemnity. To prevent such a situation the principle of contribution has been evolved under common law.

Contribution may be defined as the “right of Insurers who have paid a loss to recover a proportionate amount from other Insurers who are also liable for the same loss”. The common law allows the insured to recover his full loss within the sum insured from any of the insurers.

Condition of Contribution will only arise if all the following conditions are met:

1. Two or more policies of Indemnity should exist
2. The policies must cover a common interest
3. The policies must cover a common peril which is the cause of loss
4. The policies must cover a common subject matter
5. The policies must be in operation at the time of loss

It is not necessary that the policies be identical to one another. What is important is that there should be an overlap between policies, i.e. the subject matter should be common and the peril causing loss should be common and covered by both.

As said earlier common law gives the right to the insured to recover the loss from any one insurer who will then have to affect proportionate recoveries from other insurers, who were also liable to pay the loss. To avoid this, the insurers modify the common law condition of contribution by inserting a clause in the policy that in the event of a loss they shall be liable to pay only their “Rate-able proportion” of the loss. It means that they will pay only their share and if the Insured wants full indemnity he should lodge a claim with the other Insurers also.

Rateable Proportion

The accepted way to interpret the term Rate-able Proportion is exhibited. First being that the Insurers should pay in the proportion to the sum insured.



Example:

Sum Insured Policy A	= 10,000/-
Sum Insured Policy B	= 20,000/-
Sum Insured Policy C	= 30,000/-
Total	= 60,000/-

In case of a claim of ₹ .6000/- the three insurers would be liable to pay in the proportion 1:2:3 i.e. ‘A’ pays ₹ .1000/- ‘B’ pays ₹ .2000/- and ‘C’ pays ₹ . 3000/-.

However, the drawback of this simplistic method is that the terms and conditions of the policies may be different and it would not be prudent to ignore these terms and conditions.



Example: The condition of average may apply to one or more policies or there may be an excess clause in one policy which may affect their share of contribution to the loss.

It would therefore be correct to assess the loss as per the terms and conditions of the individual policy and pay the claims accordingly. If by following this method the total sum of the liability of the Insurers is more than the claim amount then the Insurers shall pay in proportion to the amount of liability of each.

Self Assessment

Fill in the blanks:

9. The common allows the insured to recover his full loss within the sum insured from any of the insurers.
10. There should be an between policies.

5.6 Principles of Proximate Cause

You must note that there are three types of perils related to a claim under an Insurance policy:

1. **Insured Perils:** These are the perils mentioned in the policy as being insured e.g. Fire, lightning, storm etc. in the case of a fire policy
2. **Excepted Perils:** These are the perils mentioned in the policy as being excepted perils or excluded perils e.g. Riot strike, flood etc. which may have been excluded and discount in premium availed.
3. **Uninsured Perils:** Those not mentioned in the policy at all either in Insured or excepted perils e.g. snow, smoke or water as perils may not be mentioned in the policy. Insurers are liable to pay claims arising out of losses caused by Insured Perils and not those losses caused by excepted or Uninsured perils.



Example: If stocks are burnt then the cause of loss is fire which is an insured peril under a fire policy and claim is payable. If the stocks are stolen, the loss would not be payable as burglary is not an Insured peril covered in fire policy. Burglary policy is needed to take care of 'theft'.

It is therefore important to identify the cause of loss and to see if it is an Insured peril or not before admitting a claim.

5.6.1 Need to Identify Proximate Cause

Remember, if the loss is brought about by only one event then there is no problem in settlement of liability but more often than not the loss is a result of two or more causes acting together or in tandem i.e. one after another. In such cases it is necessary to choose the most important, most effective and the most powerful cause which has brought about the loss. This cause is termed the Proximate Cause and all other causes being considered as "remote". The proximate cause has to be an insured peril for the claim to be payable.

The following illustration may help in distinguishing between the proximate cause and the remote cause:

- (i) "A person was injured in an accident and was unable to walk and while lying on the ground he contracted a cold which developed into pneumonia and died as result of this. The court ruled that the proximate cause of death was the accident and Pneumonia (which was not covered) was a remote cause and hence claim was payable under the Personal Accident Policy."

Notes

- (ii) "A person injured in an accident was taken to a hospital where he contracted an infection and died as a result of this infection. Here the court ruled that infection was the proximate cause of death and the accident was a remote cause and hence no claim was payable under the Personal Accident Policy."

5.6.2 The Meaning of Proximate Cause

Let's find out the meaning of proximate cause. The doctrine of proximate cause is based on the principle of cause and effect, which states that having proved the effect and traced the cause it is not necessary to go any further i.e. cause of cause. The law provided the rule "Causa proxima non remota spectatur", which means the immediate, and not the remote cause should be taken into consideration.

Therefore, the proximate cause should be the immediate cause. Immediate does not mean the nearest to the loss in point of time but the one most effective or efficient. Thus if there are a number of causes and the proximate cause has to be chosen the choice should be of the most predominant and efficient cause i.e. the cause which effectively caused the result.

Proximate cause has been defined as "The active efficient cause that sets in motion a train of events which bring about a result without the intervention of any force started and working actively from a new and independent source".

It is important to note that in Insurance Proximate has got nothing to do with time even though the Dictionary defines Proximity as 'The state of being near in time or space' (period or physical) and the Thesaurus given the alternate words as "adjacency of" "closeness", "nearness" "vicinity" etc. But in Insurance Proximate cause is that which is Proximate in efficiency. It is not the latest but the direct, dominant, operative and efficient cause.

Losses can occur in the following manners:

- (i) Loss due to a single cause,
- (ii) A series or chain of events one following and resulting from the other causing the loss,
- (iii) A series or chain of events which is broken by a new event independently from a different source causing the loss – Broken sequence, and
- (iv) A contribution of two or more events occurring simultaneously and resulting in loss.
 - 1. In the case of a single cause being the cause of loss then if that peril is covered the claim is payable and if not covered claim is not payable.
 - 2. Loss due to a series or chain of events. This can be illustrated by the following example event.
 - (a) A driver of a car meets with an accident,
 - (b) As a result of the accident he suffers from concussion (shock),
 - (c) Because of the concussion he strayed around not aware where he was going,
 - (d) While straying he fell into a stream, and
 - (e) He died of drowning in the stream.

It is clear that the above is a chain of events one leading to the other. The proximate cause would be accident (Disease – not covered) and hence the claim would be payable. Irrespective of the fact that subsequent causes are covered or not if it is established that the event starting the chain is a covered peril, then claim is payable.

However if reverse were the case and the chain was started by an excepted or excluded peril then the claim would not be payable.

Notes



Example: A person suffers a stroke and falls down the steps resulting in his death. He will not be entitled to any claim under his personal accident policy as the chain was started by a stroke which is an excepted peril.

3. In case of the broken sequence or interrupted chain of events if the chain of events is started by an Insured peril but interrupted by an excepted or excluded peril then the claim is paid after deducting the damage caused by the excluded peril. For example, the burglars enter the house and leave the gas stove on leading to a fire and the house is damaged in the fire. The "burglary Insurance" will only pay for the loss due to theft but exclude loss due to fire, which is accepted peril under the burglary policy.

In case the sequence of events started by an excluded peril is broken by an Insured peril, as a new and independent cause then there is a valid claim for even the damage caused by exempted peril. The burglars enter the house and after carrying out thefts put the house on fire. The fire policy will pay for the damages due to theft as well (which is an excluded peril).

4. In the case of loss due to concurrent causes or two or more causes occurring simultaneously then all the causes will have to be Insured perils only then the claim would be payable but even if one of the causes is an excluded peril the claim will not be payable.



Example: A house collapses due to an earthquake, which results in fire. Under the fire policy, earthquake is not a covered risk, hence the claim will not be payable.

To really understand the complexities of proximate cause and its proper identification one must go through the case studies and a few are being given hereunder.



Caselet

Cold Storage

In an incident where stocks of potatoes kept in a cold storage got damaged due to leakage of ammonia gas. The stock was insured against contamination/Deterioration/putrefaction due to rise in temperature in the refrigeration chamber caused by any loss or damage due to an accident. The Insurance Company did not pay the claim saying that the leakage of gas was not accidental and hence the risk was not covered. The aggrieved approached the consumer forum which held that the leakage of gas was not foreseen or premeditated or anticipated and loosening of the nuts and bolts of the flanges. The consequential escape of gas was within the meaning of the word accident and hence ordered the Insurance Co. to pay the claim.

Self Assessment

Fill in the blanks:

11. The doctrine of proximate cause is based on the principle of
12. The "..... insurance" will only pay for the loss due to theft but exclude loss due to fire, which is accepted peril under the burglary policy.

Notes



Case Study

Can an Insurance Company Independently Challenge the Award under a Professional Indemnity Policy?

During a gall bladder surgery, Mohinder Kaur developed ventricular tachycardia, followed by ventricular fibrillation. She suffered cardiac dysrhythmia and went into coma due to medical negligence, becoming bedridden at the age of 45. A case was filed against the surgeon, the anaesthetist and the hospital. The insurance company was a party to the proceedings. The District Forum awarded a compensation of ₹ 2 lakh, payable by the insurance company on behalf of the doctors under the professional indemnity policy. This was challenged in appeal before the State Commission, which upheld the Forum's order. The doctors did not continue further litigation, but the insurance company filed a revision petition before the National Commission.

Observing that it was incumbent on the insurance company to indemnify doctors under the professional indemnity policy by paying the amount awarded by the consumer fora, the commission stated the challenging of the order by the insurance company without rhyme or reason is neither proper nor desirable. The commission expressed deep anguish that such petitions were being filed. It observed that such cases are not meant to be fodder for the legal department and the insurance company cannot go on a spree in filing such petitions. The commission stated it was restraining itself this time, but warned that if such petitions are filed in future, heavy cost would be imposed. The agony of a consumer must end at some stage. It is the duty of the insurance company to see that frivolous cases were not filed so as to clog the wheels of justice, which result in wastage of time. While dismissing the revision petition, the commission directed the order be sent to the chairman-cum-managing directors of all insurance companies. [New India Assurance Co Ltd v/s Hardip Singh & Others – II (2003) CPJ 103 (NC)]

Question

Write down the case facts in your own words.

Source: http://www.business-standard.com/article/pf/case-studies-on-insurance-claims-111050500049_1.html

5.7 Summary

- The main objective of every insurance contract is to give financial security and protection to the insured from any future uncertainties. Insured must never ever try to misuse this safe financial cover.
- Seeking profit opportunities by reporting false occurrences violates the terms and conditions of an insurance contract.
- An insurer must always investigate any doubtful insurance claims. It is also a duty of the insurer to accept and approve all genuine insurance claims made, as early as possible without any further delays and annoying hindrances.
- Principle of Utmost Good Faith is a very basic and first primary principle of insurance. The person getting insured must willingly disclose and surrender to the insurer his complete true information regarding the subject matter of insurance.
- In an insurance contract, the amount of compensations paid is in proportion to the incurred losses. The amount of compensations is limited to the amount assured or the actual losses, whichever is less.

- Principle of Contribution is a corollary of the principle of indemnity. It applies to all contracts of indemnity, if the insured has taken out more than one policy on the same subject matter.
- Principle of Subrogation is an extension and another corollary of the principle of indemnity. It also applies to all contracts of indemnity. This principle is applicable only when the damaged property has any value after the event causing the damage. The insurer can benefit out of subrogation rights only to the extent of the amount he has paid to the insured as compensation.
- The Principle of Proximate Cause states that to find out whether the insurer is liable for the loss or not, the proximate (closest) and not the remote (farthest) must be looked into.

5.8 Keywords

Principle of Contribution: Principle of Contribution is a corollary of the principle of indemnity. It applies to all contracts of indemnity, if the insured has taken out more than one policy on the same subject matter.

Principle of Indemnity: According to the principle of indemnity, an insurance contract is signed only for getting protection against unpredicted financial losses arising due to future uncertainties. Insurance contract is not made for making profit else its sole purpose is to give compensation in case of any damage or loss.

Principle of Insurable Interest: The principle of insurable interest states that the person getting insured must have insurable interest in the object of insurance.

Principle of Proximate Cause: It means when a loss is caused by more than one causes, the proximate or the nearest or the closest cause should be taken into consideration to decide the liability of the insurer.

Principle of Subrogation: According to the principle of subrogation, when the insured is compensated for the losses due to damage to his insured property, then the ownership right of such property shifts to the insurer.

Principle of Utmost Good Faith: According to this principle, the insurance contract must be signed by both parties in an absolute good faith or belief or trust.

5.9 Review Questions

1. Briefly explain the principle of utmost good faith.
2. Discuss the principle of insurable interest.
3. Describe the salient features of the principle of insurable interest.
4. Explain the principle of indemnity.
5. Explain the relationship between the doctrine of indemnity and the principle of insurable interest.
6. Write a detailed note on the principle of subrogation.
7. How does the principle of subrogation supplement the doctrine of indemnity?
8. Write a short note on the principle of contribution.
9. Briefly explain the principle of causa proxima.
10. Explain the presence of insurable interest in various general insurance contracts.

Notes

Answers: Self Assessment

- | | |
|----------------------|------------------|
| 1. Utmost Good Faith | 2. Judgement |
| 3. Liability | 4. Bailee |
| 5. Insured | 6. Reinstatement |
| 7. Creditor | 8. Tort |
| 9. Law | 10. Overlap |
| 11. Cause and effect | 12. Burglary |

5.10 Further Readings



Books

- Gulati, Neelam. C. (2011), *Banking and Insurance*, Excel Books.
- Gulati, Neelam. C. (2013), *Principles of Risk Management and Insurance*, Excel Books.
- Krishnaswamy. G. (2009), *Principles and Practice of Life Insurance*, Excel Books.
- Misra, M.N. and Mishra, S.B. (2009), *Insurance Principles and Practices*, S. Chand Publication.
- Sahoo and Das (2009), *Insurance Management: Text and Case*, Himalaya Publication.



Online links

- <http://kalyan-city.blogspot.com/2011/03/principles-of-insurance-7-basic-general.html>
- <http://www.nios.ac.in/media/documents/VocInsServices/m2—f5.pdf>

Unit 6: The Insurance Act, 1938

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Objectives

After studying this unit, you will be able to:

- Discuss the definitions given in the Insurance Act, 1938
- Explain the main provisions of the Insurance Act, 1938
- Describe the registration of principal agents, chief agents and special agents
- Discuss the regulation of employment of principal agents
- Explain the renewal of registration
- Describe the capital requirements

Introduction

In the previous unit, you have studied about the various principles of insurance such as principle of utmost good faith, principle of insurable interest, principle of indemnity, principle of contribution, principle of subrogation and principle of causa proxima (nearest cause).

Notes

In this unit, we will study about the Insurance Act 1938. The insurance sector went through a full circle of phases from being unregulated to completely regulate and then currently being partly deregulated. It is governed by a number of acts. The Insurance Act of 1938 was the first legislation governing all forms of insurance to provide strict state control over insurance business. Life insurance in India was completely nationalized on January 19, 1956, through the Life Insurance Corporation Act. All 245 insurance companies operating then in the country were merged into one entity, the Life Insurance Corporation of India.

In the next unit, you will study about the History and overview of IRDA Act. You will also read about the salient features of IRDA act. The unit will also summarize the main provisions of IRDA act.

6.1 Definitions

Following section will give you an insight on the various definitions mentioned under the Insurance Act, 1938:

6.1.1 Short Title, Extent and Commencement

1. (1) This Act may be called Insurance Act, 1938.
- (2) It extends to the whole of India.
- (3) It shall come into force on such date as the Central Government may, by Notification in the Official Gazette, appoint in this behalf.

Definitions:

2. In this Act, unless there is anything repugnant in the subject or context,—

- (1) "**Authority**" means the Insurance Regulatory and Development Authority established under sub-section (1) of section 3 of the Insurance Regulatory and Development Authority Act, 1999;
- (2) "**Policy-holder**" includes a person to whom the whole of the interest of the policy-holder in the policy is assigned once and for all, but does not include an assignee thereof whose interest in the policy is infeasible or is for the time being subject to any condition;
- (3) "**Approved securities**", means:
 - (i) Government securities and other securities charged on the revenue of the Central Government or of the Government of a State or guaranteed fully as regards principal and interest by the Central Government or the Government of any State;
 - (ii) Debentures or other securities for money issued under the authority of any Central Act or Act of a State Legislature by or on behalf of a port trust or municipal corporation or city improvement trust in any Presidency-town;
 - (iii) Shares of a corporation established by law and guaranteed fully by the Central Government or the Government of a State as to the repayment of the principal and the payment of the dividend;
 - (iv) Securities issued or guaranteed fully as regards principal and interest by the Government of any Part B State and specified as approved securities for the purposes of this Act by the Central Government by notification in the Official Gazette;
- (4) "**Auditor**" means a person qualified under the Chartered Accountants Act, 1949 (38 of 1949), to act as an auditor of companies;

- (4A) *“Banking Company”* and *“Company”* shall have the meanings respectively assigned in them in clauses (c) and (d) of sub-section (1) of Section 5 of the Banking Companies Act, 1949 (10 of 1949);
- (5) *“Certified”* in relation to any copy or translation of a document required to be furnished by or on behalf of an insurer or a provident society as defined in Part III means certified by a principal officer of such insurer or provident society to be a true copy or a correct translation, as the case may be;
- (5A) *“Chief Agent”* means a person who, not being a salaried employee of an insurer, in consideration of any commission–
- (i) Performs any administrative and organizing functions for the insurer, and
 - (ii) Procures life insurance business for the insurer by employing or causing to be employed insurance agents on behalf of the insurer;
- (5B) *“Controller of Insurance”* means the officer appointed by the Central Government under section 2B to exercise all the powers, discharge the functions and performs the duties of the Authority under this Act or the Insurance Corporation Act, 1956 (31 of 1956) or the General Insurance Business (Nationalization) Act, 1972 (57 of 1972) or the Insurance Regulatory and Development Authority Act, 1999;
- (6) *“Court”* means the principal Civil Court of original jurisdiction in a district and includes the High Court in exercise of its ordinary original civil jurisdiction;
- (6A) *“Fire insurance business”* means the business of effecting, otherwise than incidentally to some other class of insurance business, contracts of insurance against loss by or incidental to fire or other occurrence customarily included among the risks insured against in fire insurance Policies;
- (6B) *“General insurance business”* means fire, marine or miscellaneous insurance business, whether carried on singly or in combination with one or more of them;
- (7) *“Government security”* means a Government security as defined in the Public Debt Act, 1944 (18 of 1944);
- (7A) *Indian Insurance Company* means any insurer being a company–
- (a) Which is formed and registered under the Companies Act, 1956 (1 of 1956);
 - (b) In which the aggregate holdings of equity shares by a foreign company, either by itself or through its subsidiary companies or its nominees, do not exceed twenty-six per cent paid-up equity capital of such Indian insurance company;
 - (c) Whose sole purpose is to carry on life insurance business or general insurance business or re-insurance business;
- (8) *“Insurance Company”* means any insurer being a company, association or partnership which may be wound up under the Indian Companies Act, 1913 (7 of 1913), or to which the Indian Partnership Act, 1932 (9 of 1932), applies;
- (9) *“Insurer”* means:
- (a) Any individual or unincorporated body of individuals or body corporate incorporated under the law of any country other than India, carrying on insurance business not being a person specified in sub-clause (c) of this clause which–
 - (i) Carries on that business in India, or

Notes

- (ii) Has his or its principal place of business or is domiciled in India, or
- (iii) With the object of obtaining insurance business, employs a representative, or maintains a place of business, in India;
- (b) Anybody corporate [not being a person specified in sub-clause (c) of this clause] carrying on the business of insurance, which is a body corporate incorporated under any law for the time being in force in India; or stands to any such body corporate in the relation of a subsidiary company within the meaning of the Indian Companies Act, 1913 (7 of 1913), as defined by sub-section (2) of section 2 of that Act, and
- (c) Any person who in India has a standing contract with underwriters who are members of the Society of Lloyd's whereby such person is authorized within the terms of such contract to issue protection notes, cover notes, or other documents granting insurance cover to others on behalf of the underwriters.

But does not include a principal agent' chief agent, special agent' or an insurance agent or a provident society as defined in Part III;

(10) **"Insurance Agent"** means an insurance agent licensed under Sec. 42 who receives agrees to receive payment by way of commission or other remuneration in consideration of his soliciting or procuring insurance business including business relating to the continuance, renewal or revival of policies of insurance;

(10A) **"Investment Company"** means a company whose principal business is the acquisition of shares, stocks debentures or other securities;

(10B) **"Intermediary or Insurance Intermediary"** shall have the meaning assigned to it in clause (f) of sub-section (1) of section 2 of the Insurance Regulatory and Development Authority Act, 1999 (41 of 1999);

(11) **"Life Insurance Business"** means the business of effecting contracts of insurance upon human life, including any contract whereby the payment of money is assured on death (except death by accident only) or the happening of any;

(12) **"Manager"** and **"Officer"** have the meanings assigned to those expressions in clauses (9) and (11), respectively of Section 2 of the Indian Companies Act, 1913 (7 of 1913);

(13) **"Managing Agent"** means a person, firm or company entitled to the management of the whole affairs of a company by virtue of an agreement with the company, and under the control and direction of the directors except to the extent, if any, otherwise provided for in the agreement, and includes any person, firm or company occupying such position by whatever name called.



Notes If a person occupying the position of managing agent calls himself manager or managing director, he shall nevertheless be regarded as managing agent for the purposes of Sec. 32 of this Act.

(13A) **"Marine Insurance Business"** means the business of effecting contracts of insurance upon vessels of any description, including cargoes, freights and other interests which may be legally insured, in or in relation to such vessels, cargoes and freights, goods, wares, merchandise and property of whatever description insured for any transit, by land or water, or both, and whether or not including warehouse risks or similar risks in addition or as incidental to such transit, and includes any other risks customarily included among the risks insured against in marine insurance policies;



Task Prepare a collage from definitions under the Insurance Act, 1938.

(13B) "*Miscellaneous Insurance Business*" means the business of effecting contracts of insurance which is not principally or wholly of any kind or kinds included in clauses (6A), (11) and (13A);

(14) "*Prescribed*" means prescribed by rules made under this Act;

(15) "*Principal Agent*" means a person who, not being a salaried employee of an insurer, in consideration of any commission,—

- (i) Performs any administrative and organizing functions for the insurer; and
- (ii) Procures general insurance business whether wholly or in part by employing or causing to be employed insurance agents on behalf of the insurer.

(16) "*Private company*" and "*public company*" have the meanings respectively assigned to them in clauses (13) and (13-A) of Sec. 2 of the Indian Companies Act, 1913 (7 of 1913);

(17) "*Special agent*" means a person who, not being a salaried employee of an insurer, in consideration of any commission, procures life insurance business for the insurer whether wholly or in part by employing or causing to be employed insurance agents on behalf of the insurer, but does not include a chief agent.



Caselet

Government keen to Push Insurance Bill in Winter Session

Keen to push insurance sector reforms, the UPA government is contemplating a proposal under which the FDI cap in insurance sector would be raised from 26 per cent to 49 per cent without commensurate increase in voting rights.

According to sources, the government is also looking at the possibility of allowing 23 per cent FII investment, over and above the existing FDI ceiling of 26 per cent in the sector.

These permutations and combinations, they said, are being worked out to elicit support of the principal opposition party BJP, which is not opposed to the insurance sector reforms but has reservations about hiking the FDI limit.

The legislation is likely to be taken up in the upcoming Winter Session of Parliament, which would be the last full session of the current government before 2014 Lok Sabha polls.

The Bill seeking to raise FDI in insurance sector to 49 per cent has been pending in Rajya Sabha since 2008. The Standing Committee, to which it was referred earlier, has already given its report to the Parliament.

The ruling UPA is keen to pursue the insurance sector reforms and the Cabinet had in October 2012 approved the proposal to raise Foreign Direct Investment (FDI) cap to 49 per cent.

Finance Minister P Chidambaram had earlier met main opposition leaders on the issue, but no compromise formula was worked out.

Contd...

Notes

The Bill could not be taken up in the Rajya Sabha as the ruling party does not enjoy a majority in the Upper House. It needs BJP's support for pushing the insurance sector reforms.

Private sector insurance companies are demanding a hike in the sectoral FDI cap as they need capital from their foreign partners to expand business.

At present, there are over 20 private sector life and non-life insurance companies each, besides state-owned LIC, GIC and four general insurance companies.

The insurance industry was opened up for private sector in 2000 after the enactment of the Insurance Regulatory and Development Authority Act, 1999 (IRDA Act, 1999).

This Act permitted foreign shareholding in insurance companies to the extent of 26 per cent with an aim to provide better insurance coverage and to augment the flow of long-term resources for financing infrastructure.

Source: http://articles.economictimes.indiatimes.com/2013-10-27/news/43432791_1_insurance-sector-development-authority-act-insurance-bill

Self Assessment

Fill in the blanks:

1. company means a company whose principal business is the acquisition of shares, stocks debentures or other securities.
2. insurance business means fire, marine or miscellaneous insurance business, whether carried on singly or in combination with one or more of them.

6.2 Main Provisions of the Insurance Act, 1938

Following are the main provisions of the Insurance Act, 1938 which you need to know:

6.2.1 Appointment of Authority of Insurance

- (1) If at any time, the Authority is superseded under sub-section (1) of section 19 of the Insurance Regulatory and Development Authority Act, 1999, the Central Government may, by notification in the Official Gazette, appoint a person to be the Controller of Insurance till such time the Authority is reconstituted under sub-section (3) of section 19 of that Act.
- (2) In making any appointment under this section, the Central Government shall have due regard to the following considerations, namely, whether the person to be appointed has had experience in industrial, commercial or insurance matter and whether such person has actuarial qualifications.

6.2.2 Requirements as to Capital

Remember, no insurer carrying on the business of life insurance, general insurance or re-insurance in India on or after the commencement of the Insurance Regulatory and Development Authority Act, 1999, shall be registered unless he has:

- (a) A paid-up equity capital of rupees one hundred crore, in case of a person carrying on the business of life insurance or general insurance; or
- (b) A paid-up equity capital of rupees two hundred crore, in case of a person carrying on exclusively the business as a reinsurer:

Provided that in determining the paid-up equity capital specified under clause (i) or clause (ii), the deposit to be made under section 7 and any preliminary expenses incurred in the formation and registration of the company shall be excluded:

Provided further that an insurer carrying on business of life insurance, general insurance or re-insurance in India before the commencement of the Insurance Regulatory and Development Authority Act, 1999 and who is required to be registered under this Act, shall have a paid-up equity capital in accordance with clause (i) and clause (ii), as the case may be, within six months of the commencement of that Act.

6.2.3 Deposits

Let's take a look at deposits. Every insurer shall, in respect of the insurance business carried on by him in India, deposit and keep deposited with the Reserve Bank of India in one of the offices in India of the Bank for and on behalf of the Central Government the amount hereafter specified, either in cash or in approved securities estimated at the market value of the securities on the day of deposit, or partly in cash and partly in approved securities so estimated:

- (a) In the case of life insurance business, a sum equivalent to one per cent of his total gross premium written direct in India in any financial year commencing after the 31st day of March, 2000, not exceeding rupees ten crore;
- (b) In the case of general insurance business, a sum equivalent to three per cent of his total gross premium written in India, in any financial year commencing after the 31st day of March, 2000, not exceeding rupees ten crore;
- (c) In the case of re-insurance business, a sum of rupees twenty crore:

Provided that, where the business done or to be done is marine insurance only and relates exclusively to country craft or its cargo or both, the amount to be deposited under this sub-section shall be one hundred thousand rupees only:

Provided further that in respect of an insurer not having a share capital and carrying on only such insurance business as in the opinion of the Central Government is not carried on ordinarily by insurers under separate policies, the Central Government may, by notification under Official Gazette, order that the provisions of this sub-section shall apply to such insurer with the modification that instead of sum of rupees twenty lakhs or rupees ten lakhs, as the case may be, the deposit to be made by such insurer shall be such amount, being not less than one hundred and fifty thousand rupees, as may be specified in the said order.

6.2.4 Audit

You must understand that the balance sheet, profit and loss account, revenue account and profit and loss appropriation account of every insurer, in the case of an insurer specified in sub-clause (a)(ii) or sub-clause (b) of clause (9) of section 2 in respect of all insurance business transacted by him, and in the case of any other insurer in respect of the insurance business transacted by him in India, shall, unless they are subject to audit under the Indian Companies Act, 1913 (7 of 1913), be audited annually by an auditor, and the auditor shall in the audit of all such accounts have the powers of, exercise the functions vested in, and discharge the duties and be subject to the liabilities and penalties imposed on, auditors of companies by section 145 of the Indian Companies Act, 1913.



Notes This Act does not apply to preparation of accounts, etc., for periods prior to this Act coming into force.

Notes

Nothing in this Act shall apply to the preparation of accounts by an insurer and the audit and submission thereof in respect of any accounting year which has expired prior to the commencement of this Act, and notwithstanding the other provisions of this Act, such accounts shall be prepared, audited and submitted in accordance with the law in force immediately before the commencement of this Act.

6.2.5 Investment of Assets

(1) Every insurer shall invest and at all times keep invested assets equivalent to not less than the sum of—

- (a) The amount of his liabilities to holders of life insurance policies in India on account of matured claims, and
- (b) The amount required to meet the liability on policies of life insurance maturing for payment in India, less—
 - (i) The amount of premiums which have fallen due to the insurer on such policies but have not been paid and the days of grace for payment of which have not expired, and
 - (ii) Any amount due to the insurer for loans granted on and within the surrender values of policies of life insurance maturing for payment in India issued by him or by an insurer whose business he has acquired and in respect of which he has assumed liability, in the manner following, namely, twenty-five per cent of the said sum in Government securities, a further sum equal to not less than twenty-five per cent of the said sum in Government securities or other approved securities and the balance in any of the approved investments specified in sub-section (1) of section 27A or, subject to the limitations, conditions and restrictions specified in sub-section (2) of that section, in any over investment.

(2) For the purposes of sub-section (1):

- (a) The amount of any deposit made under section 7 or section 98 by the insurer in respect of his life insurance business shall be deemed to be assets invested or kept invested Government securities;
- (b) The securities of, or guaranteed as to principal and interest by, the Government of the United Kingdom shall be regarded as approved securities other than Government securities for a period of four years from the commencement of the Insurance (Amendment) Act, 1950 (47 of 1950), in the manner and to the extent hereinafter specified, namely:
 - (i) During the first year, to the extent of twenty-five per cent in value of the sum referred to in sub-section (1);
 - (ii) During the second year, to the extent of eighteen and three fourths per cent in value of the said sum;
 - (iii) During the third year, to the extent of twelve and a half per cent in value of the said sum; and
 - (iv) During the fourth year, to the extent of six and a quarter per cent in value of the said sum:

Provided that, if the Authority so directs in any case, the securities specified in clause (b) shall be regarded as approved securities other than Government securities for a longer period than four years, but not exceeding six years in all and the manner in which and the extent to which the securities shall be so regarded shall be as specified in the direction;

(c) Any prescribed assets shall, subject to such conditions, if any, as may be prescribed, be deemed to be assets invested or kept invested in approved investments specified in sub-section (1) of section 27A.

(3) In computing the assets referred to in sub-section (1),—

- (a) Any investment made with reference to any currency other than the Indian rupee which is in excess of the amount required to meet the liabilities of the insurer in India with reference to that currency, to the extent of such excess; and
- (b) Any investment made in the purchase of any immoveable property outside India or on the security of any such property, shall not be taken into account:

Provided that nothing contained in this sub-section shall affect the operation of sub-section (2):

Provided further that the Authority may, either generally or in any particular case, direct that any investment, whether made before or after the commencement of the Insurance (Amendment) Act, 1950 (47 of 1950), and whether made in or outside India, shall, subject to such conditions as may be imposed, be taken into account, in such manner as may be specified in computing the assets referred to in sub-section (1) and where any direction has been issued under this proviso copies thereof shall be laid before Parliament as soon as may be after it is issued.

(4) Where an insurer has accepted reinsurance in respect of any policies of life insurance issued by another insurer and maturing for payment in India or has ceded reinsurance to another insurer in respect of any such policies issued by himself, the sum referred to in sub-section (1) shall be increased by the amount of the liability involved in such acceptance and decreased by the amount of the liability involved in such cession.

(5) The Government securities and other approved securities in which assets are under sub-section (1) to be invested and kept invested shall be held by the insurer free of any encumbrance, charge, hypothecation or lien.

(6) The assets required by this section to be held invested by an insurer incorporated or domiciled outside India shall, except to the extent of any part thereof which consists of foreign assets held outside India, be held in India and all such assets shall be held in trust for the discharge of the liabilities of the nature referred to in sub-section (1) and shall be vested in trustees resident in India and approved by the Authority, and the instrument of trust under this sub-section shall be executed by the insurer with the approval of the Authority and shall define the manner in which alone the subject-matter of the trust shall be dealt with.



Caution This sub-section shall apply to an insurer-incorporated India whose share capital to the extent of one-third is owned by, or the members of whose governing body to the extent of one-third consists of, members domiciled elsewhere than in India.

6.2.6 Power to Appoint Staff

The authority may appoint such staff, and at such places as it or he may consider necessary, for the scrutiny of the returns, statements and information furnished by insurers under this Act and generally to ensure the efficient performance of the functions of the Authority under this Act.

Self Assessment

Fill in the blanks:

3. Every insurer shall invest and at all times keep invested assets equivalent to not less than the sum of the amount of his to holders of life insurance policies in India on account of matured claims.

Notes

4. The amount of any deposit made under section 7 or section 98 by the insurer in respect of his life insurance business shall be deemed to be assets invested or kept invested securities.

6.3 Registration of Principal Agents, Chief Agents and Special Agents

In this section, we will throw some light on the registration of principle agents, chief agents and special agents.

(1) The Authority or an officer authorized by it in this behalf shall in the prescribed manner and on payment of the prescribed fee, which shall not be more than twenty-five rupees for a principal agent or a chief agent and ten rupees for a special agent, register any person who makes an application to him in the prescribed manner if,—

- (a) In the case of an individual, he does not suffer from any of the disqualifications mentioned in sub-section (4) of Section 42, or
- (b) In the case of a company or firm, any of its directors or partners does not suffer from any of the said disqualifications, and a certificate to Act as a principal agent, chief agent or special agent, as the case may be, for the purpose of procuring insurance business shall be issued to him.

(2) A certificate issued under this section shall entitle the holder thereof to act as a principal agent, chief agent, or special agent, as the case may be, for any insurer.

(3) A certificate issued under this section shall remain in force for a period of twelve months only from the date of issue, but shall, on application made on this behalf, be renewed from year to year on production of a certificate from the insurer concerned that the provisions of clauses (2) and (3) of Part A of the Sixth Schedule in the case of a principal agent, the provisions of clauses (2) and (4) of Part B of the said Schedule in the case of a chief agent, and the provisions of clauses (2) and (3) of Part C of the said Schedule in the case of a special agent, have been complied with, and on payment of the prescribed fee, which shall not be more than twenty-five rupees, in the case of a principal agent or a chief agent, and ten rupees in the case of a special agent, and an additional fee of the prescribed amount not exceeding five rupees by way of penalty, in cases where the application for renewal of the certificate does not reach the issuing authority before the date on which the certificate ceases to remain in force:

Provided that, where the applicant is an individual, he does not suffer from any of the disqualifications mentioned in clauses (b) to (d) of sub-section (4) of section 42 and where the applicant is a company or a firm, any of its directors or partners does not suffer from any of the said disqualifications.

(4) Where it is found that the principal agent, chief agent or special agent being an individual is, or being a company or firm contains a director or partner who is suffering from any of the disqualifications mentioned in sub-section (4) of section 42, without prejudice to any other penalty to which he may be liable, the Authority shall, and where a principal agent, chief agent or special agent has contravened any of the provisions of this Act may cancel the certificate issued under this section to such principal agent, chief agent or special agent.

(5) The authority which issued any certificate under this section may issue a duplicate certificate to replace a certificate lost, destroyed or mutilated on payment of the prescribed fee, which shall not be more than two rupees.

(6) Any person who acts as a principal agent, chief agent or special agent, without holding a certificate issued under this section to act as such, shall be punishable with fine which may extend to five hundred rupees, and any insurer or any person acting on behalf of an insurer, who

appoints as a principal agent, chief agent or special agent any person not entitled to act as such or transacts any insurance business in India through any such person, shall be punishable with fine which may extend to one thousand rupees.

(7) Where the person contravening sub-section (6) is a company or a firm, then, without prejudice to any other proceedings which may be taken against the company or firm, every director, manager, secretary or any other officer of the company, and every partner of the firm who is knowingly a party to such contravention shall be punishable with fine which may extend to five hundred rupees.

(8) The provisions of sub-sections (6) and (7) shall not take effect until the expiry of six months from the commencement of the Insurance (Amendment) Act, 1950.

(9) No insurer shall, on or after the commencement of the Insurance (Amendment) Act, 2002, appointment or transacts any insurance business in India through any principal agent, chief agent or special agent.

Self Assessment

Fill in the blanks:

5. A issued under this section shall entitle the holder thereof to act as a principal agent, chief agent, or special agent, as the case may be, for any insurer.
6. In the case of a company or firm, any of its directors or partners does not suffer from any of the said, and a certificate to Act as a principal agent, chief agent or special agent, as the case may be, for the purpose of procuring insurance business shall be issued to him.

6.4 Regulation of Employment of Principal Agents

Let's have a look at the regulation of employment of principal agents.

(1) No insurer shall, after the expiration of seven years from the commencement of the Insurance (Amendment) Act, 1950, appoint, or transact any insurance business in India, through a principal agent.

(2) Every contract between an insurer and a principal agent shall be in writing and the terms contained in Part A of the Sixth Schedule shall be deemed to be incorporated in, and form part of, every such contract.

(3) No insurer shall, after the commencement of the Insurance (Amendment) Act, 1950 (47 of 1950), appoint any person as a principal agent except in a presidency-town unless the appointment is by way of renewal of any contract subsisting at such commencement.

(4) Within sixty days of the commencement of the Insurance (Amendment) Act, 1950 (47 of 1950), every principal agent shall file with the insurer concerned a full list of insurance agents employed by him indicating the terms of the contract between the principal agent and each of such insurance agents, and, if any principal agent fails to file such a list within the period specified, any commission payable to such principal agent on premiums received from the date of expiry of the said period of sixty days until the date of the filing of the said list shall, notwithstanding anything in any contract to the contrary, cease to be so payable.

(5) A certified copy of every contract as is referred to in sub-section (2) shall be furnished by the insurer to the Authority within thirty days of his entering into such contract.

Notes



Did u know? Intimation of any change in any such contract shall be furnished by the insurer with full particulars thereof to the Authority within thirty days of the making of any such change.

(6) If the commission due to any insurance agent in respect of any general insurance business procured by such agent is not paid by the principal agent for any reason, the insurer may pay the insurance agent the commission so due and recover the amount so paid from the principal agent concerned.

(7) Every contract as is referred to in sub-section (2), subsisting at the commencement of the Insurance (Amendment) Act, 1950 (47 of 1950), shall, with respect to terms regarding remuneration, be deemed to have been so altered as to be in accordance with the provisions of sub-section (4) of section 40A.

(8) If any dispute arises as to whether a person is or was a principal agent the matter shall be referred to the Authority, whose decision shall be final.

(9) Every insurer shall maintain a register in which the name and address of every principal agent appointed by him, the date of such appointment and the date, if any, on which the appointment ceased shall be entered.

Commission, brokerage or fee payable to intermediary or insurance intermediary

(1) No intermediary or insurance intermediary shall be paid or contract to be paid by way of commission, fee or as remuneration in any form, an amount exceeding thirty per cent of the premium payable as may be specified by the regulations made by the Authority, in respect of any policy or policies effected through him:

Provided that the Authority may specify different amounts payable by way of commission, fee or as remuneration to an intermediary or insurance intermediary or different classes of business of insurance.

(2) Without prejudice to the provisions contained in this Act, the Authority may, by the regulations made in this behalf, specify the requirements of capital, form of business and other conditions to act as an intermediary or insurance intermediary.



Did u know? **Register of Insurance Agents**

Every insurer and every person who acting on behalf of an insurer employs insurance agents shall maintain a register showing the name and address of every insurance agent appointed by him and the date on which his appointment began and the date, if any, on which his appointment ceased.

Self Assessment

Fill in the blanks:

- 7. Every contract between an insurer and a principal agent shall be in
- 8. A certified copy of every contract as is referred to in sub-section (2) shall be furnished by the insurer to the Authority within days of his entering into such contract.

9. Every insurer shall maintain a in which the name and address of every principal agent appointed by him.
10. No intermediary or insurance intermediary shall be paid by way of commission, fee or as remuneration in any form, an amount exceeding thirty per cent of the payable.

Notes

6.5 Renewal of Registration

In this section, we will study about the renewal of registration.

(1) An insurer who has been granted a certificate of registration under section 3 shall have the registration renewed annually for each year after that ending on the 31st day of March, after the commencement of the Insurance Regulatory and Development Authority Act, 1999.

(2) *An application for the renewal of a registration for any year shall be made by the insurer to the Authority before the 31st day of December of the preceding year, and shall be accompanied as provided in sub-section*

(3) By evidence of payment of the fee as determined by the regulations made by the Authority which may vary according to the total gross premium written direct in India, during the year preceding the year in which the application is required to be made under this section, by the insurer in the class of insurance business to which the registration relates but shall not—

- (i) Exceed one-fourth of one per cent of such premium income or rupees five crore, whichever is less;
- (ii) Be less, in any case, than five hundred rupees for each class of insurance business:



Caution Provided that in the case of an insurer carrying on solely re-insurance business, the provisions of this sub-section shall apply with the modification that instead of the total gross premium written direct in India, the total premiums in respect of facultative re-insurances accepted by him in India shall be taken into account.

(3) The fee as determined by the regulations made by the Authority for the renewal of a registration for any year shall, be paid into the Reserve Bank of India, or where there is no office of that Bank, into the Imperial Bank of India acting as the agent of that Bank, or into any Government treasury, and the receipt shall be sent along with the application for renewal of the registration.

(4) If an insurer fails to apply for renewal of registration before the date specified in sub-section (2) the Authority may, so long as an application to the Court under sub-section (5-D) of section 3 has not been made, accept an application for renewal of the registration on receipt from the insurer of the fee payable with the application and such penalty, not exceeding the fee as determined by the regulations made by the Authority, and payable by him, as the Authority may require:

Self Assessment

Fill in the blanks:

11. An insurer who has been granted a certificate of registration under section 3 shall have the registration renewed
12. The fee as determined by the regulations made by the Authority for the of a registration for any year shall, be paid into the Reserve Bank of India.

Notes

6.6 Capital Requirements

You will find requirements as to capital structure and voting rights and maintenance of registers of beneficial owners of shares given as below:

6A. (1) No public company limited by shares having its registered office in India, shall carry no life insurance business, unless it satisfies all the following conditions, namely:

- (i) That the capital of the company consists only of ordinary shares each of which have a single face value;
- (ii) That, except during any period not exceeding one year allowed by the company for payment of calls on shares, the paid-up amount is the same for all shares, whether existing or new:



Notes Provided that the conditions specified in this sub-section shall not apply to a public company which has, before the commencement of the Insurance (Amendment) Act, 1950 (47 of 1950), issued any shares other than ordinary shares each of which has a single face value or any shares paid-up amount whereof is not the same for all of them for a period of three years from such commencement.

(2) Notwithstanding anything to the contrary contained in any law for the time being in force or in the memorandum or articles of association but subject to the other provisions contained in this section the voting right of every shareholder of any public company as aforesaid shall in all cases be strictly proportionate to the paid-up amount of the shares held by him.

(3) No public company as aforesaid which carries on life insurance business shall, after the commencement of the Insurance (Amendment) Act, 1950 (47 of 1950), issue any shares other than ordinary shares of the nature specified in sub-section (1).

(4) A public company as aforesaid which carries on life insurance business—

- (a) Shall maintain, in addition to the register of members to be maintained under the Indian Companies Act, 1913 (7 of 1913) a register of shares in which shall be entered the name, occupation and address of the beneficial owner of each share, and shall incorporate therein any change of beneficial owner declared to it within fourteen days from the receipt of such declaration;
- (b) Shall not register any transfer of its shares
 - (i) Unless, in addition to compliance being made with the provisions of section 34 of the Indian Companies Act, 1913 (7 of 1913), the transferee furnishes a declaration in the prescribed form as to whether he proposes to hold the shares for his own benefit or as a nominee, whether jointly or severally, on behalf of others and in the latter case giving the name, occupation and address of the beneficial owner or owners, and the extent of the beneficial interest of each;
 - (ii) Where, after the transfer, the total paid-up holding of the transferee in the shares of the company is likely to exceed five per cent of its paid-up capital or where the transferee is a banking or an investment company, is likely to exceed two and a half per cent of such paid-up capital, unless the previous approval of the Authority has been obtained to the transfer;
 - (iii) Where, the nominal value of the shares intended to be transferred by any individual, firm, group, constituents of a group, or body corporate under the same management, jointly or severally exceeds one per cent of the paid-up equity capital of the insurer, unless the previous approval of the Authority has been obtained for the transfer.

Explanation: For the purposes of this sub-clause, the expressions “group” and “same management” shall have the same meanings respectively assigned to them in the Monopolies and Restrictive Trade Practices Act, 1969 (54 of 1969);

(5) Every person who has any interest in any share of a company referred to in sub-section (4) which stands in the name of another person in the register of members of the company, shall, within thirty days from the commencement of the Insurance (Amendment) Act, 1950 (47 of 1950), or from the date on which he acquires such interest, whichever is later, make a declaration in the prescribed form (which shall be countersigned by the person in whose name the share is registered) to the company declaring his interest in such share, and notwithstanding anything contained in any other law or in any contract to the contrary, a person who fails to make a declaration as aforesaid in respect of any share shall be deemed to have no right or title whatsoever in that share:

Provided that nothing in this sub-section shall affect the right of a person who has an interest in any such share to establish in a court his right thereto, if the person, in whose name the share is registered, refuses to countersign the declaration as required by this sub-section:

Provided further that where any share, belonging to an individual who has made any such declaration as is referred to in this sub-section, is held by a company in its name in pursuance of any trust or for the purpose of safe custody or collection or realization of dividend, such individual shall, notwithstanding anything contained in the Indian Companies Act, 1913 (7 of 1913), or in the memorandum or articles of association of the company which has issued the share, be deemed to be the holder of the said share for the purpose of exercising any voting rights under this section to the exclusion of any other person.

(6) If the total paid-up holding of any person in the shares of a company referred to in sub-section (1) on the commencement of the Insurance (Amendment) Act 1950 (47 of 1950), exceeds two and a half per cent of its paid-up capital where that person is a banking company or an investment company, or five per cent of its paid-up capital in any other case, he shall not be entitled to any vote as a shareholder of the company in respect of such excess holding of shares.

(7) Where the total paid-up holding of any person in the shares of a company referred to sub-section (1) on the date of the commencement of the Insurance (Amendment) Act, 1950 (47 of 1950), exceeds five per cent of its paid-up capital where that person is a banking company or an investment company, or ten per cent of its paid-up capital in any other case, he shall dispose of the excess holding of shares within three years from such commencement or such further period not exceeding two years as may be allowed to him by the Central Government.

(8) If, after the expiry of three years or of such further period as may be allowed to any person under sub-section (7), the total paid up holding of any such person has not been reduced to the limits specified in that sub-section, any shares in excess of the limits specified in that sub-section shall vest in the Administrator-General of the State in which the registered office of the company concerned is situate and the Administrator-General shall take such steps as may be necessary for taking charge of any property which has so vested in him and shall dispose of the said shares and the proceeds thereof in such manner as may be prescribed.

(9) Subject to the other provisions contained in this section, but notwithstanding anything contained in the Indian Companies Act, 1913 (7 of 1913), or in the memorandum or articles of association of any such company as is referred to in sub-section (1), no such company shall refuse to register the transfer of any shares where the transfer is for the purpose of securing compliance with the provisions of sub-sections (7) and (8).

(10) The Central Government may, subject to such restrictions as it may think fit to impose, exempt from the operation of sub-sections (6), (7) and (8) any insurance company, in any case where the total paid-up holding of such insurance company in the shares of any other insurance company exceeds the limits specified in the said sub-sections, if the other insurance company is or is to be made a subsidiary company of the insurance company.

Notes

(11) The provisions of this section, except those of sub-sections (7), (8) and (9), shall, on and from the commencement of the Insurance (Amendment) Act, 1968, also apply to insurers carrying on general insurance business subject to the following notifications, namely:-

- (i) That references in sub-sections (1), (3), (5) and (6) to the Insurance (Amendment) Act, 1950, (47 of 1950), shall be construed as reference to the Insurance (Amendment) Act, 1968; and
- (ii) References in sub-section (10) to sub-sections (7) and (8) shall be omitted.

Explanation: For the purposes of this section, the holding of a person in the shares of a company shall be deemed to include:

- (i) The total paid-up holding in such shares held by such person in the name of others; and
- (ii) If any shares of the company are held –
 - (a) By a public limited company, of which such person is a member holding more than ten per cent of the paid-up capital, or
 - (b) By a private limited company, of which such person is a member, or
 - (c) By a company, of which such person is a managing director, manager, managing agent or in which he has a controlling interest, or
 - (d) By a firm in which such person is a partner, or
 - (e) By such person jointly with others, such part of the total paid-up holding of the company or firm or of the total joint holding in those shares, as is proportionate to the contribution made by such person to the paid-up capital of the company, the paid-up capital of the firm or the joint holding, as the case may be.

Self Assessment

Fill in the blanks:

- 13. No public company as aforesaid which carries on life insurance business shall, after the commencement of the Insurance (Amendment) Act, 1950, issue any shares other than shares of the nature specified in sub-section (1).
- 14. The holding of a person in the shares of a company shall be deemed to include the total holding in such shares held by such person in the name of others.



Case Study

Efforts on to pass Insurance Laws (Amendment) Bill in winter session: JD Seelam

Government will make all efforts to pass the Insurance Laws (Amendment) Bill in the on-going winter session of Parliament, Minister of State for Finance JD Seelam said:

“We are trying to push (for passage of the Insurance Bill in the current session). Let us see,” he said at an event on Investing in Multiple Financial Products – Optimising Returns & Minimising Risks, organised by Assocham.

The Insurance Laws (Amendment) Bill, 2008 provides for an increase in foreign investment limit from 26 per cent to 49 per cent.

Contd...

Notes

However, the standing committee on finance headed by senior BJP leader Yashwant Sinha is not in favour of the hike in FDI ceiling, indicating wide opposition to the proposal.

Seelam also said the government in association with the industry can make India an investor friendly country.

“We can in association with industry make India investor friendly. The products (financial) ought to be safe, transparent and it should be attractive... and to have a competent infrastructure. We are trying to improve the availability of finances,” he said.

He also said that savings rate in India is ‘pretty good’ and it should be used for circulation as it triggers growth.

“I think investment base needs to be increased by special design and instruments and then by specific products. Savings should be used for circulation because it triggers growth. We must have a proper regulatory and redressal mechanism so that people will find a worthy credit system.”

Referring to the economic situation, the Minister said the economy is now looking up due to strong fundamentals and that the current account deficit (CAD) would be within the prescribed limit.

“CAD will be definitely within the expected \$60 billion which is easily funded. Fiscal deficit would also be well below the red line drawn by the Finance Minister,” Seelam added.

However, he said inflation needs to be moderated and supply side bottlenecks cleared.

“Inflation of course, we need to moderate that. Thanks to the good monsoon, the food inflation should be contained after improving the supply chain because consumables like milk, eggs, vegetables and fruits are still showing up high inflation rate,” he added.

Retail or consumer price index (CPI) based inflation rose to 10.09 per cent in October due to costlier vegetables such as onion and tomatoes and fruit prices as compared to 9.52 per cent in September.

Question

Discuss the inclusions in Insurance Laws (Amendment) Bill.

Source: http://articles.economictimes.indiatimes.com/2013-12-06/news/44864212_1_winter-session-insurance-laws-current-account-deficit

6.7 Summary

- “Authority” means the Insurance Regulatory and Development Authority established under sub-section (1) of section 3 of the Insurance Regulatory and Development Authority Act, 1999;
- “Policy-holder” includes a person to whom the whole of the interest of the policy-holder in the policy is assigned once and for all, but does not include an assignee thereof whose interest in the policy is infeasible or is for the time being subject to any condition;
- “Auditor” means a person qualified under the Chartered Accountants Act, 1949 (38 of 1949), to act as an auditor of companies;
- “General insurance business” means fire, marine or miscellaneous insurance business, whether carried on singly or in combination with one or more of them;

Notes

- In making any appointment under this section, the Central Government shall have due regard to the following considerations, namely, whether the person to be appointed has had experience in industrial, commercial or insurance matter and whether such person has actuarial qualifications.
- The Government securities and other approved securities in which assets are under sub-section (1) to be invested and kept invested shall be held by the insurer free of any encumbrance, charge, hypothecation or lien.
- A certificate issued under this section shall entitle the holder thereof to act as a principal agent, chief agent, or special agent, as the case may be, for any insurer.
- The provisions of sub-sections (6) and (7) shall not take effect until the expiry of six months from the commencement of the Insurance (Amendment) Act, 1950.
- Every contract between an insurer and a principal agent shall be in writing and the terms contained in Part A of the Sixth Schedule shall be deemed to be incorporated in, and form part of, every such contract.
- An application for the renewal of a registration for any year shall be made by the insurer to the Authority before the 31st day of December of the preceding year, and shall be accompanied as provided in sub-section
- No public company as aforesaid which carries on life insurance business shall, after the commencement of the Insurance (Amendment) Act, 1950 (47 of 1950), issue any shares other than ordinary shares of the nature specified in sub-section (1).

6.8 Keywords

Fire Insurance Business: Fire insurance business means the business of effecting, otherwise than incidentally to some other class of insurance business, contracts of insurance against loss by or incidental to fire or other occurrence customarily included among the risks insured against in fire insurance Policies.

General Insurance Business: General insurance business means fire, marine or miscellaneous insurance business, whether carried on singly or in combination with one or more of them.

Managing Agent: Managing Agent means a person, firm or company entitled to the management of the whole affairs of a company by virtue of an agreement with the company, and under the control and direction of the directors except to the extent, if any, otherwise provided for in the agreement, and includes any person, firm or company occupying such position by whatever name called.

Policy-holder: Policy-holder includes a person to whom the whole of the interest of the policy-holder in the policy is assigned once and for all, but does not include an assignee thereof whose interest in the policy is infeasible or is for the time being subject to any condition.

6.9 Review Questions

1. Define authority as per the Insurance Act, 1938.
2. Explain approved securities as per the Insurance Act, 1938.
3. What do you mean by chief agent as per the Insurance Act, 1938?
4. Define Indian insurance company as per the Insurance Act, 1938.
5. Discuss fire insurance business and marine insurance business as per the Insurance Act, 1938.

6. Describe the main provisions of the Insurance Act, 1938.
7. Briefly explain the registration of principal agents, chief agents and special agents.
8. Explain the regulation of employment of principal agents.
9. Briefly discuss the renewal of registration.
10. What do you understand by capital requirements mentioned in the Insurance Act?

Notes

Answers: Self Assessment

- | | |
|----------------|----------------------|
| 1. Investment | 2. General |
| 3. Liabilities | 4. Government |
| 5. Certificate | 6. Disqualifications |
| 7. Writing | 8. Thirty |
| 9. Register | 10. Premium |
| 11. Annually | 12. Renewal |
| 13. Ordinary | 14. Paid-up |

6.10 Further Readings



Books

- Gulati, Neelam. C. (2011), *Banking and Insurance*, Excel Books.
- Gulati, Neelam. C. (2013), *Principles of Risk Management and Insurance*, Excel Books.
- Krishnaswamy. G. (2009), *Principles and Practice of Life Insurance*, Excel Books.
- Misra, M.N. and Mishra, S.B. (2009), *Insurance Principles and Practices*, S. Chand Publication.
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Online link

http://www.du.ac.in/fileadmin/DU/Academics/course_material/BI_02.pdf

Notes

Unit 7: Insurance Regulatory and Development Authority Act (IRDA Act)

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Objectives

After studying this unit, you will be able to:

- Explain the history of IRDA Act
- Discuss the overview of IRDA Act
- Describe the salient features of IRDA Act
- Explain the provisions of IRDA Act

Introduction

In previous units, you have studied the meaning of insurance and its importance and how it plays a very important role in economic development of the country. By now, you must be well versed that in insurance business, there is a contract between individuals or group or businessmen and insurance companies. The duration of these contracts varies from one year to thirty years or more and volume of such contracts are also very large.

In this unit, we will study in detail about Insurance Regulatory and Development Authority Act (IRDA Act). As you know, the insurance contract is of promises or assurances by the insurance companies to compensate the insured in case of mis-happening but nothing is tangible. When the product is intangible (which cannot be seen or touch) and volume of such contracts is huge then the disputes do arise in any industry. To settle these disputes the Government of any country appoints regulator and also enforces the law which controls the industry.

In the next unit, you will study about the meaning and definition of life insurance and whether or not life insurance is a scientific concept. You will also study about the classification of policies prevailing in market. It will also summarize the concepts of annuity and mortality tables. The next unit will also explain the role of LIC.

7.1 History

You must have observed that every country has its own insurance laws. In India also, Government started exercising control on Insurance business by passing two Acts in the year 1912 namely:

- Provident Insurance Societies Act V of 1912 and
- Indian Life Insurance Companies Act VI of 1912.

These acts were later comprehensively amended and a new Act namely Insurance Act 1938 came into existence for controlling:

- Investment of funds,
- Expenditure, and
- Management of the insurance companies.

The Office of Controller was established to implement this Act.

Again, this Act was amended in 1950 as per the need of the hour. But in view of growing malpractices in Life Insurance business and also due to the illiteracy level being high and lack of will for spread of Life Insurance business, it was nationalized by Government of India.

LIC Act was passed in June, 1956, and this Act came into force from 1st Sept.1956. Similarly general insurance business was nationalized Act came into force w.e.f. 1st April 1973 through General Insurance Business Nationalization Act 1972 (GIBN Act 1972). To implement these acts the Government made some minor changes in the Insurance Act 1938.

In early 90's, with the world market forces playing with full strength; growing literacy level; better regulatory systems and need for fast growth in this sector, the need of the hour was to go with the world and throw open Life and General Insurance Sector to private entrepreneurs once again so that there is no monopoly and the customer/consumer/buyer gets more choices than one type of Insurance product.

To study the liberalization process in Insurance sector in India, Malhotra Committee was formed under the Chairmanship of Late Shri R.N. Malhotra. The Malhotra committee submitted its report in 1994 which recommended that private companies be allowed to operate in India. The Government accepted the Committee's recommendation and Insurance Regulatory Authority (IRA) was set up in 1996 to show the path for privatization of insurance Industry. The main aim was the development of Insurance covering all strata of society (to not only rich but poor, folks from rural, tribal, unorganized sector, social sector, disabled community, daily wagers, women at large, etc.) gained importance through concerns put forth by political leaders, trade unionists, social organizations, cooperatives and policy makers; which amended the name IRA to IRDA (Insurance Regulatory & Development Authority). Again some amendments were made in the Insurance Act 1938 for smooth functioning of IRDA.

Notes

Self Assessment

Fill in the blanks:

1. The Office of was established to implement this Act.
2. The Malhotra committee submitted its report in 1994 which recommended that companies be allowed to operate in India.

7.2 Overview of IRDA Act

Let's have an overview of the IRDA Act. The IRDA (Insurance Regulatory and Development Authority) is the national regulatory body for Insurance industry (both Life and Non-Life Insurance Companies) under the auspices of Government of India, situated at Hyderabad. IRDA was established by an Act enacted in Indian Parliament known as IRDA Act 1999 and was amended in 2002 to incorporate some emerging requirements as well as to overcome some deficiencies in the entire process.



Notes The mission of IRDA as stated in the Act is as follows:

- (a) To protect the interests of the policyholders,
- (b) To promote, regulate and ensure orderly growth of the insurance industry and for matters connected therewith or incidental thereto, and
- (c) Conduction of insurance businesses across India in an ethical manner.

Full force and maximum utility of various institutions like Advisory Committee and self-regulatory organizations are not yet realized in India as the regulator seems to be in a long-learning mode. Due to over delegations, it is the individual incumbents that decide the pace and extent of utilization of prudential and statutory bodies.

Research on insurance sector is limited to opinion being sought through legacy channels. The Indian market mulls and patiently awaits the revision of Insurance Act along with establishment meaningfully functioning regulatory bodies that are devoid of excess delegation and subjective localization of development agencies.



Did u know? Unlike other Indian administrative regulatory bodies which are highly proactive, IRDA is perceived as a silent regulator with activities confined to its local existence.

Self Assessment

Fill in the blanks:

3. It is the individual incumbents that decide the pace and extent of utilization of and bodies.
4. Research on insurance sector is limited to opinion being sought through channels.

7.3 Salient Features of IRDA Act

Notes

By now, you must be eager to know the salient features of IRDA Act. Well, let's discuss them. The Insurance Regulatory Development Authority Act, 1999 marked the end of government monopoly in the insurance business. The IRDA Act received the assent of the President of India on 29 December 1999. The IRDA Act has ramifications on the Insurance Act (1938), the Life Insurance Corporation Act (1956) and the General Insurance Business (Nationalisation) Act (1972).

The following are salient features of the IRDA Act (1999):

1. The insurance sector in India has been thrown open to the private sector. The second and third schedules of the Act provide for removal of existing corporations (or companies) to carry out the business of life and general (non-life) insurance in India.
2. An Indian insurance company is a company registered under the Companies Act, 1956, in which foreign equity does not exceed 26 per cent of the total equity shareholding, including the equity shareholding of NRIs, FIIs and OCBs.
3. After commencement of an insurance company, the Indian promoters can hold more than 26 per cent of the total equity holding for a period of ten years, the balance shares being held by non-promoter Indian shareholders which will not include the equity of the foreign promoters, and the shareholding of NRIs, FIIs and OCBs.
4. After the permissible period of ten years, excess equity above the prescribed level of 26 per cent will be disinvested as per a phased programme to be indicated by IRDA. The Central Government is empowered to extend the period of ten years in individual cases and also to provide for higher ceiling on shareholding of Indian promoters in excess of which disinvestment will be required.
5. On foreign promoters, the maximum of 26 per cent will always be operational. They will thus be unable to hold any equity beyond this ceiling at any stage.
6. The Act gives statutory status for the Interim Insurance Regulatory Authority (IRA) set up by the Central Government through a Resolution passed in January 1996.
7. All the powers presently exercised under the Insurance Act, 1938, by the Controller of Insurance (CoI) will be transferred to the IRDA.
8. The IRDA Act also provides for the appointment of CoI by the Central Government when the Regulatory Authority is superseded.
9. The minimum amount of paid-up equity capital is ₹ 100 crore in case of life insurance as well as general insurance, and ₹ 200 crore in the case of re-insurance.
10. Solvency margin (excess of assets over liabilities) is fixed at not less than ₹ 50 crore for life as well as general insurance; for reinsurance solvency margin is stipulated at not less than ₹ 100 crore in each case.
11. Insurance companies will deposit ₹ 10 crore as security deposit before starting their business.
12. In the non-life sector, IRDA would give preference to companies providing health insurance.
13. Safeguards for policy holders' funds include specific provision prohibiting investment of policy holders' funds outside India and provision for investment of funds in accordance with policy directions of IRDA, including social and infrastructure investments.

Notes

14. Every insurer shall provide life insurance or general insurance policies (including insurance for crops) to the persons residing in the rural sector, workers in the unorganized or informal sector or for economically vulnerable or backward classes of the society and other categories of persons as may be specified by regulations made by IRDA.
15. Failure to fulfil the social obligations would attract a fine of ₹ .25 lakh; in case the obligations are still not fulfilled, license would be cancelled.

7.3.1 Salient Features of IRDA Guidelines for Insurance Plans

You need to know that the new guidelines issued by IRDA aim to make insurance policies more customer friendly.

The Insurance Regulatory and Development Authority (IRDA) has notified changes made to the guidelines on design of life insurance products in the gazette in February 2013. All existing group products will stand withdrawn from 1 July 2013 and all individual products from 1 October 2013.

These guidelines, effective from October 2013, aim to make insurance policies friendlier. Listed below are some salient features of these guidelines.

The new guidelines have introduced three broad categories of products—Traditional insurance plans, variable insurance plans (VIPs) and unit-linked insurance plans (ULIPs).

Traditional Plans: According to the guidelines, the product design of traditional plans would remain almost the same. These plans would continue to come in two variants: Participating and non-participating plans.

For participating policies the bonus is linked to the performance of the fund and is not declared or guaranteed before. But, the bonus once announced becomes a guarantee. It is usually paid in case of death of the policyholder or maturity benefit. This bonus is also called reversionary bonus.

In case of non-participating policies, the return on the policy is disclosed in the beginning of the policy itself. In both cases, a policyholder should calculate the net return to assess the total costs.

New traditional products will have a higher death cover. For regular premium policies, the cover will be 10 times the annualised premium paid for those below 45 and seven times for others. The minimum death benefit in case of traditional plan is at least the amount of sum assured and the additional benefits (if any).

ULIPs: In case of ULIPs, life insurers will now have to inform policyholders of the reduction in yield of their ULIPs on a monthly basis. Reduction in yield—difference between gross and net yields (expressed in %)—refers to the lowering of investment growth within a fund due to various charges.

The net yield can be arrived at after deducting all prescribed charges from the gross yield. Insurers will also issue annual certificates mentioning the premiums paid, charges and taxes deducted from the fund value, and the final payments made.

Variable Insurance Plans: The guidelines have mentioned that VIPs will guarantee a certain minimum rate of return at the beginning of buying a policy—though they are linked to an index. As VIPs will be treated at par with ULIPs, those products will follow the same commission package for ULIPs. Under linked products, agents are entitled to commission of up to only 10%. The charge structure and discontinuance norms of VIPs will be in line with ULIPs.

This basic minimum rate of return is also called floor rate. Additional benefits depend on the type of the policy. In the case of a non-participating VIP, the additional benefit will be mentioned at the time of buying the policy and may accumulate in the policy at specified intervals.

Participating VIPs normally provide a regular non-guaranteed bonus, which will be guaranteed once declared. Each policyholder will have a policy account in which the premiums—net of charges—will get credited. The minimum floor rate and additional rates will apply to this balance. On maturity, the policyholder will get the value in the policy account.

Reduced Commissions

The IRDA guidelines have reduced commissions on short-term policies and have linked the quantity of commissions to the premium paying period for all products.

Agents of single premium non-pension products will receive remuneration of up to 2% of the premium paid. In case of regular premium insurance policies, a policy with a premium paying term of five years will pay up to 15% in the first year, 7.5% in the second and third year and 5% subsequently. As the premium paying term increases to 12 years and above, the commissions payable in the first year increases up to 35% in case the company is at least 10 years old and 40% in case the company is less than 10 years old. The regulator has framed the entire format on the basis of tenure of the policies

In case of direct sale of products, such as the online mode, there will be no commissions and this benefit will be passed on to the policyholder.

Death Benefit and Surrender Value

The minimum death benefit in case of VIPs and ULIPs is the policy account value or higher of the two. The minimum guaranteed surrender value for traditional plans has been increased. For traditional plans, with a premium paying term of 10 years or more, there will be a guaranteed surrender value after three years. For premium paying terms of less than 10 years, the guaranteed surrender value will accrue after the second year. This guarantee surrender value will be 30% of total premiums paid.

Currently, the guaranteed surrender value is usually 30% of all the premiums paid minus the first-year premium and is paid only if premiums have been paid for three years.



Caution According to the new guidelines, the surrender value becomes 50% between the fourth and the seventh years, after which the insurer would have to file a surrender charge that needs to be cleared by the regulator.

Health Insurance

The IRDA in February 2013 has also issued guidelines to standardize health insurance in India. Now, all health insurance policies would be renewable for lifetime and will have an entry age of at least 65 years. All policies except customised ones will be renewable for life time. Insurers have to settle claims within 30 days after the receipt of all the documents.



Did u know? The IRDA has introduced 15 days free-look period—A period where a new insurance policyholder is able to terminate the contract without penalties such as surrender charges.

In case of a claim, no-claim bonus can be reduced proportionately, however it won't be zero. In a health insurance policy, when a renewal is made without any claims in the preceding period of the policy, the insurer offers a bonus to the policyholder. This bonus is usually in the form of

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a discount in the premium around 5% for every claim-free year. The bonus can go up to 50%, provided no claim is made for 10 consecutive years. Any discount or loading in the renewal premium will be mentioned to the policyholder at the time of policy renewal.



Caselet

New IRDA norms Promise Challenging year for Life Insurers

The new year promises to be a challenging one for life insurers. They will need to phase out various old products in keeping with new norms.

From January 1, only products that conform to the new guidelines announced by the Insurance Regulatory and Development Authority (IRDA) in the first half of 2013 are allowed for sale.

This means insurers need to re-file all their products for approval.

“We have cleared over 500 products in line with the new design norms which are being introduced by the insurers in a progressive manner,” IRDA Chairman T.S. Vijayan told Business Line. Most insurers have already redesigned their products and also obtained approvals. While some have already been launched, the rest will be rolled out in the new year.

Reliance Life Insurance CEO Anup Rau told Business Line his company has lined up over 25 products for launch from next month.

It is largely believed that the regulatory changes will pave the way for the sustainable growth of the industry in the long term. However, they may pose immediate challenges to insurers, it is feared.

The life insurance industry is just recovering from drastic regulatory changes introduced in 2010 in unit-linked insurance products, which were then the most popular products. Since then, the first year premium (new business) has declined. It was only in the quarter ended September 30, 2013 that growth was revived.

But the new norms for traditional life products might pose a fresh challenge from next month. “The industry may see some business disruption in the short term while they are engaged in retraining their distribution force. Therefore, the changes will result in short-term pains due to lower commissions by the advisors,” Rau said.

Training Agents

According to Alok Roongta, CFO of Bharti AXA Life Insurance, training a large number of agents in selling new products will be another challenge for the industry.

The business impact of the new norms has much to be watched. “Till now, most of the regulatory changes impacted only private insurers. This is the first time that Life Insurance Corporation will also be impacted by these norms. The impact could be different,” Roongta added.

Whether or not life insurance firms will sustain the growth posted after nearly three years remains to be seen.

Source: <http://www.thehindubusinessline.com/industry-and-economy/banking/new-ir-da-norms-promise-challenging-year-for-life-insurers/article5490153.ece>

Self Assessment

Notes

Fill in the blanks:

5. The IRDA Act received the assent of the of India on 29 December 1999.
6. An Indian company is a company registered under the Companies Act, 1956.
7. Insurance companies will deposit ₹ 10 crore as deposit before starting their business.
8. For policies the bonus is linked to the performance of the fund and is not declared or guaranteed before.

7.4 Provisions of IRDA Act

You must remember the provisions of IRDA Act. To provide for the establishment of an Authority to protect the interests of holders of insurance policies, to regulate, promote and ensure orderly growth of the insurance industry and for matters connected therewith or incidental thereto and further to amend the Insurance Act, 1938, the Life Insurance Corporation Act, 1956 and the General Insurance Business (Nationalisation) Act, 1972.

Be it enacted by Parliament in Fiftieth Year of Republic of India as follows:-

7.4.1 Chapter I – Preliminary

1. Short Title, Extent and Commencement - (1) This Act may be called the Insurance Regulatory and Development Authority Act, 1999.

(2) It extends to the whole of India.

(3) It shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint:

Provided that different dates may be appointed for different provisions of this Act and any reference in any such provision to the commencement of this Act shall be construed as a reference to the coming into force of that provision.

2. Definitions - (1) In this Act, unless the context otherwise requires, –

- (a) “appointed day” means the date on which the Authority is established under sub-section (1) of section 3;
- (b) “Authority” means the Insurance Regulatory and Development Authority established under sub-section (1) of section 3;
- (c) “Chairperson” means the Chairperson of the Authority;
- (d) “Fund” means the Insurance Regulatory and Development Authority Fund constituted under sub-section (1) of section 16;
- (e) “Interim Insurance Regulatory Authority” means the Insurance Regulatory Authority set up by the Central Government through Resolution No. 17(2)/94-Ins-V, dated the 23rd January, 1996;
- (f) “intermediary or insurance intermediary” includes insurance brokers, reinsurance brokers, insurance consultants, surveyors and loss assessors;

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- (g) “member” means a whole time or a part time member of the Authority and includes the Chairperson;
- (h) “notification” means a notification published in the Official Gazette;
- (i) “prescribed” means prescribed by rules made under this Act;
- (j) “regulations” means the regulations made by the Authority.

(2) Words and expressions used and not defined in this Act but defined in the Insurance Act, 1938 (4 of 1938) or the Life Insurance Corporation Act, 1956 (31 of 1956) or the General Insurance Business (Nationalization) Act, 1972 (57 of 1972) shall have the meanings respectively assigned to them in those Acts.

7.4.2 Chapter II – Insurance Regulatory and Development Authority

3. Establishment and Incorporation of Authority - (1) with effect from such date as the Central Government may, by notification, appoint, there shall be established, for the purposes of this Act, an Authority to be called “the Insurance Regulatory and Development Authority”.

(2) The Authority shall be a body corporate by the name aforesaid having perpetual succession and a common seal with power, subject to the provisions of this Act, to acquire, hold and dispose of property, both movable and immovable, and to contract and shall, by the said name, sue or be sued.

(3) The head office of the Authority shall be at such place as the Central Government may decide from time to time.

(4) The Authority may establish offices at other places in India.

4. Composition of Authority - The Authority shall consist of the following members, namely:-

- (a) A Chairperson;
- (b) Not more than five whole-time members;
- (c) Not more than four part-time members,

To be appointed by the Central Government from amongst persons of ability, integrity and standing who have knowledge or experience in life insurance, general insurance, actuarial science, finance, economics, law, accountancy, administration or any other discipline which would, in the opinion of the Central Government, be useful to the Authority:

Provided that the Central Government shall, while appointing the Chairperson and the whole-time members, ensure that at least one person each is a person having knowledge or experience in life insurance, general insurance or actuarial science, respectively.

5. Tenure of Office of Chairperson and Other Members - (1) The Chairperson and every other whole-time member shall hold office for a term of five years from the date on which he enters upon his office and shall be eligible for reappointment:

Provided that no person shall hold office as a Chairperson after he has attained the age of sixty-five years:

Provided further that no person shall hold office as a whole-time member after he has attained the age of sixty two years of age.

(2) A part-time member shall hold office for a term not exceeding five years from the date on which he enters upon his office.

(3) Notwithstanding anything contained in sub-section (1) or sub-section (2), a member may –

- (a) Relinquish his office by giving in writing to the Central Government notice of not less than three months; or
- (b) Be removed from his office in accordance with the provisions of section 6.

6. Removal From Office - (1) The Central Government may remove from office any member who-

- (a) Is, or at any time has been, adjudged as an insolvent; or
- (b) Has become physically or mentally incapable of acting as a member; or
- (c) Has been convicted of any offence which, in the opinion of the Central Government, involves moral turpitude; or
- (d) Has acquired such financial or other interest as is likely to affect prejudicially his functions as a member; or
- (e) Has so abused his position as to render his continuation in office detrimental to the public interest.

(2) No such member shall be removed under clause (d) or clause (e) of sub-section (1) unless he has been given a reasonable opportunity of being heard in the matter.

7. Salary and Allowances of Chairperson and Members - (1) The salary and allowances payable to, and other terms and conditions of service of, the members other than part-time members shall be such as may be prescribed.

(2) The part-time members shall receive such allowances as may be prescribed.

(3) The salary, allowances and other conditions of service of a member shall not be varied to his disadvantage after appointment.

8. Bar on Future Employment of Members - The Chairperson and the whole-time members shall not, for a period of two years from the date on which they cease to hold office as such, except with the previous approval of the Central Government, accept-

- (a) Any employment either under the Central Government or under any State Government; or
- (b) Any appointment in any company in the insurance sector.

9. Administrative Powers of Chairperson - The Chairperson shall have the powers of general superintendence and direction in respect of all administrative matters of the Authority.

10. Meetings of Authority - (1) The Authority shall meet at such times and places and shall observe such rules and procedures in regard to transaction of business at its meetings (including quorum at such meetings) as may be determined by the regulations.

(2) The Chairperson, or if for any reason he is unable to attend a meeting of the Authority, any other member chosen by the members present from amongst themselves at the meeting shall preside at the meeting.

(3) All questions which come up before any meeting of the Authority shall be decided by a majority of votes by the members present and voting, and in the event of an equality of votes, the Chairperson, or in his absence, the person presiding shall have a second or casting vote.

(4) The Authority may make regulations for the transaction of business at its meetings.

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11. Vacancies, etc., not to Invalidate Proceedings of Authority - No act or proceeding of the Authority shall be invalid merely by reason of –

- (a) Any vacancy in, or any defect in the constitution of, the Authority; or
- (b) Any defect in the appointment of a person acting as a member of the Authority; or
- (c) Any irregularity in the procedure of the Authority not affecting the merits of the case.

12. Officers and Employees of Authority - (1) The Authority may appoint officers and such other employees as it considered necessary for the efficient discharge of its function under this Act.

(2) The terms and other conditions of service of officers and other employees of the Authority appointed under sub-section (1) shall be governed by regulations made under this Act.

7.4.3 Chapter III – Transfer of Assets, Liabilities, etc., of Interim Insurance Regulatory Authority

13. Transfer of assets, liabilities, etc., of interim insurance regulatory authority - On the appointed day,–

(a) all the assets and liabilities of the Interim Insurance Regulatory Authority shall stand transferred to, and vested in, the Authority.



Notes The assets of the Interim Insurance Regulatory Authority shall be deemed to include all rights and powers, and all properties, whether movable or immovable, including, in particular, cash balances, deposits and all other interests and rights in, or arising out of, such properties as may be in the possession of the Interim Insurance Regulatory Authority and all books of account and other documents relating to the same; and liabilities shall be deemed to include all debts, liabilities and obligations of whatever kind.

(b) without prejudice to the previous of clause (a), all debts, obligations and liabilities incurred, all contracts entered into and all matters and things engaged to be done by, with or for the Interim Insurance Regulatory Authority immediately before that day, for or in connection with the purpose of the said Regulatory Authority, shall be deemed to have been incurred, entered into or engaged to be done by, with or for, the Authority;

(c) all sums of money due to the Interim Insurance Regulatory Authority immediately before that day shall be deemed to be due to the Authority; and

(d) all suits and other legal proceedings instituted or which could have been instituted by or against the Interim Insurance Regulatory Authority immediately before that day may be continued or may be instituted by or against the Authority.

7.4.4 Chapter IV – Role and Functions of IRDA

14. Duties, Powers and Functions of Authority - (1) Subject to the provisions of this Act and any other law for the time being in force, the Authority shall have the duty to regulate, promote and ensure orderly growth of the insurance business and re-insurance business.

(2) Without prejudice to the generality of the provisions contained in sub-section (1), the powers and functions of the Authority shall include, -

(a) Issue to the applicant a certificate of registration, renew, modify, withdraw, suspend or cancel such registration;

- (b) Protection of the interests of the policy holders in matters concerning assigning of policy, nomination by policy holders, insurable interest, settlement of insurance claim, surrender value of policy and other terms and conditions of contracts of insurance;
- (c) Specifying requisite qualifications, code of conduct and practical training for intermediary or insurance intermediaries and agents;
- (d) Specifying the code of conduct for surveyors and loss assessors;
- (e) Promoting efficiency in the conduct of insurance business;
- (f) Promoting and regulating professional organizations connected with the insurance and re-insurance business;
- (g) Levying fees and other charges for carrying out the purposes of this Act;
- (h) Calling for information from, undertaking inspection of, conducting enquiries and investigations including audit of the insurers, intermediaries, insurance intermediaries and other organizations connected with the insurance business;
- (i) Control and regulation of the rates, advantages, terms and conditions that may be offered by insurers in respect of general insurance business not so controlled and regulated by the Tariff Advisory Committee under section 64U of the Insurance Act, 1938 (4 of 1938);
- (j) Specifying the form and manner in which books of account shall be maintained and statement of accounts shall be rendered by insurers and other insurance intermediaries;
- (k) Regulating investment of funds by insurance companies;
- (l) Regulating maintenance of margin of solvency;
- (m) Adjudication of disputes between insurers and intermediaries or insurance intermediaries;
- (n) Supervising the functioning of the Tariff Advisory Committee;
- (o) Specifying the percentage of premium income of the insurer to finance schemes for promoting and regulating professional organizations referred to in clause (f);
- (p) Specifying the percentage of life insurance business and general insurance business to be undertaken by the insurer in the rural or social sector; and
- (q) Exercising such other powers as may be prescribed.

7.4.5 Chapter V – Finance, Accounts and Audit

15. Grants by Central Government: The Central Government may, after due appropriation made by Parliament by law in this behalf, make to the Authority grants of such sums of money as the Government may think fit for being utilised for the purposes of this Act.

16. Constitution of Funds - (1) There shall be constituted a fund to be called “the Insurance Regulatory and Development Authority Fund” and there shall be credited thereto-

- (a) All Government grants, fees and charges received by the Authority;
 - (b) All sums received by the Authority from such other source as may be decided upon by the Central Government;
 - (c) The percentage of prescribed premium income received from the insurer.
- (2) The Fund shall be applied for meeting -
- (a) The salaries, allowances and other remuneration of the members, officers and other employees of the Authority;

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- (b) The other expenses of the Authority in connection with the discharge of its functions and for the purposes of this Act.

17. Accounts and Audit - (1) The Authority shall maintain proper accounts and other relevant records and prepare an annual statement of accounts in such form as may be prescribed by the Central Government in consultation with the Comptroller and Auditor-General of India.

(2) The accounts of the Authority shall be audited by the Comptroller and Auditor-General of India at such intervals as may be specified by him and any expenditure incurred in connection with such audit shall be payable by the Authority to the Comptroller and Auditor-General.

(3) The Comptroller and Auditor-General of India and any other person appointed by him in connection with the audit of the accounts of the Authority shall have the same rights, privileges and authority in connection with such audit as the Comptroller and Auditor-General generally has in connection with the audit of the Government accounts and, in particular, shall have the right to demand the production of books of account, connected vouchers and other documents and papers and to inspect any of the offices of the Authority.

(4) The accounts of the Authority as certified by the Comptroller and Auditor-General of India or any other person appointed by him in this behalf together with the audit-report thereon shall be forwarded annually to the Central Government and that Government shall cause the same to be laid before each House of Parliament.

7.4.6 Chapter VI – Miscellaneous

18. Power of Central Government to Issue Directions - (1) Without prejudice to the foregoing provisions of this Act, the Authority shall, in exercise of its powers or the performance of its functions under this Act, be bound by such directions on questions of policy, other than those relating to technical and administrative matters, as the Central Government may give in writing to it from time to time:

Provided that the Authority shall, as far as practicable, be given an opportunity to express its views before any direction is given under this sub-section.

(2) The decision of the Central Government, whether a question is one of policy or not, shall be final.

19. Power of Central Government to Supersede Authority - (1) If at any time the Central Government is of the opinion-

- (a) That, on account of circumstances beyond the control of the Authority, it is unable to discharge the functions or perform the duties imposed on it by or under the provisions of this Act, or
- (b) That the Authority has persistently defaulted in complying with any direction given by the Central Government under this Act or in the discharge of the functions or performance of the duties imposed on it by or under the provisions of this Act and as a result of such default the financial position of the Authority or the administration of the Authority has suffered; or
- (c) That circumstances exist which render it necessary in the public interest so to do, the Central Government may, by notification and for reasons to be specified therein, supersede the Authority for such period, not exceeding six months, as may be specified in the notification and appoint a person to be the Controller of Insurance under section 2B of the Insurance Act, 1938 (4 of 1938), if not already done:

Provided that before issuing any such notification, the Central Government shall give a reasonable opportunity to the Authority to make representations, if any, of the Authority.

- (2) Upon the publication of a notification under sub-section (1) superseding the Authority, -
- (a) The Chairperson and other members shall, as from the date of super-session, vacate their offices as such;
 - (b) All the powers, functions and duties which may, by or under the provisions of this Act, be exercised or discharged by or on behalf of the Authority shall, until the Authority is reconstituted under sub-section (3), be exercised and discharged by the Controller of Insurance; and
 - (c) All properties owned or controlled by the Authority shall, until the Authority is reconstituted under sub-section (3), vest in the Central Government.
- (3) On or before the expiration of the period of super-session specified in the notification issued under sub-section (1), the Central Government shall reconstitute the Authority by a fresh appointment of its Chairperson and other members and in such case any person who had vacated his office under clause (a) of sub-section (2) shall not be deemed to be disqualified for reappointment.
- (4) The Central Government shall cause a copy of the notification issued under sub-section (1) and a full report to any action to be laid before each House of Parliament at the earliest.

20. Furnishing of returns, etc., to central government - (1) The Authority shall furnish to the Central Government at such time and in such form and manner as may be prescribed, or as the Central Government may direct to furnish such returns, statements and other particulars in regard to any proposed or existing programme for the promotion and development of the insurance industry as the Central Government may, from time to time, require.

(2) Without prejudice to the provisions of sub-section (1), the Authority shall, within nine months after the close of each financial year, submit to the Central Government a report giving a true and full account of its activities including the activities for promotion and development of the insurance business during the previous financial year.

(3) Copies of the reports received under sub-section (2) shall be laid, as soon as may be after they are received, before each House of Parliament.

21. Chairperson, Members, Officers and Other Employees of Authority to be Public Servants - The Chairperson, members, officers and other employees of Authority shall be deemed, when acting or purporting to act in pursuance of any of the provisions of this Act, to be public servants within the meaning of section 21 of the Indian Penal Code (45 of 1860).

22. Protection of Action Taken in Good Faith - No suit, prosecution or other legal proceedings shall lie against the Central Government or any officer of the Central Government or any member, officer or other employee of the Authority for anything which is in good faith done or intended to be done under this Act or the rules or regulations made thereunder:

Provided that nothing in this Act shall exempt any person from any suit or other proceedings which might, apart from this Act, be brought against him.

23. Delegation of Powers - (1) The Authority may, by general or special order in writing, delegate to the Chairperson or any other member or office of the Authority subject to such conditions, if any, as may be specified in the order such of its powers and functions under this Act as it may deem necessary.

(2) The Authority may, by a general or special order in writing, also form committees of the members and delegate to them the powers and functions of the Authority as may be specified by the regulations.

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24. Power to Make Rules - (1) The Central Government may, by notification, make rules for carrying out the provisions of this Act.

(2) In particular, and without prejudice to the generality of the foregoing power, such rules may provide for all or any of the following matters, namely:

- (a) The salary and allowances payable to, and other terms and conditions of service of, the members other than part-time members under sub-section (1) of section 7;
- (b) The allowances to be paid to the part-time members under sub-section(2) of section 7;
- (c) Such other powers that may be exercised by the Authority under clause (q) of sub-section (2) of section 14;
- (d) The form of annual statement of accounts to be maintained by the Authority under sub-section (1) of section 17;
- (e) The form and the manner in which and the time within which returns and statements and particulars are to be furnished to the Central Government under sub-section (1) of section 20;
- (f) The matters under sub-section (5) of section 25 on which the Insurance Advisory Committee shall advise the Authority;
- (g) Any other matter which is required to be, or may be, prescribed, or in respect of which provision is to be or may be made by rules.

25. Establishment of Insurance Advisory Committee - (1) The Authority may, by notification, establish with effect from such date as it may specify in such notification, a Committee to be known as the Insurance Advisory Committee.

(2) The Insurance Advisory Committee shall consist of not more than twenty-five members excluding ex-officio members to represent the interests of commerce, industry, transport, agriculture, consumer forums, surveyors, agents, intermediaries, organizations engaged in safety and loss prevention, research bodies and employees' association in the insurance sector.

(3) The Chairperson and the members of the Authority shall be the ex officio Chairperson and ex-officio members of the Insurance Advisory Committee.

(4) The objects of the Insurance Advisory Committee shall be to advise the Authority on matters relating to the making of the regulations under section 26.

(5) Without prejudice to the provisions of sub-section (4), the Insurance Advisory Committee may advise the Authority on such other matters as may be prescribed.

26. Power to Make Regulations - (1) The Authority may, in consultation with the Insurance Advisory Committee, by notification, make regulations consistent with this Act and the rules made thereunder to carry out the purposes of this Act.

(2) In particular, and without prejudice to the generality of the foregoing power, such regulations may provide for all or any of the following matters, namely:-

- (a) The time and places of meetings of the Authority and the procedure to be followed at such meetings including the quorum necessary for the transaction of business under sub-section (1) of section 10;
- (b) The transactions of business at its meetings under sub-section (4) of section 10;
- (c) The terms and other conditions of service of officers and other employees of the Authority under sub-section (2) of section 12;


- (d) The powers and functions which may be delegated to Committees of the members under sub-section (2) of section 23; and
- (e) Any other matter which is required to be, or may be, specified by regulations or in respect of which provision is to be or may be made by regulations.

27. Rules and Regulations to be laid Before Parliament - Every rule and every regulation made under this Act shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive session aforesaid, both Houses agree in making any, modification in the rule or regulation or both Houses agree that the rule or regulation should not be made, the rule or regulation shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that rule or regulation.

28. Application of Other Laws not Barred. - The provisions of this Act shall be in addition to, and not in derogation of, the provisions of any other law for the time being in force.

29. Power to Remove Difficulties - (1) If any difficulty arises in giving effect to the provisions of this Act, the Central Government may, by order published in the Official Gazette, make such provisions not inconsistent with the provisions of this Act as may appear to be necessary for removing the difficulty:

Provided, that no order shall be made under this section after the expiry of two years from the appointed day.

 <i>Task</i> Prepare a presentation on the main provisions of IRDA Act.

(2) Every order made under this section shall be laid, as soon as may be, after it is made, before each House of Parliament.

30. Amendment of Act 4 of 1938 - The Life Insurance Act, 1938 shall be amended in the manner specified in the First Schedule to this Act.

31. Amendment of Act 31 of 1956 - The Life Insurance Corporation Act, 1956 shall be amended in the manner specified in the Second Schedule to this Act.

32. Amendment of Act 57 of 1972 - The General Insurance Business (Nationalization) Act, 1972 shall be amended in the manner specified in the Third Schedule to this Act.

Self Assessment

Fill in the blanks:

- 9. The Authority shall be a body corporate by the name aforesaid having succession and a common seal.
- 10. The head office of the Authority shall be at such place as the Government may decide from time to time.
- 11. The Chairperson and every other whole-time member shall hold office for a term of years from the date on which he enters upon his office and shall be eligible for reappointment.
- 12. All the assets and liabilities of the Insurance Regulatory Authority shall stand transferred to, and vested in, the Authority.

- Notes
13. The accounts of the Authority shall be audited by the and of India.
 14. The Authority shall furnish to the Central Government statements and other particulars in regard to any proposed or existing programme for the and development of the insurance industry.



Case Study

IRDA Tweaks Investment Norms for Insurance Companies

IRDA tweaked norms for insurance companies to invest their funds in different market instruments like government securities and corporate debt to channelize long term savings in infrastructure sector.

Life insurance companies can now be invested in central government securities which should not be less than 25 per cent of the total corpus, Insurance Regulatory Development Authority (IRDA) said in a notification.

However, the total investment in central government securities, state government securities and other approved securities cannot be less than 50 per cent taken together.

At the same time, it has allowed life insurers to invest in housing and infrastructure bonds, with ratings of not less than AA by credit rating agencies. The total investment in the category will not be less than 15 per cent.

On pension funds, the guidelines said money generated from them will be invested in the government bonds, up to 40 per cent of the fund value, while not more than 60 per cent would be invested in other approved instruments.

As for investments in ULIP funds, the guidelines said that at least 30 per cent of the fund value would be invested in government securities and 5 per cent can be invested in housing and infrastructure bonds.

The remaining can be invested in the other approved investment categories.

Question

Analyse the pros and cons of these tweaks issued by IRDA.

Source: http://articles.economictimes.indiatimes.com/2013-03-07/news/37531996_1_infrastructure-bonds-irda-ulip

7.5 Summary

- In early 90's, with the world market forces playing with full strength; growing literacy level; better regulatory systems and need for fast growth in this sector, the need of the hour was to go with the world and throw open Life & General Insurance Sector to private entrepreneurs once again so that there is no monopoly and the customer/consumer/buyer gets more choices than one type of Insurance product.
- Full force and maximum utility of various institutions like Advisory Committee and self-regulatory organizations are not yet realized in India as the regulator seems to be in a long-learning mode.

- The Insurance Regulatory and Development Authority (IRDA) has notified changes made to the guidelines on design of life insurance products in the gazette in February 2013. All existing group products will stand withdrawn from 1 July 2013 and all individual products from 1 October 2013.
- In case of non-participating policies, the return on the policy is disclosed in the beginning of the policy itself. In both cases, a policyholder should calculate the net return to assess the total costs.
- The IRDA in February 2013 has also issued guidelines to standardize health insurance in India. Now, all health insurance policies would be renewable for lifetime and will have an entry age of at least 65 years. All policies except customised ones will be renewable for life time. Insurers have to settle claims within 30 days after the receipt of all the documents.
- The Chairperson and every other whole-time member shall hold office for a term of five years from the date on which he enters upon his office and shall be eligible for reappointment:
- Control and regulation of the rates, advantages, terms and conditions that may be offered by insurers in respect of general insurance business not so controlled and regulated by the Tariff Advisory Committee under section 64U of the Insurance Act, 1938 (4 of 1938);
- The accounts of the Authority shall be audited by the Comptroller and Auditor-General of India at such intervals as may be specified by him and any expenditure incurred in connection with such audit shall be payable by the Authority to the Comptroller and Auditor-General.

7.6 Keywords

Appointed Day: It means the date on which the Authority is established under sub-section (1) of section 3.

Intermediary: Intermediary or insurance intermediary includes insurance brokers, reinsurance brokers, insurance consultants, surveyors and loss assessors.

Member: Member means a whole time or a part time member of the Authority and includes the Chairperson.

Notification: Notification means a notification published in the Official Gazette.

Regulations: Regulations mean the regulations made by the Authority.

7.7 Review Questions

1. What is IRDA Act made for?
2. Discuss the history of IRDA Act in detail.
3. Give an overview of IRDA Act in your own words.
4. Discuss the salient features of IRDA Act.
5. Briefly explain the delegation of powers by the concerned authority.
6. Discuss the roles and functions of IRDA.
7. Describe the purpose of establishment of Insurance advisory committee.
8. Give any five definitions mentioned in the IRDA Act.

Notes

Answers: Self Assessment

- | | |
|----------------------------------|------------------|
| 1. Controller | 2. Private |
| 3. Prudential, statutory | 4. Legacy |
| 5. President | 6. Insurance |
| 7. Security | 8. Participating |
| 9. Perpetual | 10. Central |
| 11. Five | 12. Interim |
| 13. Comptroller, Auditor-General | 14. Promotion |

7.8 Further Readings



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- <http://www.medindia.net/patients/insurance/insurance-concepts-and-irda-act.htm>

Unit 8: Life Insurance

Notes

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Objectives

After studying this unit, you will be able to:

- Explain the meaning of life insurance
- Discuss if life insurance is a scientific concept

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- Classify the policies prevailing in market
- Describe the concepts of annuity, mortality tables
- Explain the role of LIC

Introduction

In the previous unit, you have studied about the history of IRDA act. The unit also gave an overview IRDA act. The previous unit also summarized the salient features of IRDA act as well as the provisions of IRDA act.

You need to know that a good financial planning will protect an individual from unforeseen financial crisis. It will provide required financial support and confidence. Financial planning can be done for long-term or short-term depending upon the need to cover the entire life or part thereof of an individual.

As we know, financial needs and priorities keep changing from one stage of life to another. Even the earning of a person may also change from time to time. An individual has to undergo various phases of life viz., student, middle-aged person, and retired individual. Each stage of life requires a different financial plan. A prudent individual will prepare his/her financial plans on the basis of the needs, desires and priorities of life.

You must also keep in mind the various related social, economic and environment factors. An individual should realize that life insurance, apart from meeting the contingencies and administering savings, also offers the benefit of peace of mind. So, in this unit you will study about life insurance in detail.

In the next unit, you will study about the various elements of general contract. The unit will also deal with the meaning and definition of marine insurance, kinds of marine insurance policies and various clauses incorporated in marine insurance. It will also summarize the concepts of marine losses and payment of claims.

8.1 Meaning and Definition of Life Insurance

You must be aware that life insurance is protection against financial loss resulting from insured Individual's death. In legal terms life insurance is a contract the policy owner and the insurer, where the latter agrees to reimburse the occurrence of the insured individual's death or other event such as terminal illness or critical illness. The insured agrees to pay the cost in terms of insurance premium for the service.

The elements of life insurance are risk coverage and savings for future. Life Insurance provides you and your family with protection against all the risks involved, moreover providing you an opportunity to grow your investments. It could be viewed as a long-term investment to provide for your child's future expenses or your expenses, post retirement.

It is the earnest desire of every individual to own property. Anyone who is in possession of something tangible feels secure. But very few people have adequate income to own something of their own. It is just they failed to plan and not planned to fail.



Caution It is always desirable that we identify our financial needs and buy an instrument rather than buy the instrument and try to fit in our needs. Financial planning has become more complex because of greater economic uncertainty, constantly changing tax laws and varieties of options.

It is very difficult to prepare a list of all financial needs. But it can be divided into capital needs like emergency funds, education needs, marriage needs and income needs like family income, retirement needs. Life Insurance has been recognized as one of the best instruments of family financial program. Usually people look at investment in life Insurance as risk cover/investment, combination of both the above, adequately long term, safe investment, moderate yield and tax savings.

The need levels of individuals in Life Insurance naturally depend on the age group. Every one of us has the following Insurance needs at every point of our life. But the degree of need depends on age. The recognized needs are protection for self and family, children needs, retirement needs, special needs like health and housing.

Several definitions of life insurance contract have been given from time to time by learned persons, Judges and in the insurance legislation as under:

A contract of life insurance is that in which one party agrees to pay a given sum on the happening of a particular event contingent upon the duration of human life, in consideration of the immediate payment of a smaller sum or certain equivalent periodical payments by another.

– Bunion

Life Insurance contract may be defined whereby the insurer, in consideration of a premium paid either in lump sum or in periodical instalments, undertakes to pay an annuity of a certain sum of money either on the death of the insured or on the expiry of a certain number of years.

– R.S. Sharma

A contract of Life Assurance is that in which one party agrees to pay a given sum on the happening of a particular event contingent upon the duration of human life in consideration of the immediate payment of a smaller sum or certain equivalent periodical payments by another.

– Bunyon's Law of Life Insurance

Life insurance business is the business of effecting contract upon human life.

- Insurance Act

Self Assessment

Fill in the blanks:

1. The of life insurance are risk coverage and savings for future.
2. planning has become more complex because of greater economic uncertainty, constantly changing tax laws and varieties of options.

8.2 Life Insurance is a Scientific Concept

You must understand that life insurance is considered to be a scientific concept owing to the following reasons:

1. **Risk Sharing:** Life Insurance means pooling of funds of people and meeting the loss of those few who have met a mishap i.e. an early death. After the death of the bread-winner of a family, the members of the family may be compelled to live a life of misery, but for the insurance cover that comes to their rescue by providing money for sustenance, education and growth.

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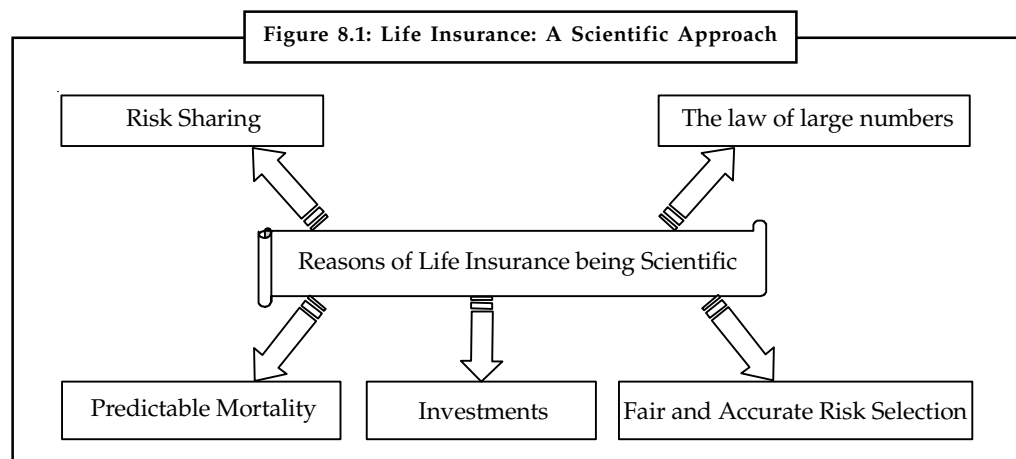
2. **The Law of Large Numbers:** The principle of risk sharing only works when the law of large numbers is operational. Under this scientific principle, the larger the group, the lesser impact the death of one member has on the group as a whole. A group with just a hundred or a thousand members would not work. The base would be too fragile, too susceptible to mortality due to situations and events that lead to unexpected mass deaths (such as an epidemic or an earthquake that would take away thousands of lives in a certain geographic location. This is one reason why groups and individuals today transfer the risk to insurance companies, in effect forming groups consisting of hundreds of thousands, very often millions, of members. Hence, larger groups make insurance successful.
3. **Predictable Mortality:** The third principle of life insurance is predictable nature of mortality. It is not possible to tell when a person will die. But as more than a century has passed for the insurers recording data about health, lifestyle and mortality trends, insurers can project life expectancies. This data is recorded in mortality tables.



Did u know? A mortality table summarizes the life span of a large number of people. Specifically, it tells about (1) the number of deaths that will occur per 1,000 individuals at a given age and (2) the life expectancy of an individual at any age. It charts a representative sample of 10 million lives and follows them to age 100, when for insurance purposes, the last person is presumed to have died.

Once the insurance company can reasonably predict how many people of a given age will die in a given year, insurer can then project costs and premium rates. More the life expectancy, the lesser is the cost of life insurance.

4. **Investments:** It may be years before a claim is made against the policy, premiums collected minus the claims paid during the year and the other expenses of insurance company are invested. Also, a percentage of assets is set aside as company reserves to meet the claims as they arise.



5. **Fair and Accurate Risk Selection:** A life insurance contract is an aleatory contract. It is based on the possibility of a chance occurrence and, in all likelihood, one side will benefit more than the other. Fair and accurate risk assessment should be done.



Notes Especially with individual insurance policies, coverage is issued based on the assumption of reasonable risk.

This means insurance of healthy people who are generally in good health should be done. This is made possible through a medical examination at time of issue of policy.

Notes

Self Assessment

Fill in the blanks:

3. The principle of only works when the law of large numbers is operational.
4. The third principle of life insurance is predictable nature of

8.3 Classification of Policies Prevailing in Market

As you are well aware that life insurance is a contract providing for the payment of a sum of money to the person assured or if not him then to the person entitled to receive the same on the happening of a certain event. The two basic needs applicable universally to all individuals are risk coverage and savings for future.

1. **Risk Coverage:** Risk is used here to mean “death”. The first basic need is to provide a lump sum amount to the family in the event of the untimely death of the bread winner. This is called term insurance or temporary insurance. The lump sum amount is payable only if the death of the insured occurs during a selected period. If the insured survives till the end of the selected period, nothing becomes payable.
2. **Savings for Future:** Savings is accumulation of funds for a specific purpose in the future. Here the lump sum insurance amount is payable only if the insured survives till the end of the selected period. If the insured dies during the period of insurance, nothing becomes payable. This is called “pure endowment”.

The two concepts, term insurance and pure endowment are the basic elements of every life insurance product. By combining these two elements in different proportions different products of life insurance are developed, and the proportion of these two elements in the mixture depends on the different needs of individuals. These two elements are therefore called the “Basic Building Blocks” in all life insurance product design.

The life insurance policies can be divided on the basis of:

Methods of premium payments

- Single premium policy
- Level premium policy

Participation in profit

- With profit policy
- Without profit policy

Number of lives covered

- Single life policy
- Multiple life policy
- Joint life policies

Method of payment of sum assured

- Instalments or annuity policies
- Lump-sum policies

Notes

Duration of policy

Methods of Duration

- Whole life policy
- Limited payment Whole life policy
- Convertible Whole life policy

Methods of Term Insurance

- Temporary assurance policy
- Renewable term policies
- Convertible term policies

Methods of Endowment

- Pure endowment policy
- Ordinary endowment policy
- Joint endowment policy
- Double endowment policy
- Fixed term endowment policy
- Educational annuity policy
- Triple benefit policy
- Anticipated endowment policy
- Multi-purpose endowment policy
- Children's deferred endowment policy
- Money back plans

Annuity plans

Market linked insurance plans

The above types of products offered are categorized as follows:

1. Pure insurance products – Term plans.
2. Pure investment products – Pension plans.
3. Investment cum insurance products – Endowment plan, Money-back plan, Whole-life and Unit Linked insurance plans.

8.3.1 Basic Plans of Life Insurance

You must remember that there are only two basic plans of Life Insurance. They are Term Assurance and Pure Endowment. In term assurance the sum assured is paid only in case of death

of the assured within the term of the contract and nothing is paid in case of survival to end of the term. But in Pure endowment, the sum assured is paid only in case the assured survives to the end of the term. Nothing is paid in case of death of the assured within the term. Based on these two basic plans, any number of plans can be devised by combination of these two plans. These two plans combined in various proportions give rise to all other plans which are called as Traditional or Conventional Plans.

The various products available in the Insurance market in India based upon about the four needs like:

1. Death
2. Living to a certain length of time
3. In capacity
4. Injury or incurring a disease.

They are the major needs and occupy prominent position in our Life Insurance planning. Any other need can be a sub division of these.

Term Assurance

Term assurance is the cheapest form of Insurance. As explained above, this plan of Insurance is just a Risk Cover plan.



Example: Young people who cannot afford high premiums can go in for this policy and obtain substantial cover at a very moderate cost.

This term assurance has undergone tremendous modification like:

1. **Term assurance:** Here sum assured is paid only in case of death of the assured within the term of the contract. Nothing is payable if the assured survives the end of the term.
2. **Term assurance with return of premiums:** In this plan, the sum assured is paid in case of death within the term. But if assured survives the term of the contract, all the premiums paid are returned.
3. **Term assurance with return of premiums and loyalty additions:** If the assured survives the term, in addition to return of premiums, loyalty additions are given. Such additions may be a percentage of premiums.
4. **Term assurance with return of premiums & loyalty additions and extended cover:** In this plan in additions to the benefits under (3), the contract does not come to end, but the insurer extends term assurance cover for a further period after the end of term. In case of death of the assured during the extended period, the Insurer pays full or part of the sum assured. This is ideal plan, whereby the assured can have risk cover at an age when he may not be eligible for Life Insurance at all.
5. **Convertible term assurance:** In this plan the assured has a choice of converting the policy into an endowment or whole life at the end of the term. The option is to exercise before 2 years from the expiry of the term and the Insurer will agree to cover risk for a sum not exceeding the original sum assured. There is no need to submit any proof of insurability.

Whole Life

Under whole life, by concept the sum assured is payable on death only. Whereas in term assurance, the death should take place within the term of the contract, in whole life there is no fixed term

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and the sum assured is paid on death at any time. The following are the modifications that have taken place over a period of time.

1. **Whole life:** Here the Sum assured is paid on death and the premiums are to be paid, as long the Life assured is alive.
2. **Whole life Limited payment:** In this, the assured has a choice of limiting the premium payment period and the sum assured however is paid on death only.

The Insurers thought the above two do not serve the need of many and decided that the premium payment automatically stops after 35 annual premiums are paid or the Life Assured reaching 80 years of age, whichever is later and the Sum assured is also payable on reaching age 100. Now this has also been modified and the sum assured is payable on reaching 80 years of age.

3. **Convertible Whole life:** In this plan, the life assured has the option of converting the policy into an endowment plan after 5 years from the date of commencement. The premium will be less during the first 5 years and will increase according to the term selected. If however the conversion is not exercised, the policy will run as whole life limited payment with premiums ceasing at age 70 of the assured and the sum assured payable on death.

Endowment Type

These are the most popular plans of Insurance as the very definition of life insurance is found here. That is the sum assured is paid on the event contingent upon the duration of human life, death or survival.

1. **Endowment policy:** The sum assured is paid on death or survival to the end of term whichever earlier.
2. **Endowment limited payment:** Here the Life Assured has choice of limiting the premium payment period.
3. **Endowment double or triple cover:** In this policy, the sum assured payable on death within the term will be two or three times the basic sum assured. But the sum on maturity will be the basic amount only.
4. **Marriage endowment:** Here the sum assured is due only at the end of the term and the payment of premiums stops at death of the assured. The objective of insurance to provide for the marriage of daughter is met under the policy

Combination of whole life, endowment and money back

1. **Endowment & whole life:** In this policy, the sum assured is paid on survival to the end of term and the contract does not end and another sum assured is paid at death any time. If however the assured dies before the expiry of the term, sum assured is paid.
2. **Money Back & whole life:** Under this plan a percentage of sum assured is paid every 5 years as long the assured is alive and full sum assured is paid on death at any time irrespective of the survival benefits paid earlier.

Money Back Type

1. **Ordinary money back:** These are fixed term policies where under, part of the Sum Assured is paid at periodical intervals. Full Sum Assured is paid at death any time within the term irrespective of the survival benefits paid.

2. **Money back with increased cover:** In this case, the survival benefits are as above. But the death benefits will be increased Sum Assured depending on the duration of the policy.

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8.3.2 Children Policies

With growing cost of education and social responsibilities, it is but proper that we provide funds for the needs of children. The following are some of the policies available:

1. **Children Deferred Assurance:** This plan can be given right from age 0. The risk commences at age 18 or 21. The period from date of commencement to start of risk is called deferment period. The policy automatically vests with the child on age 18 or 21. The proposer has a choice of taking away the cash option on the deferred date. The proposer can also avail premium waiver benefit, whereby the future premiums up to the deferred date are waived in case of the death of the proposer before deferred dated.
2. **Children Policy - Risk Bearing Type:** Here the risk on the life of child starts at age 7 or two years from the date of commencement of the policy whichever is later. The sum assured is paid on maturity or on death of the assured.
3. **Children Money Back Policy:** In this policy, the risk on the life of the child starts at age 7 or 2 years from the date of commencement. On life assured surviving 18 & 20 years of age 20% of SA is paid and 30% of SA is paid on attaining 22 & 24 and on attaining 26 years of age bonus for the entire duration of contract is paid. Full SA is paid on death at any time, irrespective of survival benefits paid.
4. **Exclusive policy for girl child:** In this policy also, the risk starts from age 7 or 2 years from date of commencement. On attaining 20 years of age, full Sum Assured is paid. But the contract does not come to end. If the girl marries, risk on the life of husband will start without proof of insurability and payment of any premium, and such risk extends up to the lady reaching age of 50. In case of husband's death, full Sum Assured is paid to the assured. If both of them survive to age 50 of the lady, bonus for entire duration of contract is paid.

8.3.3 Postal Life Insurance

You will be surprised to know that postal life insurance was started in 1884 as a welfare measure for the employees of post and telegraphs department. The scheme became popular soon and the scheme was extended to the employees of central and State governments also. Later, it was extended to the employees of the banking industry, public sector undertakings, financial institutions, local bodies, municipalities, educational institutions funded by the Government, etc. The postal life insurance was extended to cover the rural people from 24th March 1995. The administration of the scheme is controlled by the Director of the postal department at New Delhi and the accounts are maintained at Kolkata. Postal Life Insurance is easy to explain. The number of schemes is also very small compared to the schemes introduced by the insurance companies.

8.3.4 Retirement Provision

You need to know that one of the risks associated with human being is the risk of living too long. With break of joint family systems, each one of us has to start providing for the days after we cease earning. The added problem of the increased longevity has multiplied the need to provide for retirement. Life insurer is an organization, which can organize schemes to meet this need. The following are some of them:

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Annuities

Annuities are annual payments made by the Insurer to the Annuitant in return for a lump-sum or periodical payment made by the other. The annuities can be purchased in two ways:

1. **Immediate Annuity:** Here the purchaser pays a single one-time payment to the Insurer and desires that annuity to flow immediately.
2. **Deferred Annuity:** Here the purchase price is paid by the buyer in instalments and annuity starts after the corpus is built.

The annuitant can desire the payment of annuity in respect of the above in any of the following ways:

1. **Life Annuity:** Here the Insurer pays annuity instalments as long as the annuitant is alive
2. **Annuity certain:** The annuity is paid for the selected number of years irrespective whether the annuitant is alive or not.
3. **Annuity certain and life thereafter:** The annuity is paid for the selected number of years and if the annuity is alive at the end of the term, it will continue for the lifetime of the annuitant.



Notes It should be remembered that the annuity can be selected either to make yearly, half yearly, and quarterly or monthly.

Pension Plans

The life insurance industry has come out with policies, which serve the provision of pension linked with risk cover. In this type, risk on the life of the assured is covered on a notional sum assured and such notional amount is made use to buy annuity as explained above. But in case of death of the assured within the term, the nominee will be entitled to family pension based on the notional sum assured. There is an option of commutation also.

Difference between annuity and Life Insurance:

- Those who are afraid of living too long and Life Insurance by those who are afraid of premature death purchase annuity.
- In annuity there is self-selection by the annuitant and in Life Insurance there is selection by the Insurer.
- By concept wise in Life Insurance payments start at death and in case of annuity the payments stops at death, both works on the theory of large numbers.
- Life Insurance is based on rate of Mortality and Annuity is based on probability of survival.

8.3.5 Group Insurance

You will find it interesting to note that group insurance is a device by which members belonging to a homogeneous group can be given insurance cover under a single contract. The development of group insurance in India is of recent origin and now lot of emphasis is given on wide coverage in view of its simplicity and affordable cost.



Notes The salient features of Group Insurance are as follows:

- The group should be homogeneous and the insurer may prescribe minimum number depending on the scheme.
- The contract is between the Insurer and the employer/group/association.
- A single policy called master policy is issued covering all the members and spelling out the relevant terms and conditions.
- The group must have been formed other than for the purpose of taking out Insurance & the group should already exist.
- The scale of benefits is pre decided depending on the salary/grade of the employee. The individual employee has no choice of selecting the sum assured.
- At the inception of the scheme, an option is given for members to join the scheme. But new entrants have to compulsorily join the scheme.
- The selection is based on the average age of the group.
- Minimum Insurance cover will be given without strict proof of insurability.
- The premium may be contributory or non-contributory.
- The employer is eligible to treat the premium as expenses and claim tax exemptions
- The contract is renewable every year. At the time of renewal, based on the previous years' experience, the premium may get revised. This is called experience rating
- The named person of the employer will deal with the Insurer in all servicing matters.

Notes

Types of Group Insurance Schemes

One year renewable term assurance: Here the contract is for one year renewable every year. In the event of death of any member of the group during the year, the agreed sum assured is paid.

Group Gratuity Scheme

As per Gratuity Act 1972, an employer is legally bound to pay Gratuity for all employees who put in a minimum service of 5 years. Wherever the employer appoints not less than 10 people, the scale is at the rate of 15 days wages for every year service completed, subject to a maximum of ₹ 3,50,000. The employer has to therefore make provision in advance. The methods may be:

- Make payments as when it arises called as pay as you go method.
- Can create an internal reserve equal to the actuarial valuation of the liability.
- Set up a gratuity fund with trustees to manage.
- Set up a fund and transfer the same to Insurance Company under a Group Gratuity scheme.

Of the above methods, the first two methods are quite risky in the sense that the fund may be misused in terms of financial difficulties. The fourth method would be very prudent, since an Insurer has a huge portfolio and can diversify his investments and assure a guaranteed return. The Insurer has also qualified people to calculate the liability accurately.

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Group Gratuity linked with One Year Group Term Assurance (OYRTA)

Under this provision, risk on the life of the members of the group is covered and in case of premature death, the gratuity paid will be notionally calculated and we would receive higher gratuity. The balance service of the deceased member is considered and gratuity calculated.

Group Pension Scheme

The benefit of pension has the advantages of retaining the talented people with the organization; the employer is treated as a progressive and the tax advantages enjoyed by both the employer and the employee. The employer can find the same ways to provide for pension as discussed in the provision for Gratuity. But the Insurance Company can provide actuarial, legal and taxation help to the employer. Again by conjunction with OYRTA, the employee can be helped to get a higher pension in case of premature death.

Group Savings Linked Insurance Scheme

Under this scheme, the benefits offered include both death cover as well as savings. A part of the contribution goes towards the cost of risk cover and in case of death of the employee; a certain fixed amount is paid. On surviving to superannuating age, savings portion with interest is paid.

Employees Deposit Linked Insurance

All the employers have to provide for risk cover to those who come under PF Act. This provision can be arranged with an Insurance Company, whereby the Insurer will cover risk on the life of the employee to the extent of balance of PF account on the date of death or upto ₹ 62,500 whichever is lower.

Social Security Scheme

As per Article 41 of Indian Constitution, the Central Government has to provide Social Security to vulnerable sections of the Society. Life Insurance is one of the ways by which such security can be provided. Now IRDA has also prescribed that each Insurer has to compulsorily cover certain number of lives under such schemes. The scheme has to be financed either wholly by the Insurer or with nodal agencies.

8.3.6 Non-traditional Products

Let's discuss about non-traditional products. Following are the non-traditional life insurance products:

Market Linked Insurance (Unit Linked Insurance)

Traditional life insurance policies were issued to give some compensation if loss occurred in an unforeseen manner. The insurers usually added some reversionary bonus to the sum assured according to their experience in mortality, interest-earning and the office expenses. If these are favourable, surplus would result in the annual valuation. The bonus rate depends upon the investment also. The investment is regulated by the company's rules and the Insurance Act as well. The insured were growing more aware and were ambitious but the lower rate of bonus did not match with their ambition or the increasing rate of inflation. Hence insurers were obliged to introduce products which had a relationship to the financial market. The returns were also satisfactory for the insured.

The insurers put a rider that the insured's wishes would be carried out while investing the amounts collected. The insured had to be responsible for the investments. Many schemes were introduced with this condition that the insured were responsible for the returns. The insurers had to segregate the premiums (unbundling) into cost of issue of the policy, cost of covering the death risk and the amount to be invested. In the traditional policies the insurers were responsible for the investment since such splitting was not practiced. The insuring public wanted more return for the investment in insurance and wanted the life cover also at a minimum cost. In these plans the premium is unbundled, that is, the investment portion is separated from the expenses of the policy, the cost of insurance etc. The insured person knows what is invested in units. He also knows where the amount is being invested. He should be aware of the fluctuations of the market and should shift the investment from one area to another by an action called 'switching'. These plans are introduced mainly because:

1. The inflation was catching up, reducing the purchase capacity of the returns.
2. The bonus rates were coming down in conventional plans.
3. The interest rates were coming down in the financial market.
4. The insuring public was growing more and more aware of the insurance needs,
5. The boom experienced in the share market encouraged the insuring public to go for such plans which would give them adequate returns.

The financial market consisted of mutual funds and shares. The policy holder is treated as a small investor and hence investment in shares is not feasible as it involves an outlay of huge amounts. The mutual funds are representing small investors and the amounts collected are accumulated to large amounts for the investments to be made. Hence the investment is in mutual funds and the insured can opt for any of the three types:

- High risk, or
- Balanced risk, or
- Low risk.

This does not mean that there are only three types of investments. Every insurer has various methods of computations of these. The returns are directly related to the type of investment and the insured is given the privilege of changing the risk (switching) pattern after a period of time (usually after the 1st year). More than once also he can change the options but the minimum period he has to stick to the type of investment may be prescribed. After the first 3 or 4 changes (free switches) further switches are at cost. If the insured is not in a position to exercise the switch the insurer will automatically switch to the next best option as per his understanding of the market. This is done to protect the interests of the insured.

8.3.7 Other Insurance Products in India

You will find out that there are other insurance products in India as well. Following are the other insurance products in India:

Health Insurance

A Health insurance policy is a contract between an insurance company and an individual. The contract can be renewable annually or monthly, the recent health insurance products offered by the life insurance company are designed like the term insurance where in the premium is

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collected for an sum assured and the risk is covered for a longer period that is 10/20/30 years and so on. The type and amount of health care costs that will be covered by the health plan are specified in advance, in the member contract or evidence of coverage booklet.

Health insurance works by estimating the overall risk of health care expenses and developing a routine finance structure (such as a monthly premium or annual tax) that will ensure that money is available to pay for the health care benefits specified in the insurance agreement. The benefit is administered by a central organization, most often either a Government agency or a private or not for profit entity operating a health plan. There are various types of health coverage in India. Based on ownership the existing health insurance schemes can be broadly divided into categories such as:

1. **Government or state-based systems** - Products like Central Government Health Scheme (CGHS), Employees State Insurance Scheme (ESIS).
2. **Market-based systems (voluntary and private)** - Mediciam schemes.
3. **Employer provided insurance schemes** - Reimbursement facilities.
4. **Member organization (NGO or cooperative) - based systems:** Self Employed Women's Association (SEWA), Jan Arogya Bima, Aga Khan Health Services India (AKHSI), Nav-sarjan in Gujarat, ACCORD in Karnataka works with tribal population in forest areas.

Micro Insurance

The micro insurance system, a new concept in India, is capable of penetrating all sections of the masses to provide the needed social and financial security to the people. This has an upper edge over the formal insurance system, which did not possess the products suiting the people, particularly the high-risk clients. Further, it could even play a positive role when incorporated with disaster management measures.

Micro insurance is a term increasingly used to insurance characterized by low premium and low caps/coverage. Micro refers to small financial transaction that each insurance policy generates. Micro insurance is a financial arrangement to protect low income people against specific perils in exchange for regular premium payments proportionate to the likelihood and cost of the risk involved. Micro insurance is synonymous to community-based financing arrangements including community health funds, mutual health organizations, rural health insurance, revolving drug funds and community financing schemes evolved in the context of severe economic constraints, political instability and lack of good governance.

The products offered under micro insurance are categorized both under health risks (illness, injury or death) and property risks (damage or loss). A few micro insurance products offered to cover the above mentioned risks are:

1. Crop insurance.
2. Livestock/cattle insurance.
3. Insurance for theft or fire.
4. Health insurance.
5. Term life insurance.
6. Death insurance.
7. Disability insurance.
8. Insurance for natural disasters.

Rural Insurance

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Rural insurance covers take care of areas like fisheries, horticulture, floriculture, sericulture and cattle and livestock. In India considering the factors like continuum of economic activity between rural and urban areas, the insurance sector has penetrated into the rural area. The premiums collected are low and it is slightly costlier to the insurers. The various products offered under this are: Comprehensive Crop Insurance, Experimental Crop Insurance Scheme and National Agriculture Insurance Scheme.

8.3.8 Plans Offered in the Current Market in India

You must remember that the current plans offered in the market by various players are:

- Term assurance
- Endowment assurance
- Whole Life assurance
- Cash Flow or Money Back assurance
- Health insurance plan, etc.

Even the pension plans can also be opted. The premiums can be paid as (1) Single premium or (2) Regular premium (yearly etc.). The tax benefits are available under Section 80C, 80D and 10(10D) of the Income Tax Act, 1961. The above mentioned plans are offered along with additional benefits offered known as Riders. The meaning of the term Riders and its details is further explained.

Riders

Rider is an extra benefit under the policy. Extra premium has to be paid to secure the extra benefit. The rider benefit is available only on certain conditions to be decided by the insurer. Riders also enhance the value of the policy. Riders can be availed only if the premium for the basic benefit (sum assured) is being paid. Once the basic premium for the sum assured stops the rider benefit also stops. In some cases the rider benefit ceases earlier to Date of Maturity (DOM) though the basic premium for the sum assured is continuing. The rider benefit shall not exceed the basic sum assured in case of critical illness or accident benefit.



Caution The total extra premiums for all other benefits should not exceed 30 per cent of the basic premium for the basic sum assured.

The common riders granted by the insurers are:

1. Term rider
2. (Double) Accident (death) Benefit
3. Accident disability benefit
4. Critical illness benefit
5. Major surgeries benefit
6. Premium waiver benefit
7. Dreaded diseases cover benefit

- Notes
8. Guaranteed insurability benefit
 9. Extended insurance benefit.

Insurance for women

Prior to nationalization (1956), many private insurance companies would offer insurance to female lives with some extra premium or on restrictive conditions. However, after nationalization of life insurance, the terms under which life insurance is granted to female lives have been reviewed from time-to-time. At present, women who work and earn an income are treated at par with men. In other cases, a restrictive clause is imposed, only if the age of the female is up to 30 years and if she does not have an income attracting Income Tax.



Caselet

Top 10 Life Insurance Myths

Life insurance is not a simple product. Even term life policies have many elements that must be considered carefully in order to arrive at the proper type and amount of coverage. But the technical aspects of life insurance are far less difficult for most people to deal with than trying to get a handle on how much coverage they need and why. This article will briefly examine the top 10 misconceptions surrounding life insurance and the realities that they distort.

Myth #1: I'm Single and Don't Have Dependents, so I Don't Need Coverage

Even single persons need at least enough life insurance to cover the costs of personal debts, medical and funeral bills. If you are uninsured, you may leave a legacy of unpaid expenses for your family or executor to deal with. Plus, this can be a good way for low-income singles to leave a legacy to a favourite charity or other cause.

Myth #2: My Life Insurance Coverage Needs Only Be Twice My Annual Salary

The amount of life insurance each person needs depends on each person's specific situation. There are many factors to consider. In addition to medical and funeral bills, you may need to pay off debts such as your mortgage and provide for your family for several years. A cash flow analysis is usually necessary in order to determine the true amount of insurance that must be purchased - the days of computing life coverage based only on one's income-earning ability are long gone.

Myth #3: My Term Life Insurance Coverage at Work Is Sufficient

Maybe, maybe not. For a single person of modest means, employer-paid or provided term coverage may actually be enough. But if you have a spouse or other dependents, or know that you will need coverage upon your death to pay estate taxes, then additional coverage may be necessary if the term policy does not meet the needs of the policyholder.

Myth #4: The Cost of My Premiums Will Be Deductible

Afraid not, at least in most cases. The cost of personal life insurance is never deductible unless the policyholder is self-employed and the coverage is used as asset protection for the business owner. Then the premiums are deductible on the Schedule C of the Form 1040.

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Myth #5: I Absolutely MUST Have Life Insurance at Any Cost

In many cases, this is probably true. However, people with sizable assets and no debt or dependents may be better off self-insuring. If you have medical and funeral costs covered, then life insurance coverage may be optional.

Myth #6: I Should ALWAYS Buy Term and Invest the Difference

Not necessarily. There are distinct differences between term and permanent life insurance, and the cost of term life coverage can become prohibitively high in later years. Therefore, those who know for certain that they must be covered at death should consider permanent coverage. The total premium outlay for a more expensive permanent policy may be less than the on-going premiums that could last for years longer with a less expensive term policy.

There is also the risk of non-insurability to consider, which could be disastrous for those who may have estate tax issues and need life insurance to pay them. But this risk can be avoided with permanent coverage, which becomes paid up after a certain amount of premium has been paid and then remains in force until death.

Myth #7: Variable Universal Life Policies are Always Superior to Straight Universal Life Policies Over the Long Run

Many universal policies pay competitive interest rates, and variable universal life (VUL) policies contain several layers of fees relating to both the insurance and securities elements present in the policy. Therefore, if the variable subaccounts within the policy do not perform well, then the variable policyholder may well see a lower cash value than someone with a straight universal life policy.

Poor market performance can even generate substantial cash calls inside variable policies that require additional premiums to be paid in order to keep the policy in force.

Myth #8: Only Breadwinners Need Life Insurance Coverage

Nonsense. The cost of replacing the services formerly provided by a deceased homemaker can be higher than you think, and insuring against the loss of a homemaker may make more sense than one might think, especially when it comes to cleaning and day-care costs.

Myth #9: I Should Always Purchase the Return-of-Premium (ROP) Rider on Any Term Policy

There are usually different levels of ROP riders available for policies that offer this feature. Many financial planners will tell you that this rider is not cost-effective and should be avoided. Whether you include this rider will depend on your risk tolerance and other possible investment objectives.

A cash flow analysis will reveal whether you could come out ahead by investing the additional amount of the rider elsewhere versus including it in the policy.

Myth #10: I'm Better off Investing My Money Than Buying Life Insurance of Any Kind

Hogwash. Until you reach the breakeven point of asset accumulation, you need life coverage of some sort (barring the exception discussed in Myth No.5.) Once you amass \$1 million of liquid assets, you can consider whether to discontinue (or at least reduce) your million-dollar policy. But you take a big chance when you depend solely on your investments in the early years of your life, especially if you have dependents. If you die without coverage for them, there may be no other means of provision after the depletion of your current assets.

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The Bottom Line

These are just some of the more prevalent misunderstandings concerning life insurance that the public faces today. Therefore, there are many life insurance questions you should ask yourself. The key concept to understand is that you shouldn't leave life insurance out of your budget unless you have enough assets to cover expenses after you're gone. For more information, consult your life insurance agent or financial advisor.

Source: <http://www.investopedia.com/articles/pf/08/life-insurance-myths.asp>

Self Assessment

Fill in the blanks:

5. In term assurance the sum assured is paid only in case of of the assured within the term of the contract and nothing is paid in case of survival to end of the term.
6. The benefit is available only on certain conditions to be decided by the insurer.

8.4 Annuity

In this section, we will discuss about Annuity. The following are some of the important definitions and revelations in the context of Annuities/pension plans:

- According to S. S. Heubner and Kenneth Black Jr., "Life Insurance pertains to the years of ascendance and annuity to the years of decline. When coupled together, the two forms of insurance complete the economic program from start to finish on a basis of financial dependability."
- According to Bhir and Limaya, "Annuity is a contract where the annuitant agrees to pay to insurer, a certain amount either in a lump sum or spread over a period of few years and the insurer in return agrees to pay to the annuitant a certain sum every year, either so long as the annuitant is alive or for such period as may be determined by the contract of annuity."
- According to W.A. Dinsdale, annuity may be defined as "The payment of amounts periodically during the life time of the annuitant in consideration of the payment of an agreed sum to insurance company."
- According to D.S. Hansen, "Annuity is a form of pension, whereby in return for a certain sum of money, the assurer agrees to pay the annuitant, an annual amount for a specified period."
- According to Mayerson, "The life annuity is a device that liquidates the annuitant's capital over the life time, paying him an income comparing both interest on his money and portion of principal.'

Thus, annuity is a contract sold by a life insurance company that provides fixed or variable payments to an annuitant, either immediately or at a future date. The recipient of annuity is usually known as annuitant. Annuity literally means 'an annual payment', but can be described as periodical payments depending on the status, time or life.



Caution In annuity contract, the insurer undertakes to pay certain level sums periodically up to expiry of the term or up to death. Since at the early death, the insurer does not suffer loss, no medical examination is necessary. However, evidence of age is essentially asked for and taken at the time of proposal.

The annuity is beneficial to those who do not want to leave amount for others but to use their money during their lifetime. Alternatively in case of bank deposits, a person may leave certain amount at early death or may suffer loss in living long due to stoppage of the money after a certain period. The payment of annuity generally continues up to the death. Hence, the premium rate is determined according to longevity. The amount of premium is higher at younger age and lower at advanced age. This is based on the fact that a young person will stay alive for a longer period in contrast to an older person.

The situations, which can arise in connection to an annuity holder, are as under:

1. If an annuitant lives exactly his life expectancy, he neither gains nor loses under an annuity contract.
2. But if he outlives the life expectancy, the additional payments up to the date of his death will have to be drawn by the insurer from the fund created by the contributions made by all those who purchased annuity contracts.
3. If an annuitant dies in advance of his life expectancy, he would not have recovered his entire contribution and the excess would go to provide annuities to those who outlived their life expectancies.

However, it is beyond human capability to find out in advance, which of the three above categories one would fall. Hence, the very basis of life annuities is the law of large numbers, which is none other law but the law on which life insurance operates.

8.4.1 Need of Annuity Contracts

You need to know that the purpose of the annuity is protection against outliving one's income earning age. Nowadays, annuities are becoming very popular. This is due to many reasons like:

- Increasing life expectancies
- Need to maintain same life standard after retirement
- Meeting the medical needs in old age etc.

Four ways are suggested below for providing the required support for persons after they cross the stage of active life but in present times, annuities are the best tool to manage old age requirements. The suggestions are as under:

1. **Joint Family System:** The joint family system was the norm and the members of the family were looked after without much worry. However, it is now getting dismantled due to successive partitions of agricultural lands over generations, lack of work opportunities in village or hometowns. This explains the reason for the younger people moving out to distant places in search of jobs. Fewer children, weakening of family bonds and increasing independence in outlook are also other significant factors contributing to birth of nuclear (small) families.
2. **Superannuation Schemes:** It is a source for providing financial assistance to the people after retirement by the employer. Due to the pressures from trade unions as well as

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enlightenment of the employers, employees are being provided with support after they retire. Group Gratuity Schemes, Group Superannuation Schemes, Group Term Insurance, and Group Saving Linked Insurance Schemes are popular in India. But such benefits are available to salaried permanent employees and not for temporary or contractual employees.

3. **Social Security Schemes:** Some schemes have been evolved so far with the active contribution of the Government to provide for the retirement benefits for people who have crossed their working age. In less developed countries, the Governments cannot afford to provide social security benefits. Even those who try these schemes are considerably inadequate.
4. **Annuity Contracts:** Businessmen and professionals have to make arrangements on their own for the days when they will not be able to work actively. Annuity policies meet the needs of people not covered or inadequately covered under other schemes and are expected to become more and more popular.

Annuities are also an important means of insurance and are based on the same fundamental principles. Both utilize and compute the probabilities of death and survival as reflected through mortality tables. Both pay the public from the common fund created through pooling of resources during better days.

In true sense, both are insurance. Life insurance protects against the absence of income in the event of premature death of the bread earner or disability. An Annuity protects against the absence of income to those afflicted with undue longevity. Dying too soon and living too long, both are the present day problems.



Task Prepare a slideshow on the meaning and need of annuity contracts with the help of real life examples.

8.4.2 Difference between Annuity Contract and Life Insurance Policies

You will find it interesting to note that there are some differences in life insurance and annuity contracts. Some people even call annuity as the reverse application of the life insurance principle.

1. Annuity is protection against living too long whereas the life insurance contract is protection against living too short.
2. The annuity contract liquidates gradually the accumulated funds whereas the life insurance contract gradually accumulates funds.
3. Payment generally stops at death in case of annuity contracts whereas in life insurance, the payment is usually given at death.
4. The premium in annuity contract is calculated on the basis of longevity of the annuitant whereas in life insurance, the premium is based on the policy-holders mortality estimate.
5. The annuity contract is taken for one's own benefit whereas the life assurance is generally for benefits of the dependents.

Thus, one can say that annuity is opposite concept of life insurance. Both of these contracts complete the economic programme of an individual. Where life insurance stops, the annuity contract comes to the rescue of an individual. No doubt they are complimentary.

Self Assessment

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Fill in the blanks:

7. Life Insurance pertains to the years of and annuity to the years of decline.
8. Annuity is a contract sold by a life insurance company that provides fixed or variable payments to an
9. The purpose of the annuity is against one's income earning age.
10. Life insurance protects against the of income in the event of premature death of the bread earner or disability.

8.5 Mortality Tables

We will discuss mortality tables in this section. A mortality rate refers to the number of deaths in a specified population during a known period of time. The mortality rate is normally expressed in the form of deaths out of 100 or 1000 individuals.



Example: Suppose there are 10,000 inhabitants in a town, out of them 10 people die of the flu, then in that case, the flu mortality rate would be one in 1000. Mortality rates are based on purely how many die of any reason in a population, or it can be used to define the death rate of a certain illness or condition.

Mortality rates can have multiple uses, but are often used to explain the increase or decrease in *a cause of death over a lengthy time period.*



Example: Mortality rates have been used by the Centre for Disease Control (CDC) to indicate that the mortality rate for deaths caused due to car-accident in the United States have gone down from almost 25 per 100,000 to nearly 15 per 100,000 between the time period of year 1979-2006, whereas during the same period deaths caused due to poisoning rose from 5 to 15 per 100,000.

Observing the mortality rates over time can help health officials understand where to focus prevention and safety efforts, and indicate the possible trends in death caused due to factors affecting the measured population.

A mortality rate may be used to describe the chances of survival or death in the treatment of a disease. This piece of information can guide the patients to decide as to which treatment will give them the best chance of survival. Moreover, if the mortality rate of a treatment is tremendously high, patients may decide that it is too dangerous and unsafe or not worth the pain or risk of the procedure.

The mortality rate of infants and children is generally used as a factor in determining the health status of a country. A high infant mortality rate point toward poor prenatal and obstetric care, and is normally found in conjunction with very poor areas or nations. In India, infant mortality rates are frequently broken down by ethnicity or economic bracket, to highlight areas where better care is required.

A mortality rate may also be expressed as a mortality table, also called a life table. A mortality table shows the mortality rate and probability of death each year by using a generalized table broken down by age. A healthy person can determine the probability that they will die before

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their next birthday by looking at a life table. Life tables are highly generalized and do not include individual factors that may increase or decrease chances of death, for example whether the person smokes, where they live, and if they have a healthy diet or pre-existing medical conditions. At best, mortality tables should be looked at as a rough average of likely lifespan.

The three basic sources of mortality statistics are:

- Population statistics derived from census enumerations
- The returns of deaths from registration offices
- Statistics derived from insured lives

From data showing the length of life and ages at death in the past it is possible to predict probabilities of death and of survival in the future. This prediction is based on the assumption that, like the law of chance, there is a law of mortality by which human beings die; that certain causes are in operation which determine that out of a large group of persons at birth a definite number of lives will fail each year until all have died; and that the force of mortality could be measured if only the causes at work were known. But it is not necessary to analyse this law of mortality completely and to know all the operating causes in order to predict the possible rate of mortality in a group of persons. By studying the rate of death among any group and noting all the circumstances that might, according to our best knowledge, affect that rate, it is possible to surround any future group of persons with approximately the same set of circumstances and expect approximately the same rate of death. Thus without complete knowledge of the law of mortality a working basis is found for predicting future rates of death. It is necessary then to have mortality statistics in order to develop a scientific plan of life insurance.

8.5.1 The Measurement of Mortality - Mortality Tables

You must remember that the establishment of any plan of insuring against premature death requires some means of giving mathematical values to the chances of death, and the considerations advanced in the first division of this unit show that the laws of probability can be used for this purpose as soon as trustworthy data are secured showing the course of past mortality. Mortality tables, as such data are called, are records of past mortality put into such form as can be used in estimating the course of future deaths.

8.5.2 Sources of Mortality Tables

You need to know that there are two sources from which the best-known mortality tables in existence today have been obtained: (1) population statistics obtained from census enumerations, and the returns of deaths from registration offices, and (2) the mortality statistics of insured lives. Well-known examples of the former are the English life tables of Drs Farr, Ogle and Tatham, successively in charge of the General Registry Office of England and Wales. Dr Farr's life table, for instance, was based on the registered deaths in England and Wales during the years 1838-54, and on the two census enumerations of population for 1841 and 1851.

8.5.3 Description of a Mortality Table

Let's take a look at the description of a mortality table. A mortality table has been described as the picture of "a generation of individuals passing through time". It shows a group of individuals entering upon a certain age and traces the history of the entire group year by year until all have died. Since any description will best be understood by reference to an actual table, the American Experience table, used almost exclusively for the computation of premium rates by old line companies in the United States, is presented below.

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The essential features of the table are the two columns of the number living and the number dying at designated ages. It is assumed that a group of 100,000 persons comes under observation at exactly the same moment as they enter upon the tenth year of life. Out of this group, 749 die during the year, leaving 99,251 to begin the eleventh year. The table proceeds in this manner to record the number of the original 100,000 dying during each year of life and the number living at the beginning of each succeeding year until but three persons of the original group are found to enter upon the ninety-fifth year of life, these three dying during that year.

Table 8.1: American Experience Table of Mortality

Age	Number Living at Beginning of Designated Year	Number Dying * Designated Year	Yearly Probability of Dying	Yearly Probability of Survivor
10	100,000	749	.007490	.992510
11	99,251	746	.007516	.992484
12	98,505	743	.007543	.992457
13	97,762	740	.007569	.992421
14	97,022	737	.007598	.992404
15	96,285	735	.007634	.992366
16	95,550	732	.007081	.992339
17	94,818	729	.007688	.992312
18	94,089	727	.007727	.992273
19	93,362	725	.007765	.992235
20	92,637	729	.007805	.992195
21	91,914	722	.007855	.992145
22	91,192	721	.007906	.992094
23	90,471	720	.007958	.992042
24	89,751	719	.008011	.991989
25	89,032	718	.008065	.991935
26	88,314	718	.008130	.991870
27	87,598	718	.008197	.991803
28	86,878	718	.008264	.991736
29	86,160	719	.006345	.991655
30	85,441	720	.008427	.991573
31	84,721	721	.008510	.991490
32	84,000	723	.008607	.991393
33	83,277	726	.008718	.991282
34	82,551	729	.008831	.991169
35	81,822	732	.008946	.991054
36	81,090	737	.009089	.990911
37	80,353	742	.009234	.990766
38	79,611	749	.000408	.990592
39	78,862	758	.000586	.990414
40	78,108	765	.009794	.990206
41	77,341	774	.010008	.989992
42	76,567	785	.010252	.989748
43	75,782	797	.010517	.989483
44	74,985	812	.010829	.989171
45	74,173	828	.011168	.988837

Contd...

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46	73,345	848	.011562	.988438
47	72,497	870	.012000	.988000
48	71,627	898	.012509	.987491
49	70,731	927	.013106	.986894
50	69,804	962	.013781	.986219
51	68,842	1,001	.014541	.985459
52	67,841	1,044	.015389	.984611
53	66,797	1,091	.016333	.983667
54	65,706	1,143	.017396	.982604
55	64,563	1,199	.018571	.981429
56	63,364	1,260	.019885	.980115
57	62,104	1,325	.021335	.978665
58	60,779	1,394	.022936	.977064
59	59,385	1,468	.024720	.975280
60	57,917	1,546	.026693	.973307
61	56,371	1,628	.028880	.971120
62	54,743	1,713	.031292	.968708
63	53,030	1,800	.033943	.966057
64	51,230	1,889	.36873	.963127
65	49,341	1,980	.040129	.959871
66	47,361	2,070	.043707	.956293
67	45,291	2,158	.047647	.952353
68	43,133	2,243	.052002	.947998
69	40,890	2,321	.056762	.943238
70	38,569	2,391	.061993	.938007
71	36,178	2,448	.067665	.932335
72	33,730	2,487	.073733	.926267
73	31,243	2,505	.080178	.919822
74	28,738	2,501	.087028	.912972
75	26,237	2,476	.094371	.905629
76	23,161	2,431	.094371	.905629
77	21,330	2,369	.111064	.888936
78	18,961	2,291	.120827	.879173
79	16,670	2,196	.131734	.868266
80	14,474	2,091	.144466	.855534
81	12,383	1,964	.158605	.841395
82	10,419	1,816	.174297	.825703
83	8,603	1,648	.191561	.808439
84	6,955	1,470	.211359	.788641
85	5,485	1,292	.235552	.764448
86	4,193	1,114	.265681	.734319
87	3,079	933	.303020	.696980
88	2,146	744	.346692	.653308
89	1,402	555	.395863	.604137
90	847	385	.454545	.545455
91	462	246	.532466	.467534

Contd...

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92	216	137	.634259	.365741
93	79	58	.734177	.265823
94	21	18	.857143	.142857
95	3	3	1.000000	.000000

The term “mortality” is also sometimes inappropriately used to refer to the number of deaths among a set of diagnosed hospital cases for a disease or injury, rather than for the general population of a country or ethnic group. This disease mortality statistic is more precisely referred to as “case fatality”.

One distinguishes:

- The perinatal mortality rate, the sum of neonatal deaths and foetal deaths (stillbirths) per 1000 births.
- The crude death rate, the total number of deaths per year per 1000 people. As of July 2009 the crude death rate for the whole world is about 8.37 per 1000 per year according to the current CIA World Fact book.
- The maternal mortality ratio, the number of maternal deaths per 100,000 live births in same time period.
- The maternal mortality rate, the number of maternal deaths per 1,000 women of reproductive age in the population (generally defined as 15-44 years of age).
- The infant mortality rate, the number of deaths of children less than 1 year old per 1000 live births.
- The child mortality rate, the number of deaths of children less than 5 years old per 1000 live births.
- *The standardised mortality ratio (SMR)* - This represents a proportional comparison to the numbers of deaths that would have been expected if the population had been of a standard composition in terms of age, gender, etc.
- *The age-specific mortality rate (ASMR)* - This refers to the total number of deaths per year per 1000 people of a given age (e.g. age 62 last birthday).



Did u know? The crude death rate as defined above and applied to a whole population can give a misleading impression.

In regard to the success or failure of medical treatment or procedures, one would also distinguish:

1. The early mortality rate, the total number of deaths in the early stages of an on-going treatment, or in the period immediately following an acute treatment.
2. The late mortality rate, the total number of deaths in the late stages of an on-going treatment, or a significant length of time after an acute treatment.

Note that the crude death rate as defined above and applied to a whole population can give a misleading impression. The crude death rate depends on the age (and gender) specific mortality rates and the age (and gender) distribution of the population. The number of deaths per 1000 people can be higher for developed nations than in less-developed countries, despite life expectancy being higher in developed countries due to standards of health being better. This happens because developed countries typically have a completely different population age distribution, with a much higher proportion of older people, due to both lower recent birth rates and lower mortality rates. A more complete picture of mortality is given by a life table

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which shows the mortality rate separately for each age. A life table is necessary to give a good estimate of life expectancy.

8.5.4 Application of the Theory of Probabilities to the Mortality Table

The statement was made earlier in this unit that risk in life insurance is measured by the application of the laws of probability to the mortality table. Now that these laws are understood and the mortality table has been explained, a few simple illustrations may be used to show this application. Suppose it is desired to insure a man aged 35 against death within one year, within two years, or within five years. It is necessary to know the probability of death within one, two, or five years from age 35. This probability, according to the laws heretofore explained, will be determined according to the mortality table and will be a fraction of which the denominator equals the number living at age 35 and the numerator will be the number who have died during the one, two, or five years, respectively, following that age. According to the table, 81,822 persons are living at age 35, and 732 die before the end of the year. Hence the probability of death in one year is $732/81822$. During the two years following the stated age there are $732 + 737$ deaths, or a total of 1,469. The probability of dying within two years is therefore $1469/85822$. Likewise the total number of deaths within five years is $732 + 737 + 743 + 749 + 756$ or 3,716, and the probability of dying within five years is thus $3716/81822$.

Probabilities of survival can also be expressed by the table. The chance of living one year following age 35 will be a fraction of which the denominator is 81,822 and the numerator will be the number who has lived one year following the specified age. This is the number who are living beginning age 36, or 81,090, and the probability of survival for one year is therefore $81090/81822$. These illustrations furnish an opportunity for a proof of the law of certainty. The chance of living one year following age 35 is $81090/81822$ and the chance of dying within the same period is $732/81822$. The sum of these two fractions equals $81822/81822$ or 1, which is certainty, and certainty represents the sum of all separate probabilities in this case two, the probability of death and the probability of survival. In like manner many more instructive examples of the application of these laws to the mortality table could be made, but they need not be carried further at this point, for the subject will be fully covered in the units on "Net Premiums".

Self Assessment

Fill in the blanks:

- 11. Mortality rates are based on purely how many die of any reason in a
- 12. A mortality rate may be used to describe the chances of in the treatment of a disease.

8.6 Role of LIC

You will be surprised to know that insurance in India can be traced back to the Vedas. For instance, Yougkshema, the name of Life Insurance Corporation of India's corporate headquarters, is derived from the Rig Veda. The term suggests that a form of 'community insurance' was prevalent around 1000 BC and practised by the Aryans.

Bombay Mutual Assurance Society, the first Indian life assurance society, was formed in 1870. Other companies like Oriental, Bharat and Empire of India were also set up in the 1870-90s.

The Insurance Act was passed in 1912, followed by a detailed and amended Insurance Act of 1938 that looked into investments, expenditure and management of these companies' funds.

Notes

By the mid-1950s, there were around 170 insurance companies and 80 provident fund societies in the country's life insurance scene. However, in the absence of regulatory systems, scams and irregularities were almost a way of life at most of these companies' funds.

As a result, the government decided to nationalise the life assurance business in India. The Life Insurance Corporation of India was set up in 1956 to take over around 250 life assurance companies. After the RN Malhotra Committee report of 1994 became the first serious document calling for the re-opening up of the insurance sector to private players – that the sector was finally opened up to private players in 2001.

Following points will help you understand the role of LIC:

1. Largest Insurance Company in India-55 per cent share in 2009, monopoly for 50 years, insurance is not an option but necessity in current times,
2. Largest institutional investor,
3. Provides expenses of Central government-24.6 per cent of the expenses of the central government,
4. Maximum types of schemes which touch every aspect of life-40+ schemes,
5. Covers different economic sections of the society,
6. Largest insurer in rural areas,
7. Help in Channelizing Money of NRI's through schemes-Currency Policy,
8. One of the biggest employer: It has 8 zonal Offices and 101 divisional offices located in different parts of India, at least 2048 branches, 1.2 million agents,
9. Non-inflationary source of funds for the government,
10. Funds to Private sector,
11. Contribution to national GDP- In 2006, LIC created huge surpluses and contributed 7 per cent to the national GDP, and
12. Social service with profit.

8.6.1 Objectives of LIC

You need to know about the following objectives of LIC:

1. Spread Life Insurance widely and in particular to the rural areas and to the socially and economically backward classes with a view to reaching all insurable persons in the country and providing them adequate financial cover against death at a reasonable cost.
2. Maximize mobilization of people's savings by making insurance-linked savings adequately attractive.
3. Bear in mind, in the investment of funds, the primary obligation to its policyholders, whose money it holds in trust, without losing sight of the interest of the community as a whole; the funds to be deployed to the best advantage of the investors as well as the community as a whole, keeping in view national priorities and obligations of attractive return.
4. Conduct business with utmost economy and with the full realization that the moneys belong to the policyholders.
5. Act as trustees of the insured public in their individual and collective capacities.

- Notes**
6. Meet the various life insurance needs of the community that would arise in the changing social and economic environment.
 7. Involve all people working in the Corporation to the best of their capability in furthering the interests of the insured public by providing efficient service with courtesy.
 8. Promote amongst all agents and employees of the Corporation a sense of participation, pride and job satisfaction through discharge of their duties with dedication towards achievement of corporate objective.

Self Assessment

Fill in the blanks:

13. The Life Insurance Corporation of India was set up in 1956 to take over around life assurance companies.
14. Insurance in India can be traced back to the



Case Study

Sahara India Life Insurance

A little about Sahara India Life Insurance

Sahara India Life is the first private sector company in the domestic Life Insurance sector to go solo without any foreign partner. SILICL is promoted by Sahara India, a USD 7,000 million diversified conglomerate having varied business interests in Public Deposit Mobilisation, Housing, Aviation, Media and Entertainment and new forthcoming projects like Consumer Products, Information Technology, Hospitals and Agricultural products.

Sahara India is a unique business organisation that takes pride in being not just a business enterprise but an emotionally integrated family, the world’s largest family of over 600,000 members. Sahara India started 25 years ago with a small savings venture having assets of just USD 45 and only 3 members. Today, it is a major corporate entity having an asset base of over USD 7,000 million and 1707 establishments across the nation.

The company’s growing pains

Sahara India was launching their Insurance division. As an Insurance company they had to have a ready and reliable back up for their customer data.

All in all, Sahara required an integrated solution that would provide them the following benefits:

1. Better manageability through server consolidation
2. Create redundancy to support criticality of their applications
3. Flexibility to scale up servers as and when required
4. Low total cost of ownership of IT infrastructure.

The IBM Solution

Sahara India Insurance chose IBM as its partner to help with its IT infrastructure. Computer Science Corporation’s (CSC) applications span a wide spectrum of IBM platforms, including

Contd...

Notes

S/390, AS/400 (iSeries) and NetFinity, in addition to using a broad variety of IBM middleware technologies. Clients benefit from this alliance by virtue of CSC having early access to IBM's technologies and the subsequent ability to leverage these unique technologies into insurance applications by CSC.

It is no surprise that more than five of the top private life Insurance companies in India like ICICI Prudential, Tata AIG, ING Vysya, AMP Sanmar, IFFCO Tokio, etc. now run on IBM eServer iSeries. This makes iSeries the most preferred platform, in the Insurance Services Sector in India.

Details

Application	CSC application for insurance
O.S.	i5
Platform	S/390, AS/400 (iSeries)
Netfinity	(xSeries)

The result - Life made easy

The benefits of server consolidation include - low total cost of ownership, increased availability, better manageability, enhanced scalability and freedom from redundancy.

The robust and secure IT infrastructure deployed by IBM enables Sahara to cut down the go-to-market time substantially and offer new customised products that they are planning to launch into their market soon.

Questions

1. What difficulty Sahara India Life Insurance was facing in serving the customers?
2. Discuss the benefits of solution provided by IBM.

8.7 Summary

- Life insurance is protection against financial loss resulting from insured Individual's death.
- The elements of life insurance are risk coverage and savings for future.
- Usually people look at investment in life Insurance as risk cover/investment, combination of both the above, adequately long term, safe investment, moderate yield and tax savings.
- A life insurance contract is an aleatory contract. It is based on the possibility of a chance occurrence and, in all likelihood, one side will benefit more than the other.
- The two concepts, term insurance and pure endowment are the basic elements of every life insurance product. By combining these two elements in different proportions different products of life insurance are developed, and the proportion of these two elements in the mixture depends on the different needs of individuals.
- Micro insurance is a term increasingly used to insurance characterized by low premium and low caps/coverage.
- Annuity literally means 'an annual payment', but can be described as periodical payments depending on the status, time or life.
- The annuity is beneficial to those who do not want to leave amount for others but to use their money during their lifetime.

Notes

- Annuities are also an important means of insurance and are based on the same fundamental principles. Both utilize and compute the probabilities of death and survival as reflected through mortality tables. Both pay the public from the common fund created through pooling of resources during better days.

8.8 Keywords

Annuity: Annuity is a contract where the annuitant agrees to pay to insurer, a certain amount either in a lump sum or spread over a period of few years and the insurer in return agrees to pay to the annuitant a certain sum every year, either so long as the annuitant is alive or for such period as may be determined by the contract of annuity.

Life Insurance: In legal terms, life insurance is a contract the policy owner and the insurer, where the latter agrees to reimburse the occurrence of the insured individual's death or other event such as terminal illness or critical illness.

Mortality Rate: A mortality rate refers to the number of deaths in a specified population during a known period of time.

Pure Endowment: In pure endowment, the sum assured is paid only in case the assured survives to the end of the term.

Rider: It is a provision of an insurance policy that is purchased separately from the basic policy and that provides additional benefits at additional cost.

Savings: Savings is accumulation of funds for a specific purpose in the future.

Term Assurance: In term assurance, the sum assured is paid only in case of death of the assured within the term of the contract and nothing is paid in case of survival to end of the term.

8.9 Review Questions

1. Define life insurance. Explain the meaning of life insurance in brief.
2. Discuss the factors on which the need levels of individuals in Life Insurance depend on naturally.
3. Briefly explain when the principle of risk sharing works.
4. Is life insurance a scientific concept? Explain in detail.
5. Why was there a need to classify the insurance policies?
6. Write short notes on term insurance and pure endowment.
7. What do you understand by the term annuity? Explain the need of annuity contracts in brief.
8. What is group insurance? Discuss its features.
9. Write a short note on the concept of riders.
10. Differentiate between annuity contract and life insurance policies.
11. Write a detailed note on mortality tables.
12. Discuss the role of LIC in the life insurance segment in insurance industry in India.

Answers: Self Assessment**Notes**

- | | |
|-----------------|-----------------------|
| 1. Elements | 2. Financial |
| 3. Risk sharing | 4. Mortality |
| 5. Death | 6. Rider |
| 7. Ascendance | 8. Annuitant |
| 9. Protection | 10. Absence |
| 11. Population | 12. Survival or death |
| 13. 250 | 14. Vedas |

8.10 Further Readings**Books**

Gulati, Neelam. C. (2011), *Banking and Insurance*, Excel Books.

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Sahoo and Das (2009), *Insurance Management: Text and Case*, Himalaya Publication.

**Online links**

<http://www.wisegeek.com/what-are-mortality-rates.htm>

<http://www.fpanet.org/ToolsResources/TipoftheWeek/PastTips/Insurance/BasicLifeInsurancePlanningConcepts/>

Unit 9: Marine Insurance

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Objectives

After studying this unit, you will be able to:

- Discuss the elements of general contract
- Explain the meaning and definition of marine insurance
- Know the kinds of marine insurance policies
- Describe the clauses incorporated in marine insurance
- Explain the marine losses
- Learn the payment of claims under marine insurance

Introduction

Notes

In the previous unit, you have studied about the meaning and definition of life insurance. Simultaneously you have learnt whether life insurance is a scientific concept and various classifications of policies prevailing in market. The unit also dealt with the concepts of annuity and mortality tables along with explained the role of LIC in life insurance sector.

In this unit, you will study about marine insurance. The Indian Marine Insurance Act came into operation on August 1, 1963. The first instance of Marine Insurance regulation was brought in India with the enactment of this Act. It is a comprehensive document containing all the regulations of the marine insurance business in India. Prior to this Act, the insurance business was conducted on the basis of the principles of General Contract Act and the English Marine Insurance Law.

In the next unit, you will study about the meaning and definition of fire insurance. The unit will also discuss the various elements of fire insurance as well as kinds of policies in fire insurance segment. It will also deal with explaining the payment of claim under fire insurance. Simultaneously it will explain the concept of re-insurance.

9.1 Elements of General Contract

You must note that when the insured pays the premium and the insurer accepts the risk; the contract of insurance is concluded. The policy issued by the insurer to the insured is the proof of the contract between them. We know that no contract is valid without a consideration. In case of insurance contracts, premium is the consideration from the side of the insured and the promise to indemnify is the consideration from the insurer.

Both the parties should be competent to contract and must give the consent for the insurance contract for covering the same risk for same peril in the same sense. Insurance contracts which are against the public policy are not valid contracts. Care should be taken by both sides that something which is illegal cannot be insured. If insurance is affected on say for example smuggled goods, and the insurer comes to know after some time of signing the contract, he may avoid the contract.



Caselet

Premium Collection Growth among General Insurance Companies up 14%

Premium collection amongst general insurance companies grew by 14.25 per cent in the first half of the current fiscal which also saw insurers like IRDA registering Royal Sundaram, Shriram General and United India lower mop-ups.

While the premium collection of Royal Sundaram during April-September declined by 3.90 per cent, Shriram General recorded a meagre growth of 7.04 per cent during the period, as per the Insurance Regulatory and Development Authority (IRDA) data.

State-owned United India Insurance has recorded a growth in premium collection of 7.07 per cent during the six month period.

The data, which is based on the filings by the insurers to IRDA, revealed that the general insurance companies recorded a premium growth of 14.25 per cent during the period.

While 21 private sector companies together registered a growth of 20 per cent, the public sector peers saw premium income rise by 10.19 per cent, primarily because they have a higher base.

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Notes

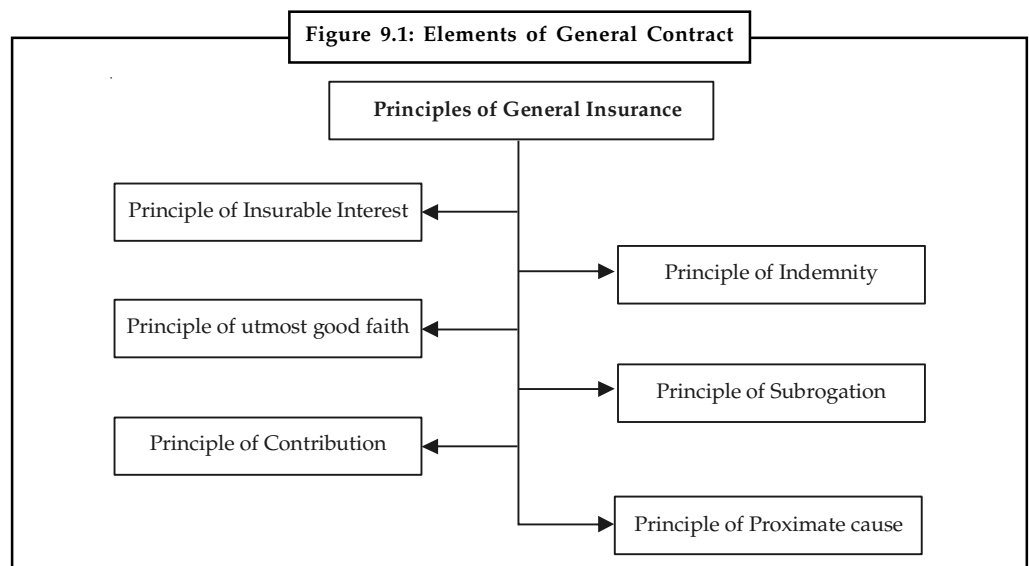
Among the private sector companies, SBI General recorded a growth of 82.23 per cent, followed by Max Bupa at 68.97 per cent and L&T General at 51.97 per cent.

Big players like ICICI Lombard, Bajaj Allianz and HDFC Ergo General recorded a premium growth of 19.02 per cent, 17.29 per cent and 18.27 per cent, respectively.

As regards the state-owned companies, New India Assurance reported an increase in premium of 12.33 per cent, followed by Oriental Insurance at 11.75 per cent, National Insurance at 9.73 per cent and United India at 7.07 per cent.

Source: http://articles.economictimes.indiatimes.com/2013-11-24/news/44412751_1_premium-collection-21-private-sector-companies-sbi-general

All Insurance contracts are governed by the basic principles of insurable interest, indemnity, utmost good faith, subrogation and proximate cause. These are discussed below:



9.1.1 Insurable interest

You must be aware that a person who wants to insure should have insurable interest in the property to be insured. Insurable interest as discussed earlier is the interest of a person in a person or property such that he/she will stand to lose if something goes wrong with the person or property. Presence of an insurable property is a must.

The insured should have a legal relation to the subject matter. This insurable interest can arise in a number of ways like:

- Ownership
- Mortgage
- Trustee
- Bailer
- Lessee

Now the question arises when should the insurable interest be present. Should it be there at the time of contract or at the time of claim or both? Let's study this in the context of various kinds of general insurance:

In fire and miscellaneous insurance, the insurable interest must exist:

- At the inception, i.e., while placing the property for insurance or we may say at time of entering into the contract.
- During the currency of the policy, i.e., the insurable interest should not end/alter during the period of insurance.
- At the time of loss, i.e., in the event of loss, the insured should have the interest in the property so that he can claim the insurance money.

In marine insurance, the insurable interest must exist, at the time of loss. It may not be there at the time of taking cover or during the currency of the policy.

In personal accident insurance, it is deemed that a person has unlimited financial interest on his own life. However, in practice there is monetary limit to the amount of insurance which matches the life of an individual. Insurable interest exists as between a husband and a wife, a parent and a dependent child. Employer is deemed to have insurable interest in employee. A creditor has interest in his debtor.



Example: Examples of Insurable Interest are:

- A person has unlimited insurable interest on his own life.
- An owner of the property (and joint owner) has insurable interest in the property.
- A bank has insurable interest in the goods on the mortgage of which, it has advanced loans. The interest is limited to the amount of the loan. Usually, under such circumstances, the policies are issued in joint names of the insured and the bank.
- The owner of a motor vehicle has insurable interest in the vehicle as well as in a potential third party liability. If a third party is injured in the accident, the damages payable to the third party would be a financial loss to the insured. Hence, he can insure his third party liability also.
- A ship owner has insurable interest in the ship owned by him. Cargo owners, both sellers and buyers, have insurable interest in the goods owned by them. A ship owner has insurable interest in the freight he is going to get by carrying the cargo.

9.1.2 Indemnity

You must understand that the objective of insurance is to indemnify i.e., to place the insured in the same financial position as he was just before the occurrence of loss. The principle prevents the insured from making a profit out of insurance. Insurance only makes good the loss and ensures public interest at large. The indemnity is the net loss suffered by the insured, and therefore, if there is any salvage/left over of the damaged property, the value of the salvage is deducted from the amount of loss subject to a maximum of the sum assured.

There are four methods of indemnification in general insurance, namely:

- Cash Payment
- Replacement
- Repair
- Reinstatement

Notes

Some examples to explain the principle of indemnity are:

- If a vehicle is insured and is destroyed by fire, the insurance company will make good the loss by taking into consideration the depreciation and the wear and tear of the vehicle, having been in use by the insured. The insurance company will not pay the price of new car. It will not be true indemnity to pay the price of a new vehicle. If the insurance company's did so, the insured will be tempted to destroy the insured assets.
- In case a building is damaged by fire, the measure of indemnity is the cost of repairing it. For machinery, the measure of indemnity is the cost of repair, if the machinery is destroyed in fire, the market value of such machine after taking into consideration the wear and tear shall be paid by the insurer.
- For manufactured stock, it is the cost of raw materials, plus cost of labour, fuel and overheads i.e., the value added will be indemnified.

It is so provided in the Marine Insurance Act, 1963 that for marine perils, the indemnity is "in the manner and to the extent agreed", by the insurers and the insured.

In the case of personal accident policies, it is not possible to place a value on life as such. Hence, personal policies are called benefit policies. Whatever is the sum assured as per the premium/ the type of policy taken, the amount shall be paid.

9.1.3 Utmost Good Faith

In any insurance contract, the proposer is the only person who is supposed to know all the facts of the subject matter of the insurance and the insurer has to completely rely on what the proposer has disclosed. The proposer, should therefore, furnish all material facts concerning the property proposed for insurance.

The insured need not disclose the facts of the following nature:

1. Which would diminish the risk of insured peril, e.g., appointing a driver or appointing a night watchman.
2. Which are presumed to have been known to the insurer, e.g., large scale rioting in the area.
3. Which could be understood from the information already, furnished, e.g., customary process in an industry.
4. Which should have been enquired but was omitted by the insurer? The insurer will construe this as warranty.

If the insured does not reveal the material facts related to the subject matter assured, then the contract is void or voidable in the hands of the insurance company as the case may be.



Example: Examples of material facts are:

- **Marine Insurance:** Method of packing, the nature of goods, the condition of vessel carrying the goods, the ports of shipment and destination, etc.
- **Fire Insurance:** Construction of the building, occupancy (e.g., office, residence, shop, godown, workshop, etc.), the nature of goods, i.e. non-hazardous, hazardous, extra-hazardous and so on.
- **Motor Insurance:** Cubic capacity of engine (private car), the year of manufacture, carrying capacity of a truck (tonnage), the purpose for which the vehicle is used, the

geographical area in which it is used, the owner's driver's convictions for traffic offences etc., age, height and weight, physical disabilities, etc.

Notes

- **General:** The fact that the previous insurers had rejected the proposal or charged extra premium, or cancelled or refused to renew the policy, previous losses suffered by the proposer.

If the insurance is placed through an agent, the agent has similar duty to disclose all material facts known to him in the agents report.

9.1.4 Subrogation

Let's discuss subrogation in this section. Subrogation is the right which an insurer gets, after he has indemnified the loss, to step into the shoes of the insured and avail himself all the rights and remedies which the insured may have in respect of the loss indemnified.



Did u know? Subrogation is the principle, which is applied to all contracts of indemnity. It means that after indemnifying the loss, the insurer gets the right of taking all steps to recover any money in compensation from the third party or by the sale of the asset against which claim has been paid.

9.1.5 Contribution

You must remember that if a property has been insured with more than one insurer and the loss occurs, the insured will get a proportionate part of the loss from each insurer. This principle of contribution is in support to the principle of indemnity which states that insurance must make good only the actual loss suffered by the insured. If a person insures his property with many insurers, it does not mean that he can recover the claim from all the insurers. Insurance does not allow an insured to make a profit out of the loss. All the insurers will contribute the insured's loss in proportion of the sum assured with each of them.

The insured may be able to recover the whole amount from one insurer, then as per the principle of contribution, the insurer will attempt proportionate recoveries from other insurers concerned.

In order to avoid this inconvenience to the first insurer, fire policies and a majority of accident policies contain a contribution condition, which says, whenever contribution applies, the insured is obliged to raise claims against all the insurers, each of whom pays only his proportion of the loss. This can be illustrated with an example.



Example: X has insured his property with three insurers AAY, BEE and CEE. He incurs a loss of ₹ 12000.

He will get claim from insurers as follows:

Sum insured with insurer AAY	₹ 10000/-	A pays ₹ 2000/-
Sum insured with insurer BEE	₹ 20000/-	B pays ₹ 4000/-
Sum insured with insurer CEE	₹ 30000/-	C pays ₹ 6000/-
Total Sum insured	₹ 60000/-	Loss ₹ 12000/-

The principle of contribution does not apply to personal accident policies as these are not contracts of indemnity.

Notes

Pre-requisites to the application of the principle of contribution:

- The subject matter of all policies must be common.
- The peril insured for, must be common to all policies.
- The policies must be affected in favour of a common insured.
- The policies must be in force at the time of loss.
- The policies must be legally enforceable.

9.1.6 Proximate Cause/Causa Proxima

You need to know that it is very important to state the perils against which the insurance cover is granted. The perils have to be specially mentioned in the insurance policy. When the actual loss takes place, the insured has to prove that the loss has occurred due to the insured peril and against not expressly or impliedly excluded peril.



Did u know? If stocks are stolen, the loss will not be indemnified under the fire policy, as burglary is not the insured peril. If a bomb dropped by an enemy in war burns stocks, then the loss is caused by war, which is an excluded peril under standard fire policy.

Hence, the insurance company is not liable to pay a loss caused by an uninsured peril or an excluded peril. In actual situations, a loss may be caused by more than one cause. The difficulty arises in determining the loss which was the nearest to the loss. The insurance companies indemnify the proximate cause of loss and not the remote cause.



Example: The following examples distinguish between 'proximate cause' and 'remote cause':

- A person insured under a personal accident policy went out hunting and met with an accident. Due to shock and weakness, he was unable to walk; he fell down on the ground. Whilst lying on the wet ground, he contracted cold, which developed into pneumonia, which caused his death. The court held that the proximate cause of death was the original accident and pneumonia (a disease which is not covered under the policy) only a remote cause. Hence, the claim was paid.
- An insured suffered accidental injuries and was taken to hospital. While undergoing treatment, he contracted an infectious disease, which caused his death. In this case, the court gave the ruling that the 'proximate cause' of death was the disease and the original accident only a 'remote cause'. Hence, the claim was not payable under a personal accident policy.

Self Assessment

Fill in the blanks:

1. The policy issued by the insurer to the insured is the proof of the between them.
2. Care should be taken by both sides that something which is cannot be insured.
3. In marine insurance, the must exist, at the time of loss.

4. This principle of contribution is in support to the principle of which states that insurance must make good only the actual loss suffered by the insured.
5. The insurance companies indemnify the proximate cause of loss and not the cause.
6. The have to be specially mentioned in the insurance policy.

Notes

9.2 Meaning and Definition of Marine Insurance

In this section, we will learn about the exact definition of marine insurance. A contract of marine insurance is defined by the Marine Insurance Act 1963 as “an agreement whereby the insurer undertakes to indemnify the assured, in the manner and to the extent thereby agreed, against losses incidental to marine adventure. It may cover loss or damage to vessels, cargo, or freight”.

The identity with which insurance contract is entered into is called the “insurer” and the person entering into contract is the “insured”.

Section 2 (C&F) of the Marine Insurance Act, 1963 defines marine insurance and includes the movables exposed to maritime perils. Movables mean movable tangible property, which includes money, valuable securities and documents, etc.

As per Arnold, marine insurance is “A contract whereby one party for an agreed consideration, undertakes to indemnify the other against loss arising from certain perils and sea risks to which a shipment and other interest in a marine adventure may be exposed during a certain age or a certain time.”

A contract of marine insurance is an agreement whereby the insurer undertakes to indemnify the insured, in the manner and to the extent thereby agreed, against transit losses, that is to say losses incidental to transit.

A contract of marine insurance may by its express terms or by usage of trade be extended so as to protect the insured against losses on inland waters or any land risk which may be incidental to any sea voyage.

Marine insurance plays an important role in domestic trade as well as in international trade. Most contracts of sale require that the goods must be covered, either by the seller or the buyer, against loss or damage. Who is responsible for affecting insurance on the goods, which are the subject of sale? It depends on the terms of the sale contract. A contract of sale involves mainly a seller and a buyer, apart from other associated parties like carriers, banks, clearing agents, etc.

Self Assessment

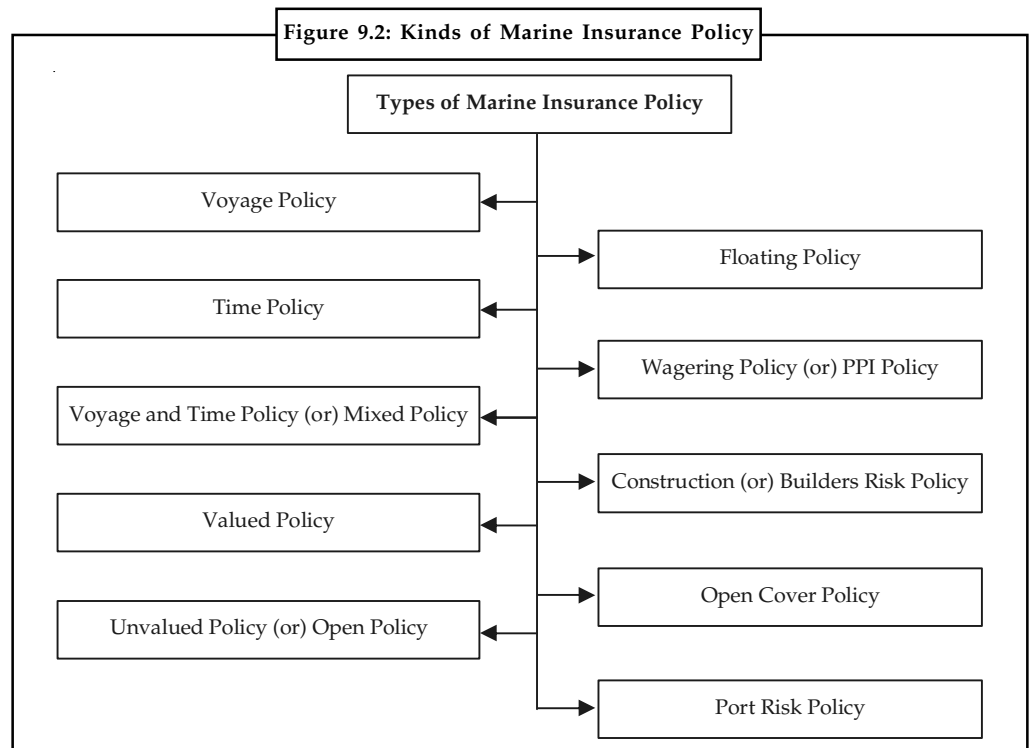
Fill in the blanks:

7. The identity with which insurance contract is entered into is called the and the person entering into contract is the
8. Movables mean movable property.

9.3 Kinds of Marine Insurance Policies

You will find it interesting to note that there are various kinds of marine insurance policies which are shown in the figure below as well as discussed in detail later on.

Notes



1. **Voyage Policy:** As the name suggests, this policy covers a voyage. This is a policy in which the limits of the risks are determined by place of particular voyage.



Example: Madras to Singapore; Madras to London.

Such policies are always used for goods insurance, sometimes for freight insurance, but only rarely nowadays for hull insurance.

2. **Time Policy:** This policy is designed to give cover for some specified period of time, say, for example 1st Jan, 2003 to noon, 1st Jan, 2004. Time policies are usual in the case of hull insurance, though there may be cases where an owner prefers to insure his vessel for each separate voyage under voyage policy.
3. **Voyage and Time Policy or Mixed Policy:** It is a combination of voyage and time policy. It is a policy, which covers the risk during a particular voyage for a specified period.



Example: A ship may be insured for voyages between Madras to London for a period of one year.

4. **Valued Policy:** This policy specifies the agreed value of the subject matter insured, which is not necessarily the actual value. Such agreed value is referred to as the insured value.



Example: A policy may be, say, for ₹ 10,000 on Hull and Machinery, etc. valued at ₹ 2,00,000 or for ₹ 7,000 on 100 cases of whisky valued at ₹ 7,000.

Once a value has been agreed, it cannot be reopened unless there is proof of fraudulent intention. It remains binding on both the parties. These policies are not common nowadays.

5. **Unvalued Policy/Open Policy:** In the case of an unvalued Policy, the value of the subject matter insured is not specified at the time of effecting insurance. It is taken for a specified

amount and the insurable value is ascertained in the case of loss. Here the insurer is liable to pay only up to actual loss incurred to the policy amount. It is also known as open policy.

6. **Floating Policy:** A floating policy describes the insurance in general terms, leaving the names of the ship or ships to be defined by subsequent declaration. Such policy has the advantage of being a valid marine policy, in all respects fully complying with the requirements of the Marine Insurance Act.

The declaration may be made by endorsement on the policy or in any other customary manner. Unless the policy otherwise provides, declaration must be made in the order of shipment. They must comprise all the consignments within the terms of the policy and values must be honestly stated. Errors and omissions however, may be rectified even after a loss has occurred, if made in good faith.

When the total amount declared exhausts, the amount for which the policy was originally issued, it is said to be "run off" or "full declared". The assured may then arrange for a new policy to be issued to succeed the one about to lapse, otherwise the cover terminates when the policy is fully declared.

7. **Wagering Policy:** This policy is issued without there being any insurable interest, or a policy bearing evidence that the insured is willing to dispense with any proof of interest. If a policy contains such words as "Policy Proof of Interest" (PPI) or "Interest or No Interest", it is a wagering or honour policy. Under section 4 of the Marine Insurance Act, such policies are void in law but such policies continue to be common.
8. **Construction or Builders Risk Policy:** This is designed to cover the risks incidental to the buildings of a vessel, usually giving cover from the time of laying the keel until completion of trails and handing over to owners. In the case of a very large vessel, the period may extend over several years.
9. **Blanket/Open Cover Policy:** In order to arrange their marine insurance in advance and to be assured to cover at all times, and also to avoid the effects of possible rapidly fluctuating rates, it is the practice of regular importers and exporters to avail "Blanket Insurance".
- One good way, and the most popular one of achieving this is by means of "Open Cover". An open cover is an agreement between the assured and his underwriters under which the former agrees to declare, and the latter to accept, all shipments coming within the scope of the open cover during some stipulated period of time.
10. **Port Risk Policy:** This is to cover a ship or cargo during a period in port against the risks peculiar to a port as distinguished from voyage risks. This kind of policy is probably very rarely used nowadays.

Self Assessment

Fill in the blanks:

9. Mixed policy is a combination of and time policy.
10. In unvalued policy the value of the subject matter insured is not specified at the time of effecting

9.4 Clauses Incorporated in Marine Insurance


You need to know that the clause makes it lawful for the assured and his servants where there is a danger that the subject matter insured may suffer loss or damage for which the underwriter would be liable, to take such steps as may be reasonable to avert or minimize the loss or damage and at the same time it binds the underwriters to pay their share of the expenses incurred.

Notes

Important Clauses

The following are the usual clauses that may be incorporated in a marine policy:

1. **Assignment Clause:** This clause makes it clear that the marine policy is assignable unless it contains terms expressly prohibiting assignment. A marine policy may be assigned either before or after a loss. Assignment may be through endorsement or in other customary manner. Where the assured has parted with or lost his interest in the subject matter insured, any subsequent assignment is inoperative.



Notes The assignee who has acquired the beneficial interest in the policy is entitled to sue thereon in his own name.

2. **Lost or Not Lost Clause:** Where the subject matter is insured “Lost or not lost” and the loss has occurred before the contract is concluded, the risk attaches. But if this fact is in the knowledge of the assured and insurer was not, then the policy will not be valid.
3. **At and From Clause:** The risk starts as soon as the contract of insurance is concluded provided the ship is in good safety at that time. If the ship is not in good safety at that time, the risk will begin on her till arriving in good safety at the port of departure. Where freight, other than chartered freight is payable without special conditions and is insured “at and from” a particular place, the risk attaches pro rata as the goods are shipped, provided that if there be cargo in readiness which belongs to the ship owner or which some other persons had contracted with him to the ship, the risk attaches as soon as the ship is ready to receive such cargo.
4. **Transit Clause or Warehouse-to-Warehouse Clause:** This clause provides with respect to goods, for the risk to attach “from the loading thereof aboard the said ship” and for the insurance to continue until the goods are discharged and safely landed at the port of discharge. This clause helps to provide protection for the entire period of transit.




Did u know? The period of cover extends from the time the goods leave the exporter’s warehouse until they are delivered to the importers warehouse at the named destination or to any other warehouse, whether prior to or at the named destination, which the assured elect to use either for storage or for allocation or distribution, or on the expiry of 60 days after discharge from the overseas vessel at the final port of discharge which ever first occurs.

5. **Change of Voyage Clause (or) Deviation Clause:** According to Marine Insurance Act, it provides that where there is a change of voyage, unless the policy otherwise provides, the insurer is discharged from liability as from the time of the change. Through this clause, the policy does provide otherwise (that means permits deviation), and the event is held covered.
6. **Touch and Stay Clause:** In the absence of any further license or usage, the liberty to “touch and stay at any port or place whatsoever” does not authorize the ship to depart from the course of her voyage from the port of departure to the port of destination.
7. **Negligence Clause:** This is designed to extend the underwriters liability to cover risks of a kind, which are not included within the ordinary meaning of maritime perils. It provides for the insurance to cover loss or damage to hull or machinery directly caused by:
 - ❖ Accident in loading or shifting cargo or fuel explosions on shipboard or elsewhere

- ❖ Bursting of boilers
 - ❖ Negligence of master, officers
 - ❖ Negligence of repairs provided such repairs are not assured hereunder
 - ❖ Contact with aircraft
 - ❖ Contact with any land conveyance, dock or harbour equipment or installation
 - ❖ Earthquake, volcanic eruption or lightning.
8. **Running down Clause:** In an ordinary marine policy, the assured is covered in respect of the damage sustained by his own ship in the case of collision, but such cover does not extend to his liability for the damage done to the other ship. This clause provides a supplementary contract whereby the assured is given some protection against such third party damages. It provides that if the insured vessel collides with another vessel, the underwriters agree to pay three-quarters of the amount of damage to which the assured becomes liable.
 9. **Sue and Labour Clause:** This clause explains in detail the extent of underwriter's liability for such expenses. In particular, it provides that liability shall not be exceeding the proportion that the amount insured bears to the value of the vessels. It has been previously mentioned that in the absence of the provision, underwriters would be liable for the full amount of sue and labour charges even where there was underinsurance.
 10. **Re-Insurance Clause:** There are various reasons why an underwriter may deem it prudent to reinsure part or all of a risk for which he has accepted liability. For instance, he may find that his commitments on any one vessel or in any locality have become too burdensome. Declarations under open covers or floating policies and acceptances by his agents in other markets give him an accumulated liability considerably in excess of his usual retention. He may have accepted a line on 'all-risks' terms and then desire to re-insure in respect to total loss only.
 11. **Memorandum Clause:** This clause is meant to provide a minimum limit to the underwriter's liability regarding claims for particular average by exempting him from such claims.
 12. **Continuation Clause:** This clause refers that the vessel shall continue to be covered even after completion of voyage under the policy at a pro rata premium to her port of destination.
 13. **Perils of the Sea Clause:** The term "perils of the sea" refers only to fortuitous accidents and casualties of the seas. It does not include the ordinary action of the winds and waves.
 14. **Warrior Clause:** This is really supplementary to the 'Sue and Labour' clause provided simply to assure that, in the event of a casualty. Either party to the contract may take such steps, or incur such expenses, as are contemplated under sue and labour clause, to minimize a loss without prejudice to the right of the assured on the one hand and the underwriter on the other.
 15. **All Risk Clause:** This provides that the insurance is against all risks of loss or damage to the subject matter insured and that claims are payable irrespective of percentage of loss.
 16. **Foreign General Average Clause (F.G.A.):** Foreign General Average clause means that the arrangement in case of General Average Claim which may arise under the policy, the average settlement made in a foreign country will be adopted as the basis for settlement.
 17. **Free of capture and seizure (F.C.S.):** This clause is generally inserted in times of war. It means that the underwriters will not be liable for loss or claim arising from seizure of ship as a price of war. In times of war this clause is inserted unless the insured pays the underwriters additional premium for war risks.

Notes

18. **Free of Particular Average Clause (F.P.A.):** This clause restricts the liability of the underwriter and the underwriter is liable only for total loss and not for particular average or partial loss.



Task Visit the websites of any two insurance firms and study their marine insurance policies and analyse the clauses they have in their policies and prepare a report on the same.

Besides the above clauses, an understanding of the following bonds is also important in marine insurance:

1. **Bottomry Bond:** It is a bond-representing loan raised by the master of the ship so as to meet certain urgent expenses like repairing a ship on the security of a ship or ship and cargo. It is repayable after a certain agreed number of days after the arrival of the ship as specified in the bond. If the vessel is lost before the arrival at destination, the lender loses his money.
2. **Respondentia Bond:** Like bottomry bond, respondentia bond also represents a monetary loan borrowed by the master of a ship to meet certain urgent expenses. The loan is raised on the security of the cargo only. The loan is to be repaid within a certain period after arrival of the cargo at the destination as specified in the Respondentia Bond. If the cargo is lost on its way, the lender loses his money.

Self Assessment

Fill in the blanks:

11. A marine policy may be assigned either before or after a
12. Memorandum clause is meant to provide a minimum limit to the liability regarding claims for particular average by exempting him from such claims.

9.5 Marine Losses

You need to know that according to the Marine Insurance Act, unless the policy otherwise provides, the insurer is liable for any loss proximately caused by a peril insured against. The insurer is not liable for any loss attributable to the wilful misconduct of the assured but, unless the policy otherwise provides, he is liable for any loss proximately caused by a peril insured against even though the loss would not have happened but for the misconduct or negligence of the master or crew of the ship.

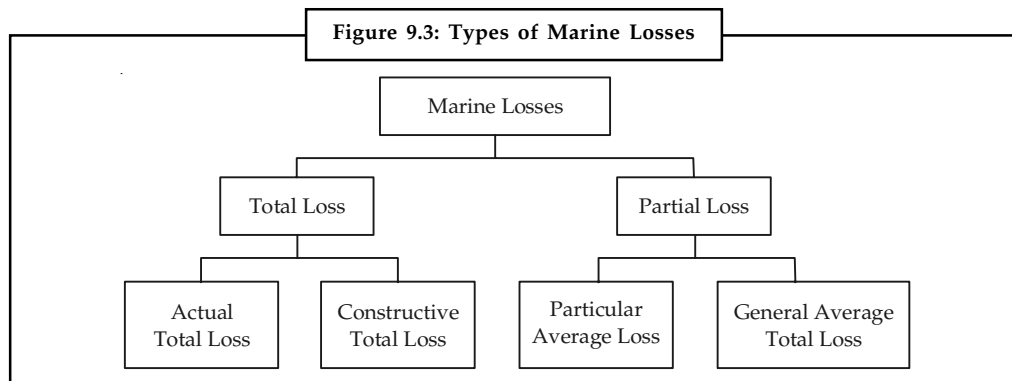


Caution Unless the policy otherwise provides, the insurer is not liable for ordinary wear and tear, ordinary leakage and breakage, inherent vice or nature of the subject matter insured, or for any loss proximately caused by rats or vermin or any injury to machinery not proximately caused by maritime perils.

The losses of insurance may be divided broadly into two classes:

1. Total Loss and
2. Partial Loss.

The total losses again can be subdivided into Actual Total Loss and Constructive Total Loss. Partial Loss may be further divided into Particular Average Loss and General Average Loss as shown in the figure below:



9.5.1 Total Loss and its Types

Let's find out what exactly is meant by total loss. When the subject matter of insurance (the ship, cargo, or freight) is totally lost, it is called total loss. A total loss may be further categorized into actual total loss, or constructive total loss.

Actual Total Loss

It is said that actual total loss has arisen:

- When the subject matter insured is destroyed or is so damaged such that it ceases to be a thing of a kind insured (or).
- When the assured is irretrievably deprived of the subject-matter.
- When the ship concerned in the adventure is missing, and after the lapse of a reasonable time, no news of it is received.

In the case of an Actual Total Loss, the insurer has to pay either the insured amount or the actual loss whichever is less. But the cause of loss must be one of the perils insured against.

Constructive Total Loss

Generally speaking, there is a Constructive total loss where the subject matter insured is reasonably abandoned on account of its actual loss appearing to be unavoidable, or because it could not be preserved from actual total loss without an expenditure, which would even exceed its value. In other words, constructive total loss is said to have occurred:

- When the assured is deprived of the possession of his ship or goods by a peril insured against and it is unlikely that he can recover the ship or goods, as the case may be (or) the cost of recovering the ship or goods, as the case may be, would exceed their value when recovered
- In the case of damage to goods, where the cost of repairing the damage and forwarding the goods to their destination would exceed their value
- In the case of damage to the ship, where it is so damaged by the peril insured against that the cost of repairing the damage would exceed the value of the ship.

Notes

Effect of Constructive Total Loss

Where there is a constructive total loss, the assured may either treat the loss as a particular loss or abandon the subject matter insured to the insurer and treat the loss as if it were an actual total loss.

Notice of Abandonment

It is a notice by the assured to the insurer that he abandons all interests in the subject-matter of insurance unconditionally to the insurer. As per section 62, the rules regarding abandonment are:

1. A notice of abandonment should be given by the insured to the insurer. If he fails to do so, the Loss can only be treated as a partial Loss.
2. The insurer may waive notice of abandonment.
3. Notice of abandonment may be given in writing, or by word of mouth or partially in writing and partly by word of mouth. There is no specified wording, which indicate the intention of the assured to abandon his insured interest in the subject matter insured, but surely it must be unconditional.
4. Notice of abandonment must be given with reasonable time after the receipt of reliable information of the Loss, but where the information is of a doubtful character, the assured is entitled to a reasonable time to make enquiry and then to notify.
5. Where the notice of abandonment is properly given, the rights of assured are not prejudiced by the fact that the insurer refuses to accept the abandonment.
6. The acceptance of abandonment may be either express or implied from the conduct of the insurer. The mere silence of the insurer after notice does not amount to an acceptance.
7. Once the notice of abandonment is accepted, the abandonment is irrevocable. The acceptance of the notice conclusively admits liability for the loss.

Effect of Abandonment

Where there is a valid abandonment, the insurer is entitled to take over the interest of the assured in whatever may remain of the subject matter insured, and all proprietary rights incidental thereto.

9.5.2 Types of Partial Loss

In marine insurance, the term partial loss is any loss other than a total loss. The partial loss as also stated above may be classified into the following:

Particular Average Loss

When the subject matter is partially lost or damaged by a peril insured against, it is called particular average loss.

A particular average loss must fulfil the following conditions:

- Only a particular subject matter is lost or damaged.
- The loss should be accidental.

Notes

- It should be caused by a peril insured against.
- The damage should not have been suffered for a general benefit.

Particular average losses can be further categorized into:

1. **Particular Average on Ship:** The loss on account of partial damage to the ship from the peril insured against is called particular average on ship. The insurer is liable to the extent of actual cost of repairs reasonably incurred to mend the fault(s).



Notes Where there is a partial loss of freight because of the peril insured against, it is called Particular Average on freight.

2. **Particular Average on Cargo:** A claim for particular average on cargo arises where the cargo has been either partially damaged by the peril insured against or when a portion of cargo is totally lost.
3. **Salvage Charges:** It is the reward paid under maritime law to the salvor for saving or helping to save property at sea or life. Further the salvor must be stranger to the adventure. In other words, he should not have been connected with the adventure. The salvage charges are recoverable from the insurers as partial loss. If the salvage charges are necessitated because of the unseaworthiness of the ship, the underwriter on the hull is not liable for any portion of the remuneration awarded to salvor. The salvor who has saved the property has a right to possession on it in respect of his award for the services.

General Average Loss

A General Average Loss occurs where any extraordinary sacrifice or expenditure is voluntarily and reasonably made or occurred in time of peril, for the purpose of preserving the property involved in a common adventure. The rule in case of general average loss is that it must be borne rateably by the parties interested in the common adventure.



Example: Cargo ship caught fire; water is thrown to extinguish fire by which cargo is damaged. The Loss caused by cargo is a General Average Loss.

Few more examples:

- Jettisoning Cargo to lighten the ship in distress.
- Money paid to pirates for the purpose of saving the ship and cargo.
- Throwing of water on board of ship to extinguish fire.
- Expenses incurred in taking vessel to its destination with outside help.

Self Assessment

Fill in the blanks:

13. The total losses again can be subdivided into total loss and total loss.
14. A notice of abandonment should be given by the to the

9.6 Payment of Claims

You need to remember that as the risk covers are different for import/export and inland (with in India) consignments, the procedure of claim settlement is explained separately:

9.6.1 For Import/Export Consignments

Claims under marine policies have to be supported by certain documents which vary according to the type of loss as also the circumstances of the claim and the mode of carriage.

The documents required for any claim are as under:

- **Intimation to the Insurance Company:** As soon as the loss is discovered then it is the duty of the policyholder to inform the Insurance Company to enable it to assess the loss.
- **Policy:** The original policy or certificate of insurance is to be submitted to the company. This document establishes the claimant's title and also serves as an evidence of the subject matter being actually insured.
- **Bill of Lading:** Bill of Lading is a document which serves as evidence that the goods were actually shipped. It also gives the particulars of cargo.
- **Invoice:** An invoice evidences the terms of sale. It also contains complete description of the goods, prices, etc. The invoice enables the insurers to see that the insured value of the cargo is not unreasonably in excess of its cost, and that there is no gross overvaluation. The original invoice (or a copy thereof) is required in support of claim.
- **Survey Report:** Survey report shows the cause and extent of loss, and is absolutely necessary for the settlement of claim. The findings of the surveyors relate to the nature and extent of loss or damage, particulars of the sound values and damaged values, etc. It is normally issued with the remarks "without prejudice," i.e. without prejudice to the question of liability under the policy.
- **Debit Note:** The claimant is expected to send a debit note showing the amount claimed by him in respect of the loss or damage. This is sometimes referred to as a claim bill.
- **Copy of Protest:** If the loss or damage to cargo has been caused by a peril of the sea, the master of the vessel usually makes a protest on arrival at destination before a Notary Public. Through this protest, he informs that he is not responsible for the loss or damage. Insurers sometimes require to see the copy of the protest to satisfy themselves about the actual cause of the loss.
- **Letter of Subrogation:** This is a legal document (supplied by insurers) which transfers the rights of the claimant against a third party to the insurers.

On payment of claim, the insurers may wish to pursue recovery from a carrier or other third party who, in their opinion, is responsible for the loss. The authority to do so is derived from this document. It is required to be duly stamped.

Some of the other documents required in support of particular average claims are Ship survey report lost overboard certificate if cargo is lost during loading and unloading operation, short landing certificate etc.

- **Bill of entry:** The other important document is bill of entry issued by the customs authorities showing therein the amount of duty paid, the date of arrival of the steamer, etc.

9.6.2 Inland Transit Claims (Rail/Road)

Notes

In regard to claims relating to inland transit, the documents required to be submitted to the insurers in support of the claim are:

- Original policy or certificate of insurance duly endorsed.
- Invoice, in original, or copy thereof.
- Certificate of loss or damage (original) issued by carriers.
- If goods are totally lost or not delivered, the original railway receipt and/or non-delivery certificate/consignment note.
- Copy of the claim lodged against the railways/road carriers (By Regd. A.D.)
- Letter of Subrogation, duly stamped.
- Special Power of Attorney duly stamped. (Railway Claims).
- Letter of Authority addressed to the railway authorities signed by the consignors in favour of consignees whenever loss is claimed by consignees.
- Letter of Authority addressed to the railway authorities signed by the consignors in favour of the insurers
- Letter of Undertaking from the claimant in case of non-delivery of consignment.
- Claim Bill, after adjusting salvage value proposed.

Self Assessment

Fill in the blanks:

15. is a document which serves as evidence that the goods were actually shipped.
16. report shows the cause and extent of loss, and is absolutely necessary for the settlement of claim.



Case Study

Marine Insurance Market Set for Shake-up

The marine insurance market is heading for a shake-up in the wake of the Costa Concordia disaster as underwriters reconsider whether they want to provide cover for ever-larger vessels, according to industry executives.

Insurers say the incident has highlighted the risks of a recent scale revolution not only in passenger liners but also in the more numerous container ships and carriers of dry-bulk commodities such as iron ore and coal.

As underwriters come to terms with one of the costliest marine accidents, some insurers are questioning whether they still want to provide cover in a fiercely competitive market from which many struggle to turn a profit.

“The question is, are these huge vessels still manageable?” said Dieter Berg, senior executive manager for marine at Munich Re, the world’s biggest reinsurance company by gross written premiums and among the many insurance groups exposed to the Costa Concordia.

Contd...

Notes

“Imagine an accident involving a cruise ship with 8,000 people and a tanker in the dead of night in the middle of the ocean.”

He added: “It’s a big shock for the market. The alarm clocks of marine insurers are ringing at the moment.”

So-called hull insurance, which covers physical damage to vessels, has failed overall to produce an underwriting profit for 15 consecutive years, according to the International Union of Marine Insurance. Cargo insurance has fared better but it too suffered an overall underwriting loss in 2010.

Analysts estimate that once environmental damage and injuries are included, losses from the Costa Concordia could amount to as much as \$1bn. In absolute terms, that would make the sunken cruise ship the biggest ever marine loss.

Duncan Southcott, head of marine UK at Allianz, Europe’s biggest insurer by market capitalisation, said the increasing size of ships “must be a concern ... This is the first example of one of these very large [passenger] vessels gone wrong”.

Two senior underwriters, who declined to be named, said insurers were hopeful of pushing through price increases of up to 20 per cent following the accident. However, brokers said the competitive nature of the marine insurance market made a significant rise in premiums unlikely.

Losses from the Costa Concordia are spread widely among several insurance and reinsurance companies including Generali, RSA Insurance Group and XL Group.

“Will this one loss have an impact? It might be the straw that breaks the camel’s back for some people – we may see some capacity withdraw,” said Marcus Baker, chairman of the marine practice at Marsh, the broker.

But he added that the cruise industry was still relatively safe. “The number of injuries and incidents has historically been low. Relatively speaking the risks have been seen by many underwriters to be quite good.”

Questions:

1. What is the prime reason for the marine insurance market shake-up? Discuss.
2. Discuss the factors affecting premiums in marine insurance market.

Source: <http://www.ft.com/cms/s/0/a06ced40-48e9-11e1-974a-00144feabdc0.html#axzz2oSa8yreR>

9.7 Summary

- In case of insurance contracts, premium is the consideration from the side of the insured and the promise to indemnify is the consideration from the insurer.
- If insurance is affected on say for example smuggled goods, and the insurer comes to know after some time of signing the contract, he may avoid the contract.
- In personal accident insurance, it is deemed that a person has unlimited financial interest on his own life.
- The objective of insurance is to indemnify i.e., to place the insured in the same financial position as he was just before the occurrence of loss.
- Subrogation is the right which an insurer gets, after he has indemnified the loss, to step into the shoes of the insured and avail himself all the rights and remedies which the insured may have in respect of the loss indemnified.

- This principle of contribution is in support to the principle of indemnity which states that insurance must make good only the actual loss suffered by the insured.
- A contract of marine insurance is an agreement whereby the insurer undertakes to indemnify the insured, in the manner and to the extent thereby agreed, against transit losses, that is to say losses incidental to transit.
- A marine policy may be assigned either before or after a loss. Assignment may be through endorsement or in other customary manner.
- The insurer is not liable for any loss attributable to the wilful misconduct of the assured but, unless the policy otherwise provides, he is liable for any loss proximately caused by a peril insured against even though the loss would not have happened but for the misconduct or negligence of the master or crew of the ship.
- In the case of an Actual Total Loss, the insurer has to pay either the insured amount or the actual loss whichever is less. But the cause of loss must be one of the perils insured against.
- Where there is a constructive total loss, the assured may either treat the loss as a particular loss or abandon the subject matter insured to the insurer and treat the loss as if it were an actual total loss.
- Claims under marine policies have to be supported by certain documents which vary according to the type of loss as also the circumstances of the claim and the mode of carriage.

9.8 Keywords

Assignment Clause: This clause makes it clear that the marine policy is assignable unless it contains terms expressly prohibiting assignment.

Construction or Builders Risk Policy: This is designed to cover the risks incidental to the buildings of a vessel, usually giving cover from the time of laying the keel until completion of trails and handing over to owners.

Floating Policy: A floating policy describes the insurance in general terms, leaving the names of the ship or ships to be defined by subsequent declaration.

Negligence Clause: This is designed to extend the underwriters' liability to cover risks of a kind, which are not included within the ordinary meaning of maritime perils.

Open Cover: An open cover is an agreement between the assured and his underwriters under which the former agrees to declare, and the latter to accept, all shipments coming within the scope of the open cover during some stipulated period of time.

Port Risk Policy: This is to cover a ship or cargo during a period in port against the risks peculiar to a port as distinguished from voyage risks.

Transit Clause or Warehouse-to-Warehouse Clause: This clause provides with respect to goods, for the risk to attach "from the loading thereof aboard the said ship" and for the insurance to continue until the goods are discharged and safely landed at the port of discharge.

Unvalued Policy/Open Policy: In the case of an unvalued policy, the value of the subject matter insured is not specified at the time of effecting insurance.

Valued Policy: This policy specifies the agreed value of the subject matter insured, which is not necessarily the actual value.

Wagering Policy: This policy is issued without there being any insurable interest, or a policy bearing evidence that the insured is willing to dispense with any proof of interest.

Notes

9.9 Review Questions

1. What is considered as consideration in case of insurance contracts?
2. Explain briefly the elements of general insurance contract.
3. Why is it important for insurable interest to exist in case of fire and miscellaneous insurance?
4. Define marine insurance. Explore the meaning of marine insurance.
5. What are the various types of marine insurance policies? Explain with the help of diagram.
6. Briefly explain the clauses that need to be incorporated in a marine insurance contract.
7. Besides clauses, what are the other bonds that are important in marine insurance?
8. Write a detailed note on marine losses.
9. What do you understand by the term partial loss? Explain with the help of suitable example.
10. Explain the procedure of payment of claims for inland consignments.
11. Describe the procedure for the payment of claims in case of import and export consignments.
12. Write short note on:
 - (a) Open Cover Policy
 - (b) Wagering Policy
 - (c) Floating Policy

Answers: Self Assessment

- | | |
|--------------------------|----------------------|
| 1. Contract | 2. Illegal |
| 3. Insurable interest | 4. Indemnity |
| 5. Remote | 6. Perils |
| 7. Insurer, insured | 8. Tangible |
| 9. Voyage | 10. Insurance |
| 11. Loss | 12. Underwriter's |
| 13. Actual, Constructive | 14. Insured, insurer |
| 15. Bill of Lading | 16. Survey |

9.10 Further Readings



Books

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Notes



Online links

<http://www.nos.org/media/documents/VocInsServices/m4-2f.pdf>

<http://www.nos.org/media/documents/VocInsServices/m4-2f.pdf>

Unit 10: Fire Insurance

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Objectives

After studying this unit, you will be able to:

- Explain the meaning and definition of fire insurance
- Know the elements of fire insurance
- Discuss the kinds of policies
- Describe the payment of claim under fire insurance
- Understand the concept of re-insurance

Introduction

In the previous unit, you have studied about the elements of general contract, meaning and definition of marine insurance. It dealt with explaining the kinds of marine insurance policies. The unit also summarized the various clauses incorporated in marine insurance and concepts such as marine losses and procedure for payment of claims under marine insurance.

In this unit, we will study about fire insurance. Fire insurance contracts cover the risks of damage by fire. They insure the risk of loss caused whether by fire or incidental to fire. Thus, fire insurance policies cover the insurance business in which the risk to the asset is from fire or incidental to fire. A fire insurance policy covers the fire and other occurrences as stated in the policy. The inclusion of various clauses to cover matters related to fire in the policy is essential to cover the loss caused due to various reasons.

The policy should mention clearly the subject matter/assets insured. The contract of fire insurance will not cover the assets, which are not mentioned in the policy document, though the loss is caused to the assets because of the fire. The policy document is the evidence of conclusion of the contract.

In the next unit, you will study about the meaning of motor insurance along with the types of motor insurance policy. The next unit will also deal with claims under motor insurance and third party claims.

10.1 Meaning and Definition

Some important definitions of Fire Insurance are given below:

1. Section 2(6A) of the Insurance Act, 1938 defines fire insurance business as “the business of effecting, otherwise than incidentally to some other class of insurances business, contracts of insurance against loss by or incidental to fire or other occurrence customarily included among the risks insured against in fire insurance policies”.
2. V.R. Bhushan and Prof. R.S. Sharma defined fire insurance as “an agreement whereby one party, in return for a consideration, undertakes to indemnify the other party against financial loss, which the later may sustain by reason of certain defined subject matter being damaged or destroyed by fire or other defined perils to an agreed amount”.
3. T.R. Smith defined fire insurance as ‘a contract whereby the insurers in return for a consideration, known as premium, undertake to indemnify the insured against financial loss which he may sustain, by reason of certain defined property, known as the property insured, being damaged or destroyed by fire or other perils within a stated period of the liability of insurer, being limited to a specified amount, called the sum insured”.

This definition is self-explanatory and includes all aspects of fire insurance.

As such, presence of a physical asset is a must to have the risk of fire covered. The asset, which is insured, becomes the subject matter of the insurance contract. Occurrence of fire is essential and the damage should be caused to the asset due to fire. The damage has to be compensated and the assured has to be indemnified. The origin or cause of origin of fire damaging the asset is not of importance.

If the insurance company finds the mala fide intentions of the assured, it can take it as a defence to avoid the fire insurance claim settlements. As such, fire insurance contracts are a part of general insurance and are contracts of good faith.



Caselet

Companies may Share Higher Risk for Engineering Fire Cover

Fire and engineering insurance tariffs will soon be revised. The Tariff Advisory Committee — an arm of the Insurance Regulatory and Development Authority (IRDA) — which looks into pricing of non-life insurance products, has already prepared a draft of the revised fire insurance tariff and is now revising engineering tariffs as well, sources confirmed to ET.

This is the first time in three years for engineering insurance and second for fire insurance that the tariffs are being revised. Corporates may end up bearing a higher share of risk on their engineering insurance in line with the international trend, while in fire the revision will be more on regulations and categories.

Movement of insurance rates in international markets impacts reinsurance rates in India. But since rates in India are tariff-governed, insurers are not absolutely free to vary rates.

Contd...

Notes

Therefore if domestic rates stagnate at lower levels, even as reinsurance rates harden, local insurers may find it hard to rope in reinsurers.

Internationally, say industry sources, reinsurers insist on insurance companies bearing a higher portion of each policy issued through higher deductibles.

A deductible is that portion of the loss that an insurer has to bear in the event of a claim. As in the case of fire insurance, a draft of the revised tariff will be placed on the TAC website for comments before a final version is notified.

In a related move, the IRDA has said that insurance companies should follow the 'file and use' practice — normally used for non-tariff products — when dealing with mega risk policies as well. The 'file and use' procedure is similar to the filing of a draft prospectus for a public issue with SEBI (Securities and Exchange Board of India). Although there is no vetting of the policy, the filing period gives the regulator time to ensure that the pricing is fair and the product is not detrimental to the market. File and use applies to non-tariff products only since tariff policies such as motor and fire insurance are standard and devised by TAC. Even in the case of non-tariff products, filing was needed only for those policies that were sold as packaged products. But tailor-made policies needed no filing.

The Mega Risk policy is a policy designed for big buyers of insurance such as refineries and other plants with heavy concentration of risk. Due to limited capacity in India these risks are typically insured only after reinsurance support is finalised. As this policy was launched in '99, when there was no regulator for insurance, the Mega Risk policies were never filed with the IRDA. This practice continued even after the IRDA was set up as insurers felt that this was not a new product but a renewal of an old cover. Sources say that now the IRDA will treat each renewal as a new product unless the terms and conditions of the renewal policy are same in all respects as the expiring policy.

Under the Mega Risk policy, these plant owners instead of purchasing insurance at the tariff rates could shop around for the best deals in the reinsurance market. After striking the deal with the reinsurer, the buyer would then strike a deal with a local insurance company who would underwrite the risk on the back of reinsurance support. IRDA has also asked insurance companies to provide details of the claims experience under each Mega Risk policy.

Source: http://articles.economictimes.indiatimes.com/2003-06-26/news/27533907_1_reinsurance-rates-insurance-products-tariff-advisory-committee

The word 'fire' should be construed in its simple meaning and sense without attributing any technical or scientific concepts or meanings to the term. The risk of fire is simply an unforeseen or unexpected event caused either by accident or incident that cannot be forecasted. The contract of fire insurance is valid as long as the assured has an insurable interest in the asset insured. In the absence of the insurable interest in the contract of insurance, the contract becomes a wagering contract, and thus, becomes void.



Task Collect some more definitions of fire insurance from internet or other sources and prepare a collage in your own handwriting.

A fire insurance policy cannot be assigned without the permission of the insurer because the insured must have insurable interest in the property at the time of contract as well as at the time of loss. The insurable interest in goods may arise out on account of (i) ownership, (ii) possession,

or (iii) contract. A person with a limited interest in a property or goods may insure them to cover not only his own interest but also the interest of others in them. Under fire insurance, the following persons have insurable interest in the subject matter:

- Owner
- Mortgagee
- Pawnee
- Pawn broker
- Official receiver or assignee in insolvency proceedings
- Warehouse keeper in the goods of customer
- A person in lawful possession e.g. common carrier, wharfinger, commission agent.

The term 'fire' is used in its popular and literal sense and means a fire which has 'broken bounds'. 'Fire' which is used for domestic or manufacturing purposes is not fire as long as it is confined within usual limits. In the fire insurance policy, 'Fire' means the production of light and heat by combustion or burning.



Caution "Fire" must result from actual ignition and the resulting loss must be proximately caused by such ignition.

The phrase 'loss or damage by fire' also includes the loss or damage caused by efforts to extinguish fire.

The types of losses covered by fire insurance are:

- Goods spoiled or property damaged by water used to extinguish the fire.
- Pulling down of adjacent premises by the fire brigade in order to prevent the progress of flame.
- Breakage of goods in the process of their removal from the building where fire is raging e.g. damage caused by throwing furniture out of window.
- Wages paid to persons employed for extinguishing fire.

The types of losses not covered by a fire insurance policy are:

- Loss due to fire caused by earthquake, invasion, act of foreign enemy, hostilities or war, civil strife, riots, mutiny, martial law, military rising or rebellion or insurrection.
- Loss caused by subterranean (underground) fire.
- Loss caused by burning of property by order of any public authority.
- Loss by theft during or after the occurrence of fire.
- Loss or damage to property caused by its own fermentation or spontaneous combustion e.g. exploding of a bomb due to an inherent defect in it.
- Loss or damage by lightning or explosion is not covered unless these cause actual ignition which spread into fire.

Notes

Self Assessment

Fill in the blanks:

1. Presence of a is a must to have the risk of fire covered.
2. Fire insurance contracts are a part of general insurance and are contracts of
3. A fire insurance policy cannot be assigned without the permission of the
4. A person with a interest in a property or goods may insure them to cover not only his own interest but also the interest of others in them.

10.2 Elements of Fire Insurance

In this section, we will discuss about the elements of fire insurance.

All the essential elements of an insurance contract are present in a fire insurance contract. The essential elements are:

1. **Capacity to Contract:** The parties to the contract should have the capacity to contract. He should not be a minor, adjudged insolvent or insane.
2. **Consideration:** The consideration of the contract should be lawful and not forbidden by the law.
3. **Object:** The object of the contract should be lawful and not against the public policy or public interest.
4. **Free Consent:** The contract should have been concluded with the free consent i.e. without coercion, undue influence, fraud or misrepresentation.
5. **Parties to Contract:** The insurer and insured are the parties to the fire insurance contract. The provisions of Insurance Act, 1938, define the insurer's role. The act defines the insurer and renders his registration compulsory.



Notes The contract should be backed by the presence of consideration. The premium paid by the assured to cover the risk is the consideration by the assured and the promise made by the insurer to pay the compensation for the damage by fire is the consideration from the insurer.

6. **Uncertain:** The happening of event should be uncertain.
7. **Insurable Interest:** The presence of insurable interest is a must to validate the fire insurance contract.
8. **Contract of Uberrima Fides:** The fire insurance contract, being a typical insurance contract, is a contract of uberrima fides, i.e. utmost good faith must be there between the insurer and the insured.
9. **Principles of General Insurance:** The fire insurance contracts insure the property of the assured and are covered by the principles of general insurance. The contract of insurance cannot save the asset from the risk but it can provide the compensation or replacement in place of the asset that is lost/damaged by fire.

10. **Existence:** The contract of fire insurance comes into existence just as any other type of an insurance contract. The assured, by filling up the proposal and providing the information of the asset insured submits the proposal of fire insurance contract to the insurer. The insurer, after verifying the facts and figures mentioned by the assured and satisfying himself accepts the premium and issues the cover note or the policy document to the assured as a token of the conclusion of the contract.
11. **Duration:** The fire insurance policies are of short duration. The period of the contract normally ranges up to one year. The policy has to be renewed after the expiry of the period of the insurance. Once the policy lapses the cover also lapses. The renewals of the policy, by paying the premium, make the contract valid for another term on the original terms and conditions of the policy. The insurer issues a new policy document to the assured on renewal.

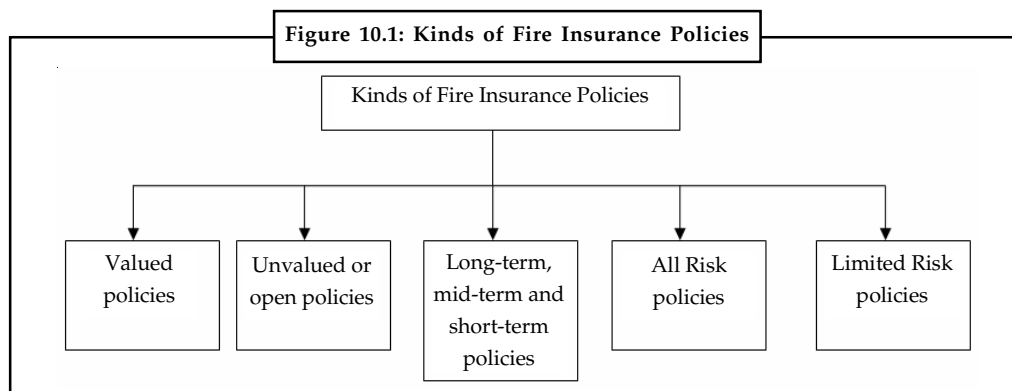
Self Assessment

Fill in the blanks:

5. The parties to the contract should have the to contract.
6. The fire insurance contract, being a typical insurance contract, is a contract of
7. The fire insurance contracts insure the of the assured.
8. The insurer issues a new policy document to the assured on

10.3 Kinds of Policies

Let's study about the various kinds of policies. This is also shown in the figure given below:



The principal types of fire insurance policies are given below:

1. **Valued policy:** It is a policy under which the insurer undertakes to pay the insured the amount of the value of the property declared in the policy. Under this policy, the value of the subject-matter is previously agreed between the insured and the insurer and this value forms the basis of indemnity. The actual market value is not taken into account. Thus, the amount payable under a valued policy may be more or less than the actual value of the property.

Valued policies are not generally issued in fire insurance. They are usually issued on pictures, works of art, sculptures and such other things whose value cannot be easily determined.

Notes

2. **Unvalued policy:** An unvalued policy is one in which the value of the subject matter is not declared at the time of policy taken. But in case of loss the value is computed by assessment. This is also called an open policy.
3. **Specific policy:** Under this policy a definite amount is insured on a specified property and in the event of loss, it will be paid if the loss falls within the specified amount. But the actual value of the subject matter is not considered in this respect.



Example:

- If a person has taken a policy of ₹ 10,000 against a property worth ₹ 15,000 and he suffers a loss of ₹ 9,000, he can realize the whole loss from the insurer. But if the loss amounts to ₹ 13,000, only ₹ 10,000 can be recovered.
 - If a policy is taken for ₹ 20,000 upon a building whose actual value is ₹ 1,00,000 and the fire occurs causing the amount of loss ₹ 20,000. The insurance company will pay the whole amount of loss of ₹ 20,000 irrespective of the fact that the building was insured for one-fifth of its value.
4. **Average policy:** A fire policy containing 'Average clause' is called an average policy. Under this policy, if the actual value is greater than the insured amount, the insurance company will pay proportionately and the insured is deemed to be his own insurer, for the balance. The claim is arrived at by dividing the amount of insurance by the actual value of the subject-matter and multiplying it by the amount of loss.



Example: If a person insures his goods worth ₹ 40,000 for ₹ 30,000 only, and the loss caused by fire is ₹ 20,000, then the amount of claim to be paid by the insurer will be $30,000 / 40,000 * 20,000 = ₹ 15,000$. The insured will have to bear his own loss for ₹ 5,000. Thus, under an average policy, the insured is penalized for under-insurance of the property.

The object of this policy is to prevent under-insurance and to induce the insured to take out a fire policy for the correct value.

5. **Floating policy:** This policy is taken out to cover goods belonging to the same person but lying in different lots at different places under one sum for one premium. For example, a manufacturer or a trader may take one floating policy for all his goods lying in part in warehouses, railway stations, port etc. The premium charged under such a policy is generally the average of the premia that would have been paid if each lot of the goods had been insured under specific policies for specific amount.

This policy is useful when the insured is in a position to declare only the total value at risk and not separate values in separate risks.



Did u know? Floating policies cannot be issued to cover goods in unspecified buildings or places, nor can they be extended to more than one town or village. Floating policies are always subject to an average clause.

6. **Stock declaration policy:** Goods which are subject to frequent fluctuations in value or in volume, present a special problem for insurance. In such a case if a businessman takes out a policy for the maximum amount, he has unnecessarily to pay a high premium and if he takes out a policy for a lower amount the large part of his stock may remain uncovered. So, to remove this difficulty, the 'declaration policy' is introduced, which intends to provide maximum cover and at the same time to avoid over-insurance with consequent over-payment of premium.

This policy is issued with a provisional premium which is calculated on 75% of the sum insured.

Notes



Notes The insured must declare in writing the stocks covered under the policy during each month within 14 days of each calendar month (or any other date specified in the policy).

At the end of the year, the average amount of stock at risk is calculated on the basis of the total declarations and this average amount forms the amount insured. A minimum amount, however, is charged by the insurer under this policy.

This policy is taken for covering the stock where great fluctuations in the value can happen throughout the contract period. On such policy 75% of the premium has to be deposited in advance. The maximum liability of insurance company is specified in the policy by the insured. At the end of year the average stock and final premium is calculated.

7. **Loss of profit policy:** Such type of policy covers the loss of profit which sustains as a result of fire. This policy is also known as consequential loss policy.
8. **Standard fire policy:** This policy is issued for compensation of all direct loss or damage caused by lighting and burning. Such policy also covers damages by earthquake, hair flood, explosion, cyclone and riot.
9. **Reinstatement policy:** Under this policy the insurer undertakes to pay the full price of the property required to be replaced. Here it is possible to recover not the depreciated value of buildings or machinery, but the cost of replacement of the damaged property by new property but of the same kind. This policy is issued in respect of buildings, or plant and machinery.

This type of policy was introduced after the First World War when there was very heavy inflation the world over. It is also called as "Replacement Policy". This type of policy is not very common in these days.
10. **Schedule Policy:** A schedule policy is one which insures many properties under collective terms and conditions, Details of the properties and their respective rates of premium are listed in one policy only for the convenience of the insured.
11. **Comprehensive Policy:** A fire policy usually does not cover loss occurring as a result of riots, civil strife, rebellion, etc. But fire insurance companies do sometimes issue policies of a comprehensive nature to house-owners. Such policies usually cover the risks such as fire, explosion, thunderbolt, lightning, riots, strike etc. Such a policy is known as comprehensive policy or "All Insurance policy." Such policies are not common in our country.
12. **Sprinkler leakage policy:** This type of policy covers the loss of building as a result of the damage by the leakage of liquid or water.
13. **Excess policy:** This policy is issued for the stock of merchandise whose value is constantly fluctuating. In such case it is not suitable to take one policy for certain sum. So the insured takes an ordinary policy for minimum value of the stock and excess policy for excess value of the stock. The actual value of the stock will be reported periodically
14. **Maximum value with Discount policy:** Under this policy one third discount of the premium paid is refundable to the insured at the maturity of the policy. This policy covers the risk for maximum amount.

Notes

15. **Consequential Loss Policy:** It is a policy in which the underwriter agrees to indemnify the insured for the loss of profits which he suffers due to the dislocation of his business, caused by fire. It is also called 'loss of profits policy.'

Self Assessment

Fill in the blanks:

9. An policy in one in which the value of the subject matter is not declared at the time of policy taken.
10. A fire policy containing '.....' is called an average policy.

10.4 Payment of Claim under Fire Insurance

You need to know the process of payment of claim under fire insurance. Following procedure should be followed in case of claim settlement under fire insurance:

1. If there is any damage or loss arising due to fire then the policy holder should immediately inform the insurance company in writing and with estimated amount of loss.
2. **Survey Report:** If the amount of loss is small (i.e. up to ₹ 20,000/-), the insurance company may depute an officer to survey the loss and decide on the settlement of the loss on the basis of the claim form and the officer's report. However, in large losses, an independent surveyor duly licensed by the Government is appointed to give a report on the loss.
3. The survey report would generally deal with the following matters:
 - ❖ Cause of loss,
 - ❖ Extent of loss,
 - ❖ Under-Insurance, if any,
 - ❖ Details and value of salvage, and how it has been disposed of or proposed to be disposed of,
 - ❖ Details of expenses (e.g. fire brigade expenses),
 - ❖ Compliance with policy conditions and warranties, and
 - ❖ Details of other insurance policies on the same property, and the apportionment of the loss and expenses among co-insurers.
4. **Claim Form:** The policy holder will submit the claim form with the following information:
 - ❖ Name and address of the Insured,
 - ❖ Date of loss, time and place from where the fire started,
 - ❖ Cause of fire,
 - ❖ Details of the property damaged such as description, etc.,
 - ❖ Value at the time of fire, value of salvage and the amount of loss,
 - ❖ Details of other policies on the same property giving the name of the insurer, policy number and sum insured,

- ❖ Details of Fire Brigade report, and
 - ❖ F.I.R. at the nearest police station regarding third party liability, if any.
5. **Settlement of claim:** On the basis of the claim form and the survey report, decision is taken about the settlement or otherwise of the loss.
- A claim for loss by fire must satisfy the following conditions:
- ❖ The loss must be caused by actual fire or ignition and not just by high temperature.
 - ❖ The proximate cause of loss should be fire.
 - ❖ The loss or damage must relate to subject matter of policy.
 - ❖ The ignition must be either of the goods or of the premises where goods are kept.
 - ❖ The fire must be accidental, not intentional. If the fire is caused through a malicious or deliberate act of the insured or his agents, the insurer will not be liable for the loss.

Self Assessment

Fill in the blanks:

11. If there is any damage or loss arising due to fire then the policy holder should immediately inform the insurance company in and with estimated amount of loss.
12. An independent surveyor duly licensed by the is appointed to give a report on the loss.

10.5 Re-insurance

In this section, we will discuss about the concept of re-insurance.

“The practice whereby one party called the Reinsurer in consideration of a premium paid to him agrees to indemnify another party, called the Reinsured, for part or all of the liability assumed by the latter party under a policy or policies of insurance which it has issued.”

Reinsurance as the term itself suggests, is insuring again. It is the transfer of insurance business from one insurer to another. Under reinsurance, the original insurer who has insured a risk insures a part of that risk with another insurer. That is to say, that he reinsures a part of the risk in order to reduce/diminish his own liability. The insurer transferring the business is called the “Principal or Direct or Ceding or Original Office” and the office to which the business is transferred is called the “Reinsurer or Assuming or Guaranteeing Office.” The reinsurer gives this facility of risk coverage for a premium which is called reinsurance premium. Reinsurance premium is an income to the reinsurer and an expense to the insurer.

Reinsurance is also a contract of indemnity. The original company must disclose all the material facts to the reinsurer. In the event of loss, the reinsurer indemnifies the loss subject to amount of reinsurance cover taken. The rest will be borne by the principal. This is called risk retention by the ceding company.

An insurance company transfers all or a portion of its risk exposure under an insurance policy to another company. Under reinsurance system, an insurer who has accepted a risk, lays off (or reinsures) part of the risk with another insurer. Reinsurance is rightly called an indirect business. It is in contrast to direct insurance business, which is received by an insurer directly from the applicant.

Notes

Recently, the Government of India made the four non-life insurance companies which were previously under General Insurance Corporation (GIC) Of India as independent and autonomous bodies and converted the GIC of India into a reinsurance company. The IRDA has also laid down the procedure to be followed in reinsurance agreements.

Reinsurance is an entirely new contract distinct from the original insurance contract entered into by the ceding company and the re-insurer. The original insured is not a party to the reinsurance contract and hence, has no rights against the reinsurer.

The general principles of the law of contracts and the special principles that govern direct insurance contracts also apply to reinsurance contracts. The principle of utmost good faith demands from the ceding company to make full disclosure of material facts. Material alternations if made are also required to be specifically stated to the reinsurers.

The ceding company acquires insurable interest in the risk underwritten in direct business accepted by it. An occurrence of a loss will result in financial loss. Hence, it is legally entitled to reinsure the risk. However, the insurable interest is limited to the extent of liability arising under the original contract of insurance. If the ceding company is not liable for a certain thing under the original policy, the reinsurer is also not liable under the reinsurance contract. Just as direct policies are contracts of indemnity against pecuniary losses, same is the case with reinsurance contracts.

A company which accepts business from public may also accept reinsurance business from other insurance companies if allowed by the statutes of the country. Professional reinsurers, however, do not accept direct insurance from the public but only reinsurance business from the insurance companies. The Swiss Reinsurance (Swiss Re) and Munich Reinsurance (Munich Re) are among the leading reinsurance companies in the world.

Under reinsurance arrangements, the ceding company receives commissions from the reinsurer at a rate higher than the original commissions paid by the ceding company. This is so because the cost of acquiring direct business is higher than the cost of obtaining business by way of reinsurance. Also the underwriting and administrative expenses of the ceding company are far more than those of the reinsurers.

10.5.1 Peculiar Features of Reinsurance Business

You must remember the peculiar features of reinsurance business. Following are some of the peculiar features of re-insurance:

1. Reinsurance business is inescapably intermediary (Brokers) driven on account of geographical remoteness and the inevitable ignorance about the potential counter-party. Brokers are in great demand. Even in a number of cases, they become surrogate insurers.
2. Brokers also handle funds on behalf of both side parties which make them powerful as well as susceptible to frailties.
3. For reinsurance, unlike direct insurance, the real price for cost of protection is the Rate of Commission (including profit commission) granted by the reinsurer to the direct insurer i.e. net premium (which is Net of commission) rather than Gross Premium cessions.
4. Reinsurers do not have the benefit of upfront assured cash flows like the direct insurer.
5. Reinsurer does not have the benefit of first-hand knowledge of exposure, peril, hazard and loss assessment.
6. Reinsurer is always a secondary insurer and his underwriting is only guided by information furnished (sometimes filtered/garbled) either by brokers.

Notes

7. Reinsurance business is transacted on the basis of international market usage, custom and conventions rather than on regulated prescriptions. Virtually, everything is contractual and mutually agreed on unlike tariffed direct insurance.
8. Reinsurance contract is between two professional insurers standing on equal footing needing less regulatory interventions.
9. Their relationship is sustained by long standing, enduring reciprocal understanding: a kind of matrimonial sacrament. Both in times of prosperity and adversity, the insurer and reinsure must coexist. This is the hallmark of reinsurance relationships.
10. Reinsurance requires a higher level of capital i.e. twice that of direct insurer.
11. Hypersensitivity to rating status: downgrades/unstable/on watch list, as reinsurers are high value risk carriers.
12. Reinsurance commission rates are much higher than that of direct insurance – part financing of costs of direct insurers.

Self Assessment

Fill in the blanks:

13. Reinsurance is also a contract of
14. The principle of utmost good faith demands from the ceding company to make full of material facts.



Case Study

Navi Mumbai Fire: Insurers take ₹ 100 cr hit

Following is an excerpt of a case of fire insurance dated Nov 14, 2006 in Navi Mumbai:

Insurance companies are expected to take a collective knock of ₹ 100 crore on their books on account of an inferno that destroyed most of a cold storage plant and its contents in Navi Mumbai last week.

Insurers said that they were not in a position to assess the loss because the situation at Savla Foods and Cold Storage in Turbhe is still not under control.

The damage caused by the blaze, which was initially estimated to have caused damages of close to ₹ 200 crore, is one of the biggest fire losses in Mumbai in recent years. However, after an initial assessment, the total loss is expected to be contained at within ₹ 100 crore. Most of the goods stored at Savla consist of huge stocks of spices and pulses belonging to traders from places lacking in proper storage facilities. Many of the small traders have not insured their holdings.

Unlike large losses in the past where the claims bill was ultimately settled by the reinsurer, industry sources said that losses are likely to be taken by companies on their own books. This is because the contents of the warehouse belonged to a large number of traders who had insured their holdings with several insurance companies. Typically, an insurance company buys specific reinsurance protection when the company writes large risks in one location. But here, since the insurance was distributed among various companies, many have taken them on their own books.

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Notes

Besides, the destruction caused by the fire, extensive loss is expected on account of collateral damage caused by fire fighting. Even if goods are not totally gutted, the chemicals that the fire-fighters use to douse the flames would themselves render the products unfit for consumption.

An importer of exotic spices faced with losses of ₹ 2 crore, said that his goods were fully insured. Out of the 2,000 clove bags kept in the custom bonded area on the fifth floor, 330 bags valued at ₹ 60 lakh belonged to him. "I had about ₹ 1.4 crore worth of cloves, black pepper, cassia, cubebs (belonging to the pepper family but not as pungent) and long pepper stored in the non-bonded areas of plant II. Since the fire has been fiercest on the 3rd, 4th and 5th floors of the plant, my cumulative losses tot up to ₹ 2 crore," he said, adding that only 10% of the traders probably had their goods insured.

Another downer for the salvage operations is the spreading of the fire once the doors of the cold storage are opened as oxygen entering the place supports combustion. Fire-fighters are reportedly hopeful of bringing the situation under control the next 48 hours after which it would become possible to assess the extent of the losses at the 8,500 tonne capacity plant.

Question

Find out the proceedings of this case with the help from the internet and prepare a presentation.

Source: http://articles.economictimes.indiatimes.com/2006-11-14/news/27462173_1_insurance-companies-cold-storage-black-pepper

10.6 Summary

- A fire insurance policy cannot be assigned without the permission of the insurer because the insured must have insurable interest in the property at the time of contract as well as at the time of loss.
- 'Fire' which is used for domestic or manufacturing purposes is not fire as long as it is confined within usual limits. In the fire insurance policy, 'Fire' means the production of light and heat by combustion or burning.
- The contract should be backed by the presence of consideration. The premium paid by the assured to cover the risk is the consideration by the assured and the promise made by the insurer to pay the compensation for the damage by fire is the consideration from the insurer.
- Valued policies are not generally issued in fire insurance. They are usually issued on pictures, works of art, sculptures and such other things whose value cannot be easily determined.
- Floating policies cannot be issued to cover goods in unspecified buildings or places, nor can they be extended to more than one town or village. Floating policies are always subject to an average clause.
- A fire policy usually does not cover loss occurring as a result of riots, civil strife, rebellion, etc. But fire insurance companies do sometimes issue policies of a comprehensive nature to house-owners. Such policies usually cover the risks such as fire, explosion, thunderbolt, lightning, riots, strike etc.
- An insurance company transfers all or a portion of its risk exposure under an insurance policy to another company.

- Reinsurance is an entirely new contract distinct from the original insurance contract entered into by the ceding company and the re-insurer. The original insured is not a party to the reinsurance contract and hence, has no rights against the reinsurer.
- A company which accepts business from public may also accept reinsurance business from other insurance companies if allowed by the statutes of the country.

10.7 Keywords

Average Policy: A fire policy containing 'Average clause' is called an average policy. Under this policy, if the actual value is greater than the insured amount, the insurance company will pay proportionately and the insured is deemed to be his own insurer, for the balance.

Floating Policy: This policy is taken out to cover goods belonging to the same person but lying in different lots at different places under one sum for one premium.

Loss of Profit Policy: Such type of policy covers the loss of profit which sustains as a result of fire. This policy is also known as consequential loss policy.

Schedule Policy: A schedule policy is one which insures many properties under collective terms and conditions, Details of the properties and their respective rates of premium are listed in one policy only for the convenience of the insured.

Specific Policy: Under this policy a definite amount is insured on a specified property and in the event of loss, it will be paid if the loss falls within the specified amount.

Standard Fire Policy: This policy is issued for compensation of all direct loss or damage caused by lighting and burning.

Unvalued Policy: An unvalued policy is one in which the value of the subject matter is not declared at the time of policy taken.

Valued Policy: It is a policy under which the insurer undertakes to pay the insured the amount of the value of the property declared in the policy.

10.8 Review Questions

1. Define fire insurance. Also, explain the meaning of fire insurance.
2. Describe the persons which have insurable interest under fire insurance.
3. Mention the types of losses both covered and not covered under fire insurance.
4. Briefly explain the elements of fire insurance contract.
5. Name the various kinds of insurance policies under fire insurance.
6. Differentiate between valued and unvalued policy.
7. Write short notes on floating policy and stock declaration policy.
8. Explain the procedure that should be followed in case of claim settlement under fire insurance.
9. Briefly explain the concept of re-insurance.
10. Discuss the features of re-insurance business.

Notes

Answers: Self Assessment

- | | |
|-------------------|--------------------|
| 1. Physical asset | 2. Good faith |
| 3. Insurer | 4. Limited |
| 5. Capacity | 6. Uberrima fides |
| 7. Property | 8. Renewal |
| 9. Unvalued | 10. Average clause |
| 11. Writing | 12. Government |
| 13. Indemnity | 14. Disclosure |

10.9 Further Readings



Books

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Online links

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Unit 11: Motor Insurance

Notes

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Objectives

After studying this unit, you will be able to:

- Explain the meaning of motor insurance
- Enumerate the various types of motor insurance policy
- Discuss the procedure for payment of claims under fire insurance
- Describe the third party claims

Introduction

In the previous unit, you have studied about the meaning and definition of fire insurance. It has dealt with explaining the elements of fire insurance. It has summarized the various kinds of policies under fire insurance along with the procedure for payment of claim under fire insurance and the concept of re-insurance.

In this unit, you will study about motor insurance. Vehicle insurance is the insurance which consumers can purchase for cars, trucks, and other vehicles. Its primary use is to provide protection against losses incurred as a result of traffic accidents. Generally speaking, it is a cover in respect of motorized vehicles including fire, theft, impact, collision and third party liability cover.

In the next unit, you will study about the features of health insurance policy and the procedure and benefits of health insurance purchase. It will also deal with the claim settlement procedure. You will study about the various types of health insurance policy in the next unit. The unit will also explain the concept of catastrophe insurance.

11.1 Meaning of Motor Insurance

You must be aware that earlier, several pedestrians were knocked down by motor vehicles. They were either injured or killed. They did not receive any compensation as the vehicle owners did not have sufficient resources to compensate them because they were not insured.

Notes

The Motor Vehicles Act, 1939, introduced compulsory insurance with the intention of safeguarding the interests of pedestrians.

The insurance of third party liability taking place from the use of motor vehicles in public areas is made compulsory while the insurance of motor vehicles against damage is not compulsory. No motor vehicle can stroll in a public place without such insurance.

The liabilities which involve compulsory insurance are as follows:

- (a) Liability incurred in respect of damage to any property of a third party;
- (b) Liability incurred in respect of death or bodily injury of any passenger of a public service vehicle;
- (c) Any liability incurred by the insured in respect of death or bodily injury of any person including owner of the goods or his authorised representative carried in the carriage;

Liability arising under Workmen’s Compensation Act, 1923 in respect of death or bodily injury of:

- ❖ Conductor, or ticket examiner (Public service vehicles);
 - ❖ Paid driver of the vehicle;
 - ❖ Workers, carried in a goods vehicle.
- (d) Liability in respect of bodily injury or death of commuters who are brought for hire or reward or by reason of or in pursuance of contract of employment.

The policy of insurance must wrap the liability incurred with respect to any type of accident as follows:

- (a) In respect of damage to any possessions of third party: A limit of ₹ 6,000/-.
- (b) In respect of death of or bodily injury to any person, the amount of liability incurred is unlimited.

If the liability caused due to death of any passenger or bodily injury to any passenger of a public service vehicle in a public place, then in that case the amount of liability incurred is unlimited.



Caselet

6 Things That Spike Your Auto Insurance

You may already know the importance of shopping around to score the best rate on your auto insurance premiums, but did you know that certain factors (or the absence of them) could cause your insurance premiums to rise?

To understand what makes your insurance premiums spike, it helps to understand the basic nature of auto insurance: Insurers make money when they insure drivers who don’t have accidents, and don’t make claims. They lose money when the opposite happens. As such, it is in the insurer’s best interest to predict driver risk factors as accurately as possible. When any of the following factors are present in your life, they indicate an increased likelihood that you, as a potential auto insurance policyholder, may have an insurance claim that will cost the insurer money. To compensate for the increased likelihood of a pay-out, insurers charge you more money in the form of a raised premium. Here are six things that spike your auto insurance.

Contd...

Buying a New Car

Because a new car as an asset is worth more money than an older model, it will cost more to replace. Additionally, if you finance or lease your new car purchase, most lenders require you to carry full coverage at a stated level, which makes it impossible to skimp or strategize only on the coverage you need. You can be wise about how your new ride will impact insurance premiums before you buy. According to a recent study by Insure.com, the cheapest new cars to insure tend to be larger, sturdy models such as minivans, SUVs and trucks. Don't assume that premium boosts come only with a flashy sports car or other high-priced model. The study indicated that the Honda Civic, for example, commands higher insurance rates simply because it tends to be driven by younger, childless owners who are inherently deemed riskier than parents. Further, it's one of the most stolen vehicle models in the United States.

Increasing Your Commute

Long commutes to work don't just cost you in time and fuel; they'll also boost your auto insurance premiums. Again, the risk is much greater that you'll get into an accident when you're driving during rush hour. Further, if you are in a profession that involves frequent driving, like a pizza delivery person or salesperson, you'll pay for the increased time that you spend in the car because more time spent driving increases the risk of an accident.

Though actual risk is determined by the zip code you live in, city residents statistically have more accidents, which drive their premiums higher than those who live in rural areas. Additionally, more people living in an area means more claims, which is reflected in the higher premium prices in such places. If you've recently taken up residence in New Mexico, Alabama, Oklahoma or Florida, expect to pay higher premiums. According to the Insurance Research Council, these states have the greatest concentrations of uninsured motorists, which ultimately seep into insured drivers' premiums.

Marital Status and Age

If you're unmarried and without children, you're considered part of a higher-risk category than married couples with kids. If you're 26 or younger, and male, you'll pay even more.

Dumping Your Auto Insurance

If you ditched your auto insurance in an effort to save some money, you've committed a classic case of being "penny smart and pound-foolish." Not having any auto insurance, even for just over 30 days, will cause your premiums to jump.

Having a Brush with the Law

Having no accidents or tickets will lower your auto insurance premiums and, as you might imagine, having either or both could raise them. When and if you'll see the spike is largely determined by your locale and your insurance provider. Insurance companies use a "merit plan" system. Most insurance companies periodically scan for recent traffic violations, whether you are a new or existing customer. After you commit a traffic violation and your insurer learns of it, your auto insurance rates could be higher for the next few years.


The Bottom Line

Auto insurance rates are often based on factors out of your immediate control, including age, occupation and accidents. Understanding what factors cause your auto insurance rates to spike can help you to shop around for a more competitive provider before you receive a surprise rate increase. It may also cause you to rethink some of your current driving habits.

Source: <http://www.investopedia.com/financial-edge/1012/6-things-that-spike-your-auto-insurance.aspx>

Notes

Section 140 of the Motor Vehicles Act 1988, provides for liability of the owner of the Motor Vehicle to pay compensation in certain cases, on the principle of “no fault”. The amount of compensation, so payable, is, ₹ 50,000/- for death, and ₹ 25,000/- for permanent disability of any person resulting from an accident occurring from the use of any kind of motor vehicle.



Notes The principle of “no fault” means the claimant need not prove negligence on the part of the motorist. Liability is automatic.

Certificate of Insurance

The Motor Vehicles Act provides that the policy of insurance shall be of no effect unless and until a certificate of insurance in the form prescribed under the Rules of the Act is issued.

The only evidence of the existence of a valid insurance as required by the Motor Vehicles Act acceptable to the police authorities and R.T.O. is a certificate of insurance issued by the insurers. The points covered under a certificate of insurance differ according to the type of vehicle insured.

Self Assessment

Fill in the blanks:

1. The insurance of third party liability taking place from the use of motor vehicles in public areas is made
2. The Motor Vehicles Act provides that the policy of insurance shall be of no effect unless and until a in the form prescribed under the Rules of the Act is issued.

11.2 Types of Motor Insurance Policy

Let’s discuss about the types of Motor Insurance Policy. For all classes of vehicles, there are two types of Policy Forms:

Form “A”: It is used to cover Act Liability. Form “A” is called “Standard Form for “A” Policy for Act Liability”. This form applies uniformly to all classes of vehicles, whether Private Cars, Commercial Vehicles, Motor Cycles or Motor Scooters, with suitable amendments in “Limitations as to Use”.

Form “B”: It is used to cover Own Damage Losses and Act Liability. The policy can also be extended to cover additional liabilities as provided in the Tariff. Form “B”, which provides wider cover as indicated above, varies with the class of vehicle covered. There are therefore Form “B” Policies for Private Cars, Commercial Vehicles, Motor Cycles/Scooters, etc.

Policy Form B

This policy provides the so-called ‘comprehensive’ cover and the structure of the policy form is the same for all vehicles, (with some differences which are pointed out, wherever applicable).

Section I: Loss or Damage (or “Own Damage”). The risks covered are:

- (a) Fire, explosion, self-ignition or lightning
- (b) Burglary, house breaking or theft

- (c) Riot and strike
- (d) Earthquake (fire and shock damage)
- (e) Flood, typhoon, hurricane, storm, tempest, inundation, cyclone, hailstorm, frost
- (f) Accidental external means
- (g) Malicious act
- (h) Terrorist activity
- (i) Transit by road, rail, inland waterway, lift, elevator or air
- (j) Landslide/rockslide

Notes

Exclusions:

- Consequential loss,
- Depreciation,
- Wear and tear,
- Mechanical or electrical breakdowns, failures or breakages,
- Damage to tyres unless the vehicle is damaged at the same time, and
- Loss when the vehicle is driven under the influence of intoxicating liquor or drugs.



Notes

In the motor cycle and commercial vehicle policy there are additional exclusions:

- (a) Loss of or damage to accessories by burglary, housebreaking or theft unless the vehicle is stolen at the same time.
- (b) In commercial vehicle policy, there is a further exclusion: Damage caused by overloading or strain of the vehicle.

Towing Charges

If the motor car is disabled as a result of damage covered by the policy, the insurers bear a reasonable cost of protecting the car and removing it to the nearest repairers, as also the reasonable cost of re-delivery to the insured. The amount so borne by the insurers is limited to maximum of ₹ 2,500/- in respect of any one accident.



Example: For motor cycles, the limit is ₹ 300/-, for cars ₹ 1500/- and for commercial vehicles ₹ 2500/-.

Repairs

Ordinarily repairs arising out of damage covered by the policy can be carried out only after they are authorized by the insurers. However, the insured is allowed to carry out the repairs without authorization from the insurers, provided that:

- (a) The estimated cost of such repair does not exceed ₹ 500/- (₹ 150/- for motor cycles).
- (b) The insurers are furnished forthwith with a detailed estimate of the cost; and
- (c) The insured gives the insurers all the assistance to ensure that such repair is necessary and that the charge is reasonable.

Notes

Compulsory Excess

This applies to all vehicles. The insured has to bear a part of the claim amount in respect of each accident. Further loss/damage to lamps, tyres, mudguards and/or bonnet side parts, bumpers and/or paintwork is not payable except in the case of a total loss of vehicle.

Section II: Liability to Third Parties: The insurers indemnify the insured against all sums which he may become legally liable to any person including occupants carried in the motor car (provided that they are not carried for hire or reward) by reason of death or bodily injuries caused to such third parties or by reason of damage to the property of third parties caused by or arising out of the use of the motor car. The insured's liability for damage to property of third parties is limited to ₹ 6000; whilst liability for death of or bodily injury to third party is unlimited.

The legal costs and expenses incurred by such third parties are reimbursed in addition. The legal costs and expenses incurred by the insured are also reimbursed provided that they were incurred with the insurer's written consent.

The insurers are liable for the death of or bodily injury arising out of and in the course of employment, but only to the extent necessary to meet the requirements of the Motor Vehicles Act. The damage to property is not paid for, if the damaged property belonged to the insured or was held in trust by him or was in the custody or control of the insured.



Notes This section is, more or less, the same for all vehicles, subject to some variations for motor cycles and commercial vehicles.

Section III: This appears in commercial vehicle policies only. This section provides cover while the vehicle is towing one disabled mechanically – propelled vehicle. It provides that whilst the insured vehicle is being used for the purpose of towing any one disabled mechanically – propelled vehicle (a) The cover provided by the policy remains operative, and (b) under Section II of the policy, indemnity will also be provided for the liability in connection with such towed vehicle. This however is subject to the following two provisions:

- (i) The towed vehicle should not be towed for hire or reward, and
- (ii) No cover is available under the policy for the damage to the towed vehicle or the property conveyed thereby.

General Exclusions (applicable to all sections)

These provide that the insurer shall not be liable in respect of:

- (a) Any accident outside the geographical area specified in the policy, that is, India. The limit can be extended to cover Bangladesh, Bhutan, Nepal, Pakistan, Sri Lanka & Maldives on payment of extra premium.
- (b) Contractual liability.
- (c) Any accident when the vehicle is used not in accordance with the Limitations (Use Clause)
- (d) Any accident when the vehicle is driven without an effective driving licence (Driver's Clause).
- (e) War, etc. and nuclear risks.

Conditions

Notes

Apart from the usual conditions such as notice of loss, cancellation of policy, arbitration, etc. there are two conditions which are specific to motor policies.

- The insured is required to safeguard the vehicle from loss or damage and maintain it in efficient condition. In the event of an accident, the insured shall take precautions to prevent further damage. If the vehicle is driven before repairs any further damage is at insured's risk.
- The insurer has the option to repair or replace the vehicle or parts or pay in cash the amount of damage or loss. The insurer's liability cannot exceed the insured's estimated value of the vehicle (specified in the policy) or the value of the vehicle at the time of loss whichever is less.

Rating/Proposal Form

The proposal form elicits all information necessary for rating and underwriting. Some examples of rating are given:

Private Cars/ Scooters/ Motorcycles

Rates are based upon the cubic capacity as given by manufacturers, Insured's Declared Value (IDV), the Zone of operation and age of the vehicle.

The cubic capacity of the vehicle indicates the power of the engine. Separate rates apply for cars up to 1000 cc, from 1000 cc – 1500 cc and above 1500 cc and scooters/motorcycles up to 150cc, 150-350cc and above 350cc.

Similarly there are different rates for vehicles in the age groups up to 5 yrs.; 5 yrs. to 10 yrs. and above 10 yrs. There are two Zones of operation, Zone A and Zone B, as follows:

Zone A: Ahmedabad, Bangalore, Chennai, Hyderabad, Kolkata, Mumbai, New Delhi & Pune

Zone B: Rest of India.

Note: The rates for Zone A are higher than those for Zone B.

Commercial Vehicles

The rating depends upon the Zone of operation, passenger carrying capacity/ gross vehicle weight, Insured's Declared Value (IDV) and age of the vehicle.

There are three Zones for commercial vehicles:

1.	Zone A	Chennai, New Delhi, Kolkata and Mumbai
2.	Zone B	All other state capital
3.	Zone C	Rest of India

Personal Accident Cover

There is provision for compulsory personal accident cover for owner-driver of cars and commercial vehicles of ₹ 2 lakh and ₹ 1 lakh for owner driver of scooters/motorcycles. It covers death, PTD and PPD only.

Notes

Extra benefits

All Vehicles

- (a) The Third Party premium includes cover for third party property damage in excess of the required coverage of liability of ₹ 6,000/- as per the M.V.Act. In case the insured wants to get only the liability as per act covered (i.e. ₹ 6,000/-) then discount in T.P. premium is allowed.
- (b) Wider legal liability to persons e.g. paid drivers etc. employed in operation and/or maintenance of the vehicle i.e. under W.C. Act and at common law.
- (c) Personal Accident cover for unnamed passengers as per the registered carrying capacity of the vehicle up to a maximum of ₹ 2 lakh/person on payment of extra premium.

Private Cars

- Extra fittings like radios, tape-recorders, air conditioners, etc. (Also applicable to commercial vehicles), and
- Reliability Trials and Rallies in India (Also applicable to motor cycles).

Discounts (some examples)

- Voluntary excess under Own Damage Section – (Applicable to all vehicles)
- Membership of recognised Automobile Association (Private cars and motor cycles)
- Deletion of Riot, Strike, Earthquake, Flood, etc. (All vehicles)
- Special discount for Anti-Theft device approved by AAI (2.5% on O.D. premium max. of ₹ 500)
- Special discount of 25% on O.D. premium for vintage cars

No Claim Bonus

A discount in the premium is allowed at renewal if there is no claim during the policy year for all vehicles.

1st Year	20%
2nd Year	25%
3rd Year	35%
4th Year	45%
5th Year	50%

Underwriting

There are several factors which are important for underwriting such as type of vehicle e.g. imported cars, sports cars, use of the vehicle, geographical area etc. But the most important is the age of the vehicle.

Self Assessment**Notes**

Fill in the blanks:

3. repairs arising out of damage covered by the policy can be carried out only after they are authorized by the insurers.
4. The insured's liability for damage to property of third parties is limited to
5. The insurers are liable for the death of or bodily injury arising out of and in the course of....., but only to the extent necessary to meet the requirements of the Motor Vehicles Act.
6. The insurer's liability cannot exceed the insured's value of the vehicle.

11.3 Procedure for Payment of Claims

In this section, we will discuss about the procedure for payment of claims. On receipt of notice of loss, the policy records are checked to see that the policy is in force and that it covers the vehicle involved. The loss is entered in the claims register and a claim form is issued to the insured for completion and return. The insured is required to submit a detailed estimate of repairs from any repairer of his choice. Generally, these repairs are acceptable to the insurers but they at times ask the insured to obtain repair estimate from another repairer, if they have reason to believe that the competence, moral hazard or business integrity of the repairer first chosen is not satisfactory.

Assessment

Independent automobile surveyors with engineering background are assigned the task of assessing the cause and extent of loss. They are supplied with a copy of the policy, the claim form and the repairer's estimate. They inspect the damaged vehicle, discuss the cost of repair or replacement with the repairer, negotiate as per the indemnity, and submit their survey report.

In respect of minor damage claims, independent surveyors are not always appointed. The insurer's own officials or their own automobile engineers inspect the vehicle and submit a report.

Settlement

The survey report is examined and settlement is effected in accordance with the recommendations contained therein. The usual practice is to authorise the repairs directly with the repairer to whom a letter is issued to that effect. In this letter, the repairers are also instructed to collect direct from the insured the amount of the excess, depreciation, salvage, etc. if applicable to the claim, before delivering the repaired vehicle to him. The repairers are also instructed to keep aside the salvage of damaged parts, if there are any, for being collected by the salvage buyer nominated by the Insurers. Or else, if the repairers are willing to retain the salvage, its value, as indicated by the surveyor, is deducted from the claim bill.

On receipt of their final bill of repairs after completion of repairs and a satisfaction note or voucher from the insured that the vehicle has been repaired to his satisfaction, the payment to the repairer is affected.

Notes

Sometimes, the repairer is paid directly by the insured in which case the latter is reimbursed on submission of a receipted bill from the repairers. In either case, discharge voucher or receipt is obtained. The claims register and the policy and renewal records are marked that the claim is paid indicating the amount of claim and the amount of salvage, if any.

Claims Documents

Apart from claim form and Survey report the other documents required for processing the claim are:

- (1) Driving Licence
- (2) Registration Certificate Book
- (3) Fitness Certificate (Commercial Vehicles)
- (4) Permit (Commercial Vehicles)
- (5) Police Report (Taxis, commercial Vehicle needs F.I.R./spot survey if loss is heavy or T.P. loss occurs)
- (6) Final Bill from repairers
- (7) Satisfaction Note from the insured
- (8) Receipted bill from the repairer, if paid by insured.
- (9) Discharge voucher (full and final payment)

Total Loss Claims

Whenever a surveyor finds that a vehicle is either beyond repairs or the repairs are not an economic proposition, he negotiates with the insured to assess the loss on a Total Loss basis – for a reasonable sum representing the market value of the vehicle immediately prior to the loss.

If the market value is more than the insured value, the settlement will be brought about for the insured value. The Insured will be paid in cash and the Insurers will take over the salvage of the damaged vehicle which will thereafter be disposed of for their own benefit calling tenders through advertisements in newspapers.

However, before the actual payment is made to the Insured, the Insurer will collect from him the Registration and Taxation books, ignition keys and blank T.O. and T.T.O. forms duly signed by the insured, so that the salvage is usually not encouraged, unless insured desires, so as to avoid the hassle of salvage disposal.

Theft Claims

Total losses can also arise due to the theft of the vehicle and its remaining untraced by the police authorities till the end.



Caution These losses will have to be supported by a copy of the First Information Report (FIR) lodged with the Police authorities immediately after the theft has been detected.

The police authorities register the complaint allotting it a number of the entry made in the Station Diary. This number, which is usually known as SDE No. or C.R. No. (Crime Register), has to be quoted by the Insured in the claim intimation to the Insurers.

Notes

The police keep the investigations going until the vehicle is traced and delivered to its owner. However, if they do not succeed in recovering the vehicle after a period of, say 1-2 months, they file away the case certifying that the case is classified as true but undetected. This police certificate referred as "Non-Traceable" certificate is essential before a total loss following theft is settled by the insurers.

The documents to be submitted by the insured will be the same as those described above. It will be necessary for the insured to obtain duplicate ones from the Registering Authority and thereafter deposit them with the insurers.

The only additional documents will be addressed by the Insured to the R.T.O. informing about the loss of the vehicle due to theft and filing a non-user form so that he is not made liable to pay the taxes.

Some insurers also obtain from the insured a special type of a Discharge on a stamped paper whereby the Insured undertakes to refund the claim amount if the vehicle is subsequently traced and delivered to him by the police. He also undertakes in the Discharge Form to pay any taxes which may be outstanding against the stolen vehicle. The ignition keys R.C. Books etc. are preserved by the Insurer in their custody so that these are made readily available if the vehicle is traced at a later date. It is always prudent to inform the concerned Registering Authority by a Registered A/D letter that a total loss claim is being processed for payment in respect of the stolen vehicle and to request them not to transfer the ownership of the vehicle to anyone. This will prevent the thief from disposing of the stolen vehicle.

Self Assessment

Fill in the blanks:

7. On receipt of, the policy records are checked to see that the policy is in force and that it covers the vehicle involved.
8. Independent automobile surveyors with engineering background are assigned the task of assessing the and of loss.
9. The is examined and settlement is effected in accordance with the recommendations contained therein.
10. Total losses can arise due to the of the vehicle and its remaining untraced by the police authorities till the end.

11.4 Third Party Claims

You need to learn about third party claims. Let's discuss about them. Section 165 of the Motor Vehicles Act 1988, empowers the State Governments to set up Motor Accident Claims Tribunals (MACT) for adjudicating upon third party claims. When a tribunal has been set up for an area, no civil court has any jurisdiction to entertain any claim falling under the tribunal's jurisdiction.

The aggrieved party has to move the tribunal within a period of six months from the date of accident. While making the award, the tribunal has to specify the amount payable by the insurer.



Task Collect some real life examples of third party claims and prepare a chart.

Notes

The procedure for third party claims is briefly described as follows:

1. On receipt of notice of claim from the insured, or the third party or from the MACT, the matter is entrusted to an advocate.
2. Full information relating to the accident is obtained from the insured. The various documents are collected and these include:
 - ❖ Driving Licence
 - ❖ Police report
 - ❖ Details of driver's prosecution, if any
 - ❖ Death certificate, coroner's (PM report) report, if any (fatal claims).
 - ❖ Medical Certificate (bodily injury claims)
 - ❖ Details of age, income and number of dependants etc.
3. A written statement is then filed on the facts of the case with the MACT by the advocate. Eventually, if the award is made by the MACT, the amount is paid to the third party against proper receipt.



Did u know? **Compromise Settlements**

Where there is clear liability under the policy, claims are negotiated with the third party to accept a compromise settlement, which if accepted by the third party, is registered with the MACT and its consent obtained. The cheque is deposited with MACT for disbursement to the rightful beneficiaries.

Lok Adalats

Pending cases with the MACT where the liability under the policy is not in doubt are placed before the Lok Adalat or Lok Nyayalaya, for a voluntary and amicable settlement between the parties. A copy of decision in the prescribed memo and the cheque is deposited with MACT. Lok Adalat sessions are organized regularly by the insurance companies in liaison with the Legal Aid Board of each State and MACT to effect amicable settlement of third party claims.

No Fault Liability

These claims can be made by depositing the appropriate amount with the MACT after obtaining death certificate, medical certificate and police report.

Self Assessment

Fill in the blanks:

11. When a tribunal has been set up for an area, no civil court has any jurisdiction to entertain any claim falling under the jurisdiction.
12. A copy of decision in the prescribed and the cheque is deposited with MACT.



Case Study

Is Motor Insurance Hike Justified?

Any change in the pricing of motor insurance, which accounts for 41 per cent of the premium and a substantial component of the claims of the entire general insurance industry, is bound to generate interest.

Historically, motor insurance business has been loss making, running at loss ratios of approximately 120 per cent, that too without accounting for management expenses.

While the losses on account of vehicle damages are high – around 70 per cent–75 per cent of the premium — those relating to third party are consistently above 200 per cent.

Although insurers are saddled with unlimited bodily injury liability, the premium charged for the risk is very low — approximately 5 per cent of the own damage premium and less than quarter per cent of the vehicle value. This accounts for more than 50 per cent of the losses.

To provide adequate financial security to dependents of victims of road accident is the rationale for the provision of compulsory unlimited liability for bodily injury in the Motor Vehicles Act.

However, it is unfair for the insurers to be asked to bear this liability at non-commensurate rates. This would be a sure formula for losses for any general insurer in the country.

In India, the prices have been ‘administered’ by tariff as opposed to a price that would recover the costs i.e. the ‘Pure Premium’. Ideally, as is in most developed markets, the market forces should be allowed to operate to determine pure premium-based price of products.

The insurers should be free to fix a ceiling on the maximum third party bodily injury liability, which they would be able to support under the current/proposed pricing.

Since the third party bodily injury cover is a governmental measure, the government should meet the liabilities in excess of these limits from a fund like the ‘Solatium Fund’.

Such arrangements between the government and the insurers have been successful in Japan.

The proposed hike in premium is the first step in the direction of realistic pricing of the motor insurance policies. We certainly look forward to an active participation of the government, general insurers and the insuring public in moving towards a sustainable pricing regime. (The author is MD, Tata-AIG General Insurance).

Questions

1. Discuss the rationale for the provision of compulsory unlimited liability for bodily injury in the Motor Vehicles Act in a group of five students.
2. What is your opinion about the realistic pricing of the motor insurance policies? Discuss.

Source: http://articles.economicstimes.indiatimes.com/2002-06-07/news/27340174_1_motor-insurance-damage-premium-tata-aig-general-insurance

Notes

11.5 Summary

- The insurance of motor vehicles against damage is not made compulsory, but the insurance of third party liability arising out of the use of motor vehicles in public places is made compulsory. No motor vehicle can play in a public place without such insurance.
- The liability in respect of death of or bodily injury to any passenger of a public service vehicle in a public place, the amount of liability incurred is unlimited.
- The Motor Vehicles Act provides that the policy of insurance shall be of no effect unless and until a certificate of insurance in the form prescribed under the Rules of the Act is issued.
- If the motor car is disabled as a result of damage covered by the policy, the insurers bear a reasonable cost of protecting the car and removing it to the nearest repairers, as also the reasonable cost of re-delivery to the insured.
- The legal costs and expenses incurred by such third parties are reimbursed in addition. The legal costs and expenses incurred by the insured are also reimbursed provided that they were incurred with the insurer's written consent.
- The insurer has the option to repair or replace the vehicle or parts or pay in cash the amount of damage or loss.
- Any claim on account of damage of the vehicle will be paid by the insurance company subject to the assessment of loss by the independent Surveyor.
- Third party claim is settled by the court and the government has laid down the procedure to settle these cases.

11.6 Keywords

Commercial Vehicles: A commercial vehicle is any type of motor vehicle used for transporting goods or paid passengers.

Compulsory Insurance: Compulsory insurance is any type of insurance coverage that is required by law before individuals or businesses may engage in certain activities.

Motor Insurance: Motor insurance is the insurance which consumers can purchase for cars, trucks, and other vehicles.

Proposal Form: The proposal form elicits all information necessary for rating and underwriting.

Third Party Claims: Third party claims is a derivative lawsuit brought by a defendant in an original lawsuit, claiming that another new party being brought in is responsible for or should share in the plaintiff's damages against the defendant.

11.7 Review Questions

1. Define motor insurance. Also, explain the meaning of motor insurance.
2. What do you understand by certificate of insurance under motor insurance? Explain.
3. What are the various kinds of motor insurance policies?
4. Define the term towing charges.
5. Explain the claim settlement under motor insurance.

6. What are theft claims?
7. Discuss the term third party claims.
8. Mention the documents which are important while claiming motor insurance.
9. How many sections are in commercial vehicles insurance policy?
10. In how many zones is India divided for the commercial vehicles?

Notes

Answers: Self Assessment

- | | |
|-------------------|-----------------------------|
| 1. Compulsory | 2. Certificate of Insurance |
| 3. Ordinarily | 4. ₹ 6000 |
| 5. Employment | 6. Estimated |
| 7. Notice of Loss | 8. Cause, extent |
| 9. Survey report | 10. Theft |
| 11. Tribunal's | 12. Memo |

11.8 Further Readings



Books

- Gulati, Neelam. C. (2011), *Banking and Insurance*, Excel Books.
- Gulati, Neelam. C. (2013), *Principles of Risk Management and Insurance*, Excel Books.
- Krishnaswamy, G. (2009), *Principles and Practice of Life Insurance*, Excel Books.
- Misra, M.N. and Mishra, S.B. (2009), *Insurance Principles and Practices*, S. Chand Publication.
- Sahoo and Das (2009), *Insurance Management: Text and Case*, Himalaya Publication.



Online links

- <http://www.soa.org/files/pdf/P-21-05.pdf>
- <http://www.wikihow.com/Select-the-Best-Motor-Insurance>

Unit 12: Health and Catastrophe Insurance

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Objectives

After studying this unit, you will be able to:

- Define the features of health insurance policy
- Explain the procedure and benefits of health insurance purchase
- Discuss the claim settlement procedure
- Describe the various types of health insurance policy
- Explain the concept of catastrophe insurance

Introduction

In the previous unit, you have studied about the meaning of motor insurance. It has explained the various types of motor insurance policy along with the procedure for payment of claims under motor insurance as well as third party claims.

In this unit, you will study about health and catastrophe insurance. With the increasing cost of health services and medical bills which a common man cannot afford, this class of insurance has a growing market. It is estimated that a family spends an average of 10% of its monthly income on health care. In India where there is no Social Insurance for the public the individual has to take care of himself and his family. A prolonged illness or disability can spell havoc for the family budget and upset all the planning.

While the importance of health Insurance cannot be denied, it is unfortunate that so far in India the Health Insurance policy is being purchased by families and individuals who can afford to pay the medical bills. But the Govt. of India is putting all its efforts to encourage people to buy health insurance and specialized insurance companies are promoted which are exclusively dealing in health insurance. The life insurance companies are also permitted to issue the health insurance policy.

In the next unit, you will study about the privatization of insurance sector. The unit will update you about the current scenario of insurance industry in India and the opportunities and challenges in insurance sector today. The next unit will also summarise the way ahead for insurance sector.

12.1 Features of Health Insurance Policy

Now, let us study about the features of health insurance policy. Any health insurance policy should cover the following the expenses:

1. The policy should provide for reimbursement of hospitalisation/domiciliary hospitalisation expenses for illness/disease suffered or accidental injury sustained during the policy period.

Hospital/Nursing Home: It means any institution in India established for indoor care and treatment of sickness and injuries, which–

- (a) Has been registered either as a hospital or nursing home with the local authorities and is under the supervision of a registered and qualified medical practitioner.
- (b) Should comply with the minimum criteria as under:
 - ◆ It should be equipped with at least 15 in-patient beds.
 - ◆ Fully equipped operation theatre of its own where the surgical operations are carried out.
 - ◆ Availability of fully qualified nursing staff round the clock. Fully qualified doctor(s) should be in charge round the clock.

The term Hospital/Nursing Home shall not include an establishment which is a place of rest, a place for the aged, a place for drug addicts or place for alcoholics, a hotel or a similar place.

Domiciliary Hospitalisation Benefit means medical treatment for a period exceeding three days for such illness/injury which in the normal course would require treatment at the hospital/nursing home but actually taken whilst confined at home in India under any of the following circumstances namely:

- (i) The condition of the patient is such that he/she cannot be removed to the hospital/nursing home, or
 - (ii) The patient cannot be removed to hospital/nursing home due to lack of accommodation therein.
2. The policy should pay during the period of insurance maximum up to the sum insured for expenses incurred under the following heads:
 - (a) Room, Boarding Expenses in the Hospital/Nursing Home,
 - (b) Nursing Expenses,
 - (c) Surgeon, Anaesthetist, Medical Practitioner, Consultants. Specialist fees, and
 - (d) Anaesthesia, Blood, Oxygen, Operation Theatre Charges, Surgical Appliances, Medicines and Drugs, Diagnostic Materials, and X-Ray, Dialysis, Chemotherapy, Radiotherapy, Cost of Pacemaker, Artificial Limbs and Cost of organs and similar expenses.
 3. Reimbursement is allowed only when treatment is taken in a hospital or nursing home which satisfies the criteria specified in the policy.

Notes

4. Expenses on hospitalisation for minimum period of 24 hours are admissible. However, this time limit is not applied to specific treatment i.e. Dialysis, Chemotherapy, Radiotherapy, Eye Surgery, Dental Surgery, Lithography Kidney stone removal), D&C, Tonsillectomy taken in the hospital/nursing home and the insured is discharged on the same day; the treatment will be considered to be taken under hospitalisation benefit.



Notes Relevant medical expenses incurred prior to up to certain period, say 30 days and after hospitalization up to certain period, say 60 days, are treated as part of the claim.

5. Any one illness means continuous period of illness and it includes relapse within 105 days from the day of last consultation with the Hospital/Nursing Home where treatment may have been taken. Occurrence of same illness after a lapse of 105 days will be considered as fresh illness for the purpose of this policy.
6. The policy does not cover some disease i.e. Asthma, Bronchitis, Chronic Nephritis Diarrhoea and all type of Dysenteries including Gastroenteritis, Diabetes Mellitus and Insipid us, Epilepsy, Hypertension, Influenza, Cough and cold, All psychiatric or Psychosomatic Disorders Pyrexia of unknown origin for less than 10 days, Tonsillitis and upper respiratory Tract infection including Laryngitis and Pharyngitis, Arthritis, Gout and Rheumatism.

Exclusions that the Health Insurance Policy does not cover the following:

1. All diseases/injuries which are pre-existing when the cover incepts for the first time.
2. Any disease other than those stated in clause (c) below, contracted by the insured person during the first 30 days from the commencement date of the policy. This exclusion shall not, however, apply if in the opinion of Panel of Medical Practitioners constituted by the company for the purpose, the insured person could not have known of the existence of the disease or any symptoms or complaints thereof at the time of making the proposal for insurance to the company. This condition shall not however apply in case of the insured person have been covered under this scheme or group insurance scheme with any of the Indian Insurance Companies for a continuous period of preceding 12 months without any break.
3. During the first or more years of the operation of the policy the expenses on treatment of diseases such as Cataract, Benign Prostates Hypertrophy, Hysterectomy for Menorrhagia or Fibromyoma, Hernia, Hydrocele, Congenital Internal Disease, Fistula in anus. Piles, Sinusitis and related disorders. If these diseases are pre-existing at the time of proposal they will not be covered even during subsequent period of renewal.
4. Circumcision unless necessary for treatment of a disease not excluded hereunder or as may be necessitated due to an accident, vaccination or inoculation or change of life or cosmetic or aesthetic treatment of any description, plastic surgery other than as may be necessitated due to an accident or as a part of any illness.
5. Cost of spectacles and contact lenses, hearing aids. (These may be termed as normal maintenance expenses.)
6. Dental treatment or surgery of any kind unless requiring hospitalisation.
7. Convalescence, general debility, run down condition or rest cure, congenital external disease, or defects or anomalies, sterility, venereal disease, intentional self-injury and use of intoxicating drugs/alcohol.

8. Various conditions commonly referred to as AIDS.
9. Charges incurred at hospital or nursing home primarily for diagnostic. X-Ray or laboratory examinations or other diagnostic studies not consistent with the positive existence or presence of any ailment, sickness or injury for which confinement is required at a Hospital/ Nursing Home or at Home under Domiciliary Hospitalisation as defined.
10. Expenses on vitamins and tonics unless forming part of treatment.
11. Treatment arising from childbirth including Caesarean section (can be deleted, if maternity benefit is covered).
12. Voluntary medical termination of pregnancy (abortion) during the first 12 weeks from the date of conception.
13. Naturopathy treatment.

Notes

Self Assessment

Fill in the blanks:

1. The term shall not include an establishment which is a place of rest, a place for the aged, a place for drug addicts or place for alcoholics, a hotel or a similar place.
2. The policy should pay during the period of insurance maximum up to the sum insured for incurred as mentioned in the policy.
3. is allowed only when treatment is taken in a hospital or nursing home which satisfies the criteria specified in the policy.
4. The health insurance policy does not cover any
5. All diseases or injuries which are when the cover incepts for the first time are not included in health insurance policy.

12.2 Procedure and Benefits of Health Insurance Purchase

In this section, we will discuss about the procedure and benefits of health insurance purchase. Procedure to be followed for buying health insurance policy:

1. **Filling of proposal form:** The proposal form will contain the personal information of the person like name, address, age, occupation, sum insured etc. and two photographs of an individual is to be enclosed.
2. **Declaration of good health/medical questionnaire:** A person should give a declaration of his good health. In case of adverse health then he should submit the certificate from the doctor.
3. **Medical examination report:** It is required from the doctor, who is having the qualification of MD, if the age of person is more than 45 years. It is must even if the person is possessing good health.
4. **Payment:** The premium is paid through cheque to get the tax benefit under Income Tax Act, 1961.
5. **Issue of Policy documents:** The policy document is issued once above mentioned information/documents submitted.

Notes

6. **Issue of Photo Card by Third Party Administrator (TPA):** After issuing the policy documents, the TPA will issue the photo identity card for each person which will help to get the treatment in the hospital on cashless basis. TPA is licensed by the IRDA who will settle the health insurance claims on behalf of the insurance companies.

TPAs have empanelled various hospitals on all India basis who will provide the health treatment on cashless basis meaning thereby, that the policyholder will not pay any amount to the hospital and the hospital will get the payment directly from the TPA up to the sum insured of a person. If some insured is not sufficient to meet the bill of the hospital then the excess amount will be paid by the policyholder.

Following are the miscellaneous benefits of health insurance policy:

1. **Age Limit:** This insurance is available to persons between the ages of 5 years to 80 years. Children between the ages of 3 months to 5 years can be covered provided one or both parents are covered concurrently.
2. **Family Discount:** This discount of 10% in the total premium is allowed to a family comprising the insured and any one or more of the following:
 - ❖ Spouse
 - ❖ Dependent children (i.e. legitimate or legally adopted)
 - ❖ Dependent parents
3. **Cumulative Bonus:** The sum insured is increased by certain percentage, say 5% for each claim from the year of insurance subject to a maximum accumulation of 10 years. In the event of a claim, the increased percentage will be reduced to a certain percentage; say the double of the bonus rate by 10% of the sum insured at the next renewal but the basic sum insured will remain the same.



Caution Some companies do not allow this cumulative bonus but instead of this allow a discount in the premium on the next renewal if no claim is reported during the currency of the previous policy.

4. **Cost of Health Check-up:** The insured shall be entitled to reimbursement of medical check-up, generally once in every four underwriting years, subject to no claim preferred during this period. The cost shall not exceed 1% of the average sum insured during the block of four years.
5. **Extension of Cover:** The health cover is available for Indian Territories but it can be extended to Nepal and Bhutan with prior permission.

Self Assessment

Fill in the blanks:

6. The proposal form will contain the information of the person.
7. A person should give a of his good health.
8. The premium is paid through to get the tax benefit under Income Tax Act, 1961.

12.3 Claim Settlement Procedure

Notes

You need to know about the details of the claim settlement procedure. The claims that arise in case of health insurance can be settled in any of the following ways:

1. Reimbursement of expenses.
2. Cashless facility for planned hospitalization.
3. Cashless facility for emergency hospitalization.

The claims are defined as follows:

1. **Reimbursement of expenses:** If a policyholder falls sick and hospitalized in non-empanelled hospital then he should follow the following procedure:
 - ❖ Intimation to the insurer/Third Party Administrator (TPA) along with the name of the person who has fallen sick
 - ❖ Policy number
 - ❖ Name of the hospital
 - ❖ Name of the doctor

The above information should be sent within 7 days of the hospitalization.

Within 30 days final claim form should be furnished along with the following documents:

- ❖ Hospital receipts/original bills.
- ❖ Cash memos.
- ❖ Various reports and tests.
- ❖ Hospital admission and discharge slip.
- ❖ Case history.
- ❖ Any other documents desired by TPA or hospital.



Notes It is a must to ensure that insured person has been admitted to a hospital/nursing home as defined in the policy.

2. **Cashless facility for planned hospitalization:**
 - ❖ The expected expenses to be incurred should be sent to TPA through the agreed list of network hospital,
 - ❖ Policy no. and card number should be shown to the hospital,
 - ❖ On confirmation from the TPA the treatment can be taken in that hospital,
 - ❖ If expenses increase during the treatment then the hospital will send revised estimate to the TPA for their approval,
 - ❖ For any post hospitalization treatment the original bills/cash memos can be sent to the TPA after completing the treatment for the reimbursement.
3. **Cashless facility for emergent hospitalization**
 - ❖ A card issued by the insurer should be shown to the hospital.
 - ❖ The expected expenses may send to the TPA for their approval.

Notes

- ❖ For any post hospitalization treatment the original bills/cash memo can be sent to the TPA after completing the treatment for the reimbursement.



Caution It is necessary to ensure that the Identity-Card is easily available with the policyholder.

Self Assessment

Fill in the blanks:

9. The expected expenses to be incurred should be sent to through the agreed list of network hospital.
10. A card issued by the should be shown to the hospital.

12.4 Types of Health Insurance Policy

You must remember that there are various types of health insurance policy. Following are the various types of health insurance policies.

The escalating cost of medical treatment today is beyond the reach of a common man. In case of a medical emergency, cost of hospital room rent, the doctor's fees, medicines and related health services can work out to be a huge sum. In such times, health insurance provides the much needed financial relief.

An investment in health insurance scheme would be a judicious decision. The health insurance scheme could either be a personal scheme or a group scheme sponsored by an employer. Some of the existing health insurance schemes currently available are individual, family, group insurance schemes, senior citizens insurance schemes, long-term health care and insurance cover for specific diseases. There are two major insurance companies in India namely:

- The Life Insurance Company of India (LIC)
- The General Insurance Company of India (GIC)

The Life Insurance Corporation (LIC) offers:

Jeevan Asha: The Jeevan Asha policy is the other healthcare product offered by LIC. It is an open-ended scheme covering many surgical procedures.

Asha Deep Plan: It provides cover for cancer, paralytic stroke resulting in permanent disability, renal failure and coronary artery disease where by-pass surgery has been done. It caters to people between 18–65 years.



Did u know? While LIC deals with insurance for life coverage only, the GIC deals with the other aspects of insurance, including health.

Following are the main health policies offered by the Indian Insurance Companies. These policies are regulated by the General Insurance Corporation and are marketed by the four big insurance companies: United India Insurance Co Ltd., New India Assurance Co Ltd., Oriental Insurance Co Ltd. and National Insurance Co Ltd.

The insurance policies offered by GIC are:

1. **Medicclaim:** Insures against any hospitalisation expenses that may arise in future. This policy is designed to prevent the insured from paying for any hospitalisation expenses

owing to illness or injury suffered by the insured, whether the hospitalisation is domiciliary or otherwise.

Notes

It covers the expenses incurred on the following:

- ❖ Room boarding expenses by the hospital nursing home
- ❖ Nursing expenses
- ❖ Operation theatre expenses
- ❖ Surgeon, anaesthetist, medical practitioner, consultants, specialist's fees
- ❖ Also for any cost of equipment like pacemaker, artificial limbs and charges paid for anaesthesia, blood, oxygen, operation charge, surgical appliances, medicines and drugs, diagnostic material and x-rays, dialysis and chemotherapy, radiotherapy, and cost of organs etc.

2. **Jan Arogya Bima Policy:** It insures hospitalisation or domiciliary hospitalisation expenses incurred on medical or surgical treatment for any illness or disease (contracted after 30 days from the commencement of the policy) or injury. Any person in the age group of three months to 70 years can be insured under this. The risk insured include sudden illnesses like heart attack, jaundice, pneumonia, appendicitis, paralytic attack, food poisoning or accidents that require hospitalisation. This insurance policy was designed for the lower income group of society and the common masses. The entire idea was to protect them from high costs of hospitalisation.
3. **Overseas Mediclaim Policy:** Any person going abroad on holiday, business, study or employment can avail this policy. Coverage under the medical expense section of this insurance is intended for use by the Insured person in the event of a sudden and unexpected sickness or accident arising when the Insured is outside the Republic of India.
4. **Personal Accident Policy:** The policy compensates an individual against death, loss of limbs, loss of eyesight, permanent total disablement, permanent partial disablement and temporary total disablement, solely and directly resulting from accidental injuries.
5. **Critical Illness Policy:** Critical Illness Policy is an exclusive benefit policy for individuals in the age group 20-65 years covering coronary artery surgery, cancer, renal failure, stroke, multiple sclerosis and major organ transplants like kidney, lung, pancreas or bone marrow.
6. **New India Assurance Bhavishya Arogya:** This caters to persons between 3 to 50 years. This policy is essentially to take care of medical expenses needs of persons in their old age. The policy provides for expenses in respect of hospitalisation and domiciliary hospitalisation during the period commencing from the Policy Retirement Age selected till survival. This is selected by the insured for the purpose of commencement of benefits in the policy.



Task Search over the internet and find out the policies offered by international insurance providers in case of health insurance.

Health insurance products from some private insurance companies:

1. **ICICI Pru:** ICICI Prudential Life Insurance is a joint venture between the ICICI Group and Prudential plc. of the UK. ICICI started off its operations in 1955 with providing finance

Notes

- for industrial development, and since then it has diversified into housing finance, consumer finance, mutual funds to being a Virtual Universal Bank and its latest venture Life Insurance.
2. **HDFC Standard Life:** HDFC Standard Life Insurance Co. Ltd. is a joint venture between HDFC Ltd., India's largest housing finance institution and Standard Life Assurance Company, Europe's largest mutual life company.
 3. **Om Kotak Mahindra:** Established in 1985 as Kotak Capital Management Finance promoted by Uday Kotak, the company has come a long way since its entry into corporate finance. It has dabbled in leasing, auto finance, hire purchase, investment banking, consumer finance, broking etc.
 4. **Bajaj Allianz Health Guard:** It covers individuals between 5 and 55 years. Children below 5 years can be insured if the parents are concurrently insured with the company. It provides cashless facility across various hospitals across India. Herein pre-existing illness and injuries are covered in the year of cover, if the insured renews his policy consecutively for 5 years.
 5. **Tata AIG General Insurance Company:** The Tata AIG joint venture is a tie up between the established Tata Group and American International Group Inc. The Tata Group is one of the largest and most respected industrial houses in the country, while AIG is a leading US based insurance and financial services company with a presence in over 130 countries and jurisdictions around the world.
 6. **Max India:** Max India Limited is a multi-business corporation that has business interests in telecom services, bulk pharmaceuticals, electronic components and specialty products. It is also the service-oriented businesses of healthcare, life insurance and information technology.
 7. **Royal Sundaram Health Shield Gold:** It covers individuals between 5 and 55 years. All in hospitalisation expenses are covered (period of stay in hospital should be more than 24 hours). Pre hospitalisation expenses are covered for a period of 30 days and post hospitalisation for 60 days. Under this policy pre-existing illness and injuries are covered in the 6th year of cover, if the insured renews his policy consecutively for 5 years. Maternity treatment charges are covered up to the extent of ₹ 20,000. These include expenses incurred in hospital/nursing homes as in-patient in India.
 8. **Birla Sun Life:** Birla Sun Life Insurance is the coming together of the Aditya Birla group and Sun Life Financial of Canada to enter the Indian insurance sector. The Aditya Birla Group, a multinational conglomerate has over 75 business units in India and overseas with operations in Canada, USA, UK, Thailand, Indonesia, Philippines, Malaysia and Egypt to name a few.

Self Assessment

Fill in the blanks:

11. The cost of medical treatment today is beyond the reach of a common man.
12. The health insurance scheme could either be a scheme or a group scheme sponsored by an employer.

12.5 Catastrophe Insurance

In this section, we will study about catastrophe insurance. Catastrophe insurance refers to the insurance that is used to protect residences and businesses against natural adversities such as

floods, earthquakes, cyclones and hurricanes, and also against man-made disasters for instance terrorist attacks. These high-cost and low-probability events are normally excluded from standard hazard insurance policies, and thus the need of catastrophe insurance arises.

Catastrophe insurance is unlike from various other kinds of insurance in that it is hard to estimate the entire potential cost of an insured and protected loss and a catastrophic event results in an extremely large number of claims being filed at the same time. This makes it difficult for catastrophe insurance issuers to effectively manage risk. Reinsurance and retrocession are used along with catastrophe insurance to manage catastrophe risk.

Trends in Indian Catastrophe Insurance Market

Following are the various trends in Indian catastrophe insurance market:

- After opening up in 2001, the non-life insurance market in India has developed into a competitive market with 27 public and private firms. Despite some barriers to growth, available statistics suggest some potential.
- One of the major areas for growth is the disaster insurance, a market in which Indian insurers bear less than 5% of the total economic cost of disaster claims. The industry could play a major role in removing the burden of post-disaster relief from government.
- Clearly there is a need for a shift in disaster risk management from micro-risk, ad hoc, needs-based post-disaster recovery in favour of a long-term integrated approach that emphasises a pre-disaster investment in risk reduction and adaptation. Insurance-linked securities are a means of ceding insurance-related risks to the capital markets.
- Many countries have meaningful mechanisms for disaster risks, with involvement by private insurers a common feature. For the Indian market, potentially prohibitive insurability issues will need a public-private partnership involving Government subsidy to provide coverage to those unable to afford it.
- Overall, creating alternative risk-transfer instruments for the Indian insurance industry would be a more efficient approach to disaster risk management, and also provide an opportunity for better growth in the Indian insurance industry.



Caselet

No Catastrophe Insurance Cover Yet

In the wake of the natural disaster in Uttarakhand, the proposal for 'catastrophe insurance' is in spotlight. Early this year, non-life insurance companies had presented a concept paper on catastrophe insurance to the National Disaster Management Authority (NDMA). The concept paper highlights the need for a pool mechanism to deal with losses from catastrophic events. In the absence of such a pool, both insurers and reinsurers have to bear the cost, leading to a big hit on their profitability.

However, it is still stuck as a concept because there has been no consensus between the insurers and NDMA on who would fund the process and how the pool will function.

Officials from the general insurance sector said that while they had presented their case to the finance minister, a formal decision is yet to be taken.

A senior official of a public general insurer said that the model of insurance in this category, means of settling claims, reimbursements to NDMA and other authorities are areas are

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being debated upon. “The main areas that are being discussed include who would fund the process and formation of the pool, which are the categories of population that would be covered and whether to have this cover applicable across India or only in those regions prone to such natural calamities.”

He added while earlier, it was proposed to have separate covers for people below and above the poverty line, this was scrapped later.

According to industry experts, the General Insurance Council and NDMA would have to discuss each of these issues in detail and decide on the nature and pricing of this cover. They added it would take at least 8-12 months for it to be implemented.

In India, while there are covers to protect property and life from incidents such as fire, floods and earthquake, there is an absence of a ‘natural catastrophe cover’ to cater to the needs of people. India, along with Bangladesh and Sri Lanka, faced an estimated economic loss of ₹ 1,517.1 crore in 2012 from natural disasters including floods and Nilam Cyclone, according to Aon Benfield’s Annual Global Climate and Catastrophe Report.

While both the General Insurance Council and Insurance Regulatory and Development Authority (IRDA) have made efforts to set up this pool, a formal notification giving guidance for its implementation has not yet been given. In fact, former IRDA chairman J Hari Narayan had mentioned catastrophe insurance (and pool formation) as one of the unfinished agendas of his tenure.

Reinsurance is also a critical issue, which has dissuaded the industry from taking further steps in this direction. The CEO of a private general insurance firm explained that at least 60-65 per cent of the risks would have to be reinsured, to enable them to provide cover. “Since the risks associated with this segment are very high and we do not have the pricing and pool mechanism in place, reinsurers are not very comfortable in taking a big exposure in this segment in India, at present,” said the official.

A pool-based concept for natural catastrophe events was first mooted by finance ministry and later backed by the general insurers. If a pool is formed, on the lines of the terrorism-pool in India, the losses would be distributed evenly. The pool would consist of regular premiums being made by the common citizens, with or without additional government funds infused in it.

A Swiss Re study had said that in 2011, insured losses from global natural catastrophes exceeded \$110 billion, which made it the second-highest catastrophe loss year ever for the insurance industry.

According to a recent report from catastrophe modelling firm AIR worldwide, there is nearly a seven per cent probability that the global insurance industry will experience this loss-level in any given year.

Source: http://www.business-standard.com/article/finance/no-catastrophe-insurance-cover-yet-113062500013_1.html

Self Assessment

Fill in the blanks:

- 13. A event results in an extremely large number of claims being filed at the same time.
- 14. and are used along with catastrophe insurance to manage catastrophe risk.



Case Study

How to Claim Insurance in Times of Natural Disaster?

The death toll in the devastation in Uttarakhand could eventually far exceed the number of bodies found. The flash floods would have swept away many, while many would be buried under the rubble, never to be found. Most of them would be eventually pronounced as 'missing'.

In an effort to partially alleviate the pains of survivors and the next of kin of those 'missing' in the aftermath of the calamitous flash floods in the hills the Finance Minister, P Chidambaram, on Tuesday asked the country's largest life insurer – the government-owned Life Insurance Corporation, or LIC – not to insist on the usual condition that requires the passage of seven years in case of missing people before death certificate is issued.

Addressing an LIC function, Chidambaram said that the public sector insurer can get an indemnity bond from the claimants in such cases and the claims may be settled on priority and asked it to constitute a special team to settle claims of those affected in a centralised basis.

The cases where there is no physical proof of death, claims settlement process may take many years. "For missing cases, as per the provisions of section 108 of Indian Evidence Act, presumption of death can be made only after a lapse of seven years from the date of a person being reported missing. After the lapse of seven years, the nominee or legal heir has to submit the FIR and non-traceable report issued by police authorities along with the court order (presuming the death of the person) for settlement of claims, along with other necessary documents required for deceased claim settlement," says Vishal Chopra, Executive Vice President & Head Operations, DLF Pramerica Life Insurance. This has to be supported by other necessary documents required to process a deceased claim.

While LIC might heed the Finance Minister's directive of not sticking to the seven-year period, private sector insurers might hasten the process only if there is a declaration from government of the missing being "presumed dead". "If the government announces a person is 'presumed dead' then the company would supersede the usual claim procedure and settle such claims much faster," says Chopra.

"Generally a Death Certificate from municipal authorities is required. However, in this case, we will accept the list issued by hospitals or that issued by police/armed forces in case a municipal death certificate is not available," Kalpana Sampat, Chief – Branch Operations, Underwriting and Claims, ICICI Prudential Life Insurance. Since the dust has not settled on the tragedy in the hills, most companies have not received any claims. However, some have already constituted special cells to take care of such cases. "In August last year when where flash floods in Leh-Ladakh region, our company proactively reached out to the victim families and settled quite a few claims. However, civilian movement is still restricted in the Uttarakhand region and it is therefore it is difficult for us to reach these people," says Sampat of ICICI Prudential.

In the meantime, the claim care helpline is active round the clock. "We have released alerts to all our service locations in close proximity to the affected areas. Also, we have reached out to our policyholders in the affected areas to connect directly with our help line numbers for any assistance. This would continue till the situation stabilizes," says Chopra.

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Home and Motor

Alongside the loss of life has been huge destruction of personal property as well. The claims procedure becomes difficult as the policy documents won't be available in most cases.

"The surveyor may rely either on other documentary evidence of existence or ownership like the sale deed in case of property or physical evidence at the scene to access the loss," says Amarnath Ananthanarayanan, MD & CEO Bharti AXA General Insurance.

Cases where the house or vehicle has been completely washed will be categorised under 'complete loss' and full sum insured will be claimable, otherwise, the surveyor will put the case under partial loss and one will get refund for repair or reinstatement. Regular deductibles will apply as in case of jewellery and domestic appliances (usually up to 20% of contents sum insured).

Health Insurance

If one survives the calamity, there might be need for medical care, which in the immediate aftermath may be funded by the government. However, there may be situations when one may not receive assistance from the authorities. In such situations, if the insurance documents are not available or the policyholder gets treatment in a non-network hospital, one can always take the reimbursement route when the insured recovers.

"In emergency situations, we are liberal and proactive. In the past, during the Mumbai floods, there were cases where policyholders had lost their documents, but claims have been processed without any hassle on the basis of policy numbers and basic verification documents," says Antony Jacob, Chief Executive Officer, Apollo Munich Health Insurance.

The claims are processed in the same way as it would be in a normal situation; that is, the customer has to pay the bill and then send in the claim for reimbursement up to the level of sum insured, for the medical expenses incurred. Therefore original medical bills will be the proof for getting any reimbursement. "It is only in the case of a personal accident that a claimant is advised to produce a government issued death certificate for verification," adds Jacob.

Question

What are the difficulties that appear in order to claim insurance in times of natural disaster?

Source: <http://indiatoday.intoday.in/story/uttarakhand-disaster-insurance-claim-settlement-natural-disaster/1/285402.html>

12.6 Summary

- The policy should provide for reimbursement of hospitalisation/domiciliary hospitalisation expenses for illness/disease suffered or accidental injury sustained during the policy period.
- The term Hospital/Nursing Home shall not include an establishment which is a place of rest, a place for the aged, a place for drug addicts or place for alcoholics, a hotel or a similar place.
- Any one illness means continuous period of illness and it includes relapse within 105 days from the day of last consultation with the Hospital/Nursing Home where treatment may have been taken. Occurrence of same illness after a lapse of 105 days will be considered as fresh illness for the purpose of this policy.

- Treatment arising from childbirth including Caesarean section (can be deleted, if maternity benefit is covered).
- TPA is licensed by the IRDA who will settle the health insurance claims on behalf of the insurance companies.
- An investment in health insurance scheme would be a judicious decision. The health insurance scheme could either be a personal scheme or a group scheme sponsored by an employer. Some of the existing health insurance schemes currently available are individual, family, group insurance schemes, and senior citizens insurance schemes, long-term health care and insurance cover for specific diseases.
- Critical Illness Policy is an exclusive benefit policy for individuals in the age group 20-65 years covering coronary artery surgery, cancer, renal failure, stroke, multiple sclerosis and major organ transplants like kidney, lung, pancreas or bone marrow.
- The Tata Group is one of the largest and most respected industrial houses in the country, while AIG is a leading US based insurance and financial services company with a presence in over 130 countries and jurisdictions around the world.
- Catastrophe insurance is unlike from various other kinds of insurance in that it is hard to estimate the entire potential cost of an insured and protected loss and a catastrophic event results in an extremely large number of claims being filed at the same time.
- Many countries have meaningful mechanisms for disaster risks, with involvement by private insurers a common feature. For the Indian market, potentially prohibitive insurability issues will need a public-private partnership involving Government subsidy to provide coverage to those unable to afford it.

12.7 Keywords

Catastrophe Insurance: Catastrophe insurance refers to the insurance to protect businesses and residences against natural disasters such as earthquakes, floods and hurricanes, and against man-made disasters such as terrorist attacks.

Domiciliary Hospitalisation Benefit: It means medical treatment for a period exceeding three days for such illness/injury which in the normal course would require treatment at the hospital/nursing home but actually taken whilst confined at home in India.

Family Discount: It is a discount of 10% in the total premium is allowed to a family comprising the insured and spouse, dependent children and dependent parents.

Health Insurance: It refers to a type of insurance coverage that pays for medical and surgical expenses that are incurred by the insured. Health insurance can either reimburse the insured for expenses incurred from illness or injury or pay the care provider directly.

Hospital/Nursing Home: It means any institution in India established for indoor care and treatment of sickness and injuries.

Third Party Administrator (TPA): TPA is licensed by the IRDA who will settle the health insurance claims on behalf of the insurance companies.

12.8 Review Questions

1. Describe the various features of health insurance policies.
2. What is the minimum criterion for health insurance policy?

Notes

3. What are the exclusions that the health insurance policy does not cover?
4. Describe the procedure to be followed for buying health insurance policy.
5. Briefly explain the products offered by Life Insurance Corporation (LIC).
6. Describe the various kinds of health insurance products from some private insurance companies.
7. Briefly discuss the catastrophic insurance.
8. Explain the trends in Indian catastrophe insurance market.

Answers: Self Assessment

- | | |
|------------------------------------|-------------------------------|
| 1. Hospital | 2. Expenses |
| 3. Reimbursement | 4. Disease |
| 5. Pre-existing | 6. Personal |
| 7. Declaration | 8. Cheque |
| 9. Third Party Administrator (TPA) | 10. Insurer |
| 11. Escalating | 12. Personal |
| 13. Catastrophic | 14. Reinsurance, retrocession |

12.9 Further Readings



Books

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<http://www.nos.org/media/documents/VocInsServices/m4-5f.pdf>

Unit 13: Insurance Industry: India

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Objectives

After studying this unit, you will be able to:

- Examine the privatization of insurance sector
- Explain the current scenario of insurance industry in India
- Describe the insurance sector today: opportunities and challenges
- Discuss the way ahead for Indian insurance industry

Introduction

In the previous unit, you have studied all about the health insurance and catastrophe insurance such which included the features of health insurance policy and procedure to be followed in case of health insurance purchase. It also summarized the claim settlement procedure and the various types of health insurance policies along with catastrophe insurance.

In this unit, we will study about insurance industry in India. Insurance business has emerged as one of the prominent financial services during recent times, particularly in developing countries where it could not grow before globalisation. But it is very difficult to trace exactly when insurance originated.

If we go back to ancient times, we realize that the first insurers of life were the marine insurance underwriters. They used to issue life insurance policies on the lives of their master and the crew of the ship and the merchants. These policies were issued only for short periods. The first life insurance policy was issued on 18th June 1583 on the life of William Gibbons, for a period of 1 year.

You must be aware that people always felt the need to have security of their lives and the property they owned. Somewhere in 18th century, societies like the Amicable Society, Equitable

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Life Assurance Society, Hand in Hand Society etc. were formed for issuing life insurance policies. During the early 19th century, a large number of life insurance companies were formed in India as well, which eventually became part of today's Life Insurance Corporation of India.

As far as the evolution of non-life insurance is concerned, it all began with the boycott of British goods and the British administration. These nationalists' movements made Indians come together for the common cause of protection of life and goods. This was the time when the swadeshi movement began. Thus over the years it forced the Government to have its own autonomous bodies like LIC and GIC taking care of the life and the general insurance in India.

Insurance today is not restricted just to life alone. But it has become the trend or the need of the hour to insure each and everything one has. So the different areas wherein insurance business can be done are – Life insurance, Health insurance, Automobile insurance, Property insurance, Casualty insurance, Liability insurance, Title insurance, Credit insurance, Terrorism insurance, Political risk insurance.

In the next unit, you will study about the actuarial services and some recent trends in insurance sector.

13.1 Privatisation of Insurance Sector

You need to know that insurance has always been a politically sensitive subject in India. After 40 years of government protectionism of this massive sector, the new United Front government is touching dangerous yet interesting ground with their intentions of opening this sector to private Indian business houses, as well as international players.

Since then, state-owned insurance companies have grown into monoliths, lumbering and often inefficient but the only alternative. They have been criticized for their huge bureaucracies, but still have millions of policy holders as there is no alternative.

Any attempt to even suggest letting private players into this vital sector has met with resistance and agitation from the powerful insurance employees' unions. The Narasimha Rao government (1991-96) which unleashed liberal changes in India's rigid economic structure could not handle this political hot potato. Ironically, it is the coalition government in power today which has declared its intention of opening up insurance to the private sector. Ironical because this government is at the mercy of support from the left groups which have been the most vociferous opponents of any such move.

No policy initiatives have yet been announced, but the government has already clarified it will not privatize the existing insurance companies. But while the decision has been welcomed by the big companies who were planning to make a foray into this lucrative business, the move has been criticized by trade unions and even some left supporters of the government.

In some ways, it was inevitable – all segments of the financial sector had been opened to private players and it was only a matter of time before insurance followed. The bigger private players claim that opening up insurance will give policy holders better products and service; the opponents of privatization argue that in a poor country like India insurance needs to have social objectives and newcomers will not have that commitment.

Many international players are eyeing the vast potential of the Indian market and are already making plans to come in. But it will take some time before the intent translates into policy-the unions are not going to give up without a fight and in that they will get the support of some elements of the coalition government.

On October 23, 2000, the Government of India created history once again through the IRDA, by returning insurance business to private companies which had been abolished way back in 1956.

At that time LIC was the only corporation providing life insurance to the people of this country. Although its own business grew, the people it sought to serve remained largely unsatisfied and unhappy. As the Indian populace grew, the LIC also grew, but there was also an increasing clamour for removing the monopoly of the LIC. People basically wanted better service and a wider range of products. But LIC failed on both counts. Despite these shortcomings, LIC continued to grow on account of four factors, viz. the sheer need for insurance, the tax benefits it gave taxpayers, the savings factor and its monopoly status.



Caselet

General Insurers Focus on Retail, Small Towns to beat Slowdown

The economic slowdown and falling auto sales are prompting general insurers to focus on retail segment and smaller towns.

Industry officials also say that there is an increasing focus on renewal premium, as the new premium growth from the motor, engineering segments has slowed.

“The general insurance industry will definitely be impacted due to the slowdown. As automobile sales are down, new premium collection will also dip. However, we are focusing on more personal line of businesses and entering into small towns to offset this,” general manager and whole-time director of New India Assurance K Sanath Kumar told PTI.

Motor insurance is the single largest segment of general insurance industry.

However, slowing automobile sales and dearth of new projects have pulled down growth to around 12 per cent in June from an average of around 18 per cent in the past.

Further, drastic dip in commercial vehicle sales due to the halting of mining operations also has an impact on the industry.

“Going forward, we will bring down our over-dependence on motor insurance to well below 60 per cent, and increase health insurance to about 20 per cent apart from growing the fire, engineering and marine portfolios significantly,” Reliance General Insurance chief executive Rakesh Jain said.

The industry is also facing the challenge of sustaining the investment income due to recent RBI tightening.

Most of the general insurers have posted sound growth from sale of investments in the first quarter due to fall in yields in government securities and other money market instruments.

However, due to the recent RBI liquidity tightening measures, investment income is likely to fall in the current quarter, said industry experts.

“As a company, we don’t focus much on investment income. Rather, our focus is on underwriting profit, which is core to our operations,” Bajaj Allianz General Insurance managing director and chief executive Tapan Singhel said, adding that company will focus on protecting the income of distributors.

Source: http://articles.economicstimes.indiatimes.com/2013-08-04/news/41059359_1_general-insurance-industry-tapan-singhel-investment-income

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Before market liberalisation, LIC sold mostly savings with premiums being tax-deductible in the hands of the consumers. Protection business was a relatively small proportion of its total business and riders were not popular. Not surprisingly, the new companies have introduced a wider range of products along with more need-based selling techniques. Some companies are selling protection plans in abundance. Most companies are offering a choice of riders, covering benefits such as accidental death, critical illness, waiver of premium, total and permanent disability, and guaranteed insurability. Several of the new players have already launched unit-linked products. For instance, Birla Sunlife's portfolio has unit-linked products which incorporate certain guarantees.

Before liberalization, distribution was entirely via agencies. The focus of many of the entrants has been to implement multi-channel strategies, including a significant bancassurance element. An interesting development has been the proactive response of LIC to its competitors. The private players are bringing international experience, new technology, new channels of distribution and new products. The ground rules in the insurance business are being redefined. The existing public sector players are gearing up with matching strategies so as to face the competition. The majority of insurance companies today are under tariff. This means that insurance companies cannot price the product to suit the customer or customer group. The way to serve the customer is to segment the market and offer the correct product at the correct price to that market segment.

Undoubtedly, the biggest beneficiaries of the liberalization of the insurance sector will be the Indian consumers. While there may not be any significant benefit in terms of the cost of premiums, they would surely benefit in terms of the number and variety of products and service standards. Consumers now have a wider choice of insurance schemes. However, it must be noted that at present Indians are the most deprived customers in the world. Out of about 150 general insurance schemes on the global level, only 10 per cent of them are offered by the four subsidiaries of the GIC. Through privatization, consumers will get a wide range of insurance products. Furthermore, the claims settlement will be customer-friendly.

Self Assessment

Fill in the blanks:

1. It is the government in power today which has declared its intention of opening up insurance to the private sector.
2. Before market liberalization, LIC sold mostly savings with premiums being in the hands of the consumers.
3. The majority of insurance companies today are under
4. The biggest beneficiaries of the liberalization of the insurance sector will be the consumers.

13.2 Current Scenario of Insurance Industry in India

You will find it interesting to note that life insurance in its current form came to India from the United Kingdom with the establishment of the Oriental Life Insurance Company in 1818. Thereafter Bombay Life Assurance Company was formed in 1823, the Madras Equitable Life Insurance Society in 1829 and the Oriental Life Assurance Company in 1874.

The Government felt the need to regularize life insurance and for the first time an Act pertaining to insurance was passed viz. the Indian Life Assurance Companies Act 1923; later, in 1928 the Indian Insurance Companies Act was enacted by the government to collect statistical data on life and non-life business in India.

In order to protect the interests of policyholders, earlier legislation was consolidated and amended by the Insurance Act 1938 with comprehensive provisions for detailed and effective control over the activities of insurers.

Earlier life insurance was confined mainly to the cities and better-off segments of society. With a view to spread life insurance to the rural areas, to have control over all the insurance providers in India and to bring them under one roof the Government of India decided to nationalize the life insurance business. Thus in 1956, the President of India passed an ordinance for nationalization, thereby giving birth to the Life Insurance Corporation of India.

Since 1956, with the nationalization of insurance industry, the state run Life Insurance Corporation of India (LIC) has had a monopoly in India's life insurance sector. Over the years, it has reaped the advantages of monopoly and enjoyed a virtual prerogative in setting premiums. With more than 6 lakh agents in every nook and corner of the country, it has created a brand name for itself. It has, to its credit, around \$44 billion as its life fund and is a strong player in the financial sector. Over the years the government felt that the Life Insurance Corporation of India was losing its grip, and decided it was time to let private players enter the market.

Present Scenario

You must remember that the liberalisation, privatisation and globalisation policies of the nation along with the revolution in the field of Information Technology and communication have been advantageous for the insurance sector in India.

- **Entry of private players and foreign collaborations:** It was on the recommendation of the Malhotra Committee that private players were allowed to enter into the insurance market. Today there are almost 22 players who have entered the Indian insurance market besides the giant Life Insurance Corporation of India (LIC).

Another major development that has taken in the field of general insurance is the de-linking of the 4 subsidiaries of the General Insurance Corporation of India (viz. Oriental Insurance Company Ltd., New India Assurance Company Ltd., National Insurance Company Ltd. and United India Insurance Company Ltd.) from the parent company.

- **Marketing strategies and approaches:** The entry of private players and their foreign partners has given domestic players a tough time, because the opening up of the sector has not brought in only foreign players, but also professional techniques and technologies. The present scene in India is such that everyone is trying to put in the best efforts. One can see strategies being more for survival than growth. But the most important gift of privatisation is the introduction of customer-oriented services. Utmost care is being taken to maximize customer satisfaction.

Self Assessment

Fill in the blanks:

5. The Government felt the need to life insurance.
6. The President of India passed an for nationalisation, thereby giving birth to the Life Insurance Corporation of India.
7. The most important gift of privatisation is the introduction of services.
8. The entry of private players and their foreign partners has given players a tough time.

13.3 Insurance Sector Today: Opportunities and Challenges

Following section will assist you in understanding the opportunities and challenges in Indian insurance sector:

13.3.1 Opportunities

As compared to the Western countries, where they have already reached a stage of saturation, India can exploit some golden opportunities in the following fields.

Mass Marketing

India is a highly populated country and would continue to be so in the near future. New players may tend to favour the “creamy” layer of the urban population. But, in doing so, they may well miss a large chunk of the insurable population. A strong case in point is the current business composition of the dominant market leader – the Life Insurance Corporation of India. The lion’s share of its new business comes from the rural and semi-rural markets. In a country of 1 billion people, mass marketing is always a profitable and cost-effective option for gaining market share. The rural sector is a perfect case for mass marketing.

Competition in rural areas tends to be “kinder and gentler” than that in urban areas, which can easily be termed cutthroat. Identifying the right agents to harness the full potential of the vibrant and dynamic rural markets will be imperative. Rural insurance should be looked upon as an opportunity and not an obligation.



Did u know? A smaller bundle of innovative products in sync with rural needs and perceptions, and an efficient delivery system are the two aspects that have to be developed in order to penetrate the rural markets.

Job Opportunities

You must have observed that job opportunities are likely to increase manifold. The liberalization of the insurance sector promises several new job opportunities for those who are equipped with degrees in finance. Finance professionals who had witnessed a slump in the job market would be much relieved.

There will be demand for marketing specialists, finance experts and human resource professionals. Apart from this, there will be high demand for professionals in streams like underwriting and claims management, and actuarial sciences.

Inflow of Funds

There could be a huge inflow of funds into the country. Given the industry’s huge requirement of start-up capital, the initial years after opening up are bound to see a strong inflow of foreign capital. A rise in the equity share of foreign partners to 49 per cent will act as a boost to them.

Reinsurance

Huge capacity is likely to be created in the area of reinsurance. Apart from pure reinsurance activities, which involve providing insurance protection, there will be a revolution in service-related fields like training, seminars, workshops, know-how transfer regarding risk assessment and rating, risk inspections, risk management and devising new policy covers, etc.

Marketing Strategies

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Also, with more players in the market, there will be significant increase in advertising, brand building, and this will benefit whole lot of ancillary industries.

A substantial shift is likely to take place in the distribution of insurance in India. Many of these changes will echo international trends. Worldwide, insurance products move along a continuum from pure service products to pure commodity products. Initially, insurance is seen as a complex product with a high advice and service component. Buyers prefer a face-to-face interaction and place a high premium on brand names and reliability.

As products become simpler and awareness increases, they become off-the-shelf, commodity products. Sellers move to remote channels such as the telephone or direct mail. Various intermediaries, not necessarily insurance companies, sell insurance. In some countries like Netherlands and Japan, insurance is marketed using the Post Office's distribution channels. At this point, buyers look for low price. Brand loyalty could shift from the insurer to the seller.

Bancassurance

In other markets, notably Europe, this has resulted in bank assurance: banks entering the insurance business. The Netherlands led with financial services firms providing an entire range of products including bank accounts, motor, home and life insurance, and pensions. Other European markets have followed suit. In France, over half of all life insurance sales are made through banks. In the UK, almost 95% of banks and building societies are distributing insurance products today.

In India too, banks hope to maximize expensive existing networks by selling a range of products. Many bankers have shown an inclination to enter the insurance market by leveraging their strengths in the areas of brand image, distribution network, face to face contact with the clients and telemarketing coupled with advanced information technology systems. Insurers in India should also explore distribution through non-financial organisations.



Example: Insurance for consumer items such as refrigerators can be offered at the point of sale.

Information Technology

Worldwide interest in E-commerce and India's predominant position in Information Technology and software development are also likely to be major factors in the marketing of insurance products in the immediate future. The number of internet accounts is increasing and the trend has already been set by some of the leading insurers and insurance brokers worldwide.



Task Prepare a presentation on the various opportunities available in insurance sector today.

13.3.2 Challenges

You will agree that if one has opportunities, one has to face challenges; it is like two sides of the same coin. No doubt India has a lot of opportunities coming her way, but there are a few challenges and threats as well.

The four main challenges facing the industry are product innovation, distribution, customer service, and investments. Unit-linked personal insurance products might find greater acceptability

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with rising customer awareness about customised, personalised and flexible products. Flexible products and new technology will play a crucial role in reducing the cost and, therefore, the price of insurance products.



Example: Finding niche markets, having the right product mix through add-on benefits and riders, effective branding of products and services and product differentiation will be some of the challenges faced by new companies.

Technology

In today’s highly competitive financial services environment, effective organisations will employ technology in a strategic way so to achieve a competitive edge. Technology will play an increasing role in aiding design and administering of products, as well in efforts to build life-long customer relationships. At the same time, investment in technology will only help as long as firms find the right people: people with the right attitude, values, and ethics, commitment to excellence, and focus on customer service.



Notes The critical success factor is a top-down emphasis on exceeding customer expectations with quality people, excellent products, and legendary service.

As has been seen in other financial services, the entry of private players ensures that the customer will be the beneficiary in the long run. It will also result in enlarging the market and extending the reach of insurance across the country.

Competition

Thus, apart from the normal issues facing any new company, many new Indian private insurance players will need to cope with the challenges of working with a joint venture partner. They will be competing with large and well-entrenched government-owned players. They have to overcome regulatory hurdles, change the attitude of new recruits and satisfy some very high customer expectations. Also, the players will have to consider the Indian market as a long-term investment, and maintain clear-cut objectives and constant monitoring at all levels.

Table 13.1: Major Players in the Insurance Sector Today

S.No.	Date of Reg.	Name of the Company
1	23.10.2000	HDFC Standard Life Insurance Company Ltd.
2	23.10.2000	Royal Sundaram Alliance Insurance Company Limited
3	23.10.2000	Reliance General Insurance Company Limited.
4	15.11.2000	Max New York Life Insurance Co. Ltd.
5	24.11.2000	ICICI Prudential Life Insurance Company Ltd.
6	04.12.2000	IFFCO Tokio General Insurance Co. Ltd
7	10.01.2001	Kotak Mahindra Old Mutual Life Insurance Limited
8	22.01.2001	TATA AIG General Insurance Company Ltd.
9	31.01.2001	Birla Sun Life Insurance Company Ltd.
10	12.02.2001	Tata AIG Life Insurance Company Ltd.
11	30.03.2001	SBI Life Insurance Company Limited.

Contd...

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12	02.05.2001	Bajaj Allianz General Insurance Company Limited
13	02.08.2001	ING Vysya Life Insurance Company Private Limited
14	03.08.2001	ICICI Lombard General Insurance Company Limited.
15	03.08.2001	Bajaj Allianz Life Insurance Company Limited
16	06.08.2001	Metlife India Insurance Company Pvt. Ltd.
17	03.01.2002	AMP Sanmar Life Insurance Company Limited.
18	14.05.2002	Aviva Life Insurance Co. India Pvt. Ltd.
19	15.07.2002	Cholamandalam General Insurance Company Ltd.
20	27.08.2002	Export Credit Guarantee Corporation Ltd.
21	27.08.2002	HDFC-Chubb General Insurance Co. Ltd.
22	06.02.2004	Sahara India Insurance Company Ltd.
23	17.11.2005	Shriram Life Insurance Company Ltd.

Self Assessment

Fill in the blanks:

9. New players may tend to favour the “.....” layer of the urban population.
10. The rural sector is a perfect case for
11. The liberalisation of the insurance sector promises several new job opportunities for those who are equipped with degrees in
12. Huge capacity is likely to be created in the area of

13.4 The Way Ahead

You must remember that with the entry of competition, the rules of the game are set to change. The market is already beginning to witness a wide array of products from players whose number is set to grow. In such a scenario, the differentiators among the different players are products, pricing, and service. Consumers are increasingly more aware and are actively managing their financial affairs. Today, while boundaries between various financial products are blurring, people are increasingly looking not just at products, but at integrated financial solutions that can offer stability of returns along with total profits. To satisfy these myriad needs of customers, insurance products will need to be customised. Insurance today has emerged as an attractive and stable investment alternative that offers total protection – Life, Health and Wealth Protection. Consumers today also seek products that offering flexible options, preferring products with benefits unbundled and customisable to suit their diverse needs.

The trend in developed economies where people live longer and retire earlier is now emerging in India too. With the breakdown of traditional forms of social security like the joint family system, consumers are now concerned with the need to provide for a comfortable retirement. This trend has been further driven by the long-term decline in interest rates, which makes it all the more necessary to start saving early to ensure long term wealth creation. Today’s consumers are increasingly interested in products to help build wealth and provide for retirement income.

This all adds up to a major change in the demand for insurance products. While sales of traditional life insurance products like individual, whole life and term will remain popular, sales of new products like single premium, investment linked, retirement products, variable life and annuity products are also set to rise.

Notes



Caution Firms will need to constantly innovate in terms of product development to meet ever-changing consumer needs. However, product innovations are quickly and easily cloned.

Pricing will also not vary significantly, with most product premiums hovering around a narrow band.

In this competitive scenario, a key difference will be the customer experience that each life insurance player can offer in terms of quality of advice on product choice, along with policy servicing, and settlement of claims. Service should focus on enhancing the customer experience and maximising customer convenience. Long-term growth in the business will depend greatly on the distribution network, where the emphasis must evolve from merely selling insurance to acting as financial advisors, helping customers plan their finances depending on life stage and personal requirements. This calls for a strong focus on training of the distribution force to act as financial consultants and build a lasting relationship with the customer. This would help create a sustainable competitive advantage that cannot be easily matched.

Self Assessment

Fill in the blanks:

- 13. While boundaries between various financial products are blurring, people are increasingly looking not just at products, but at integrated that can offer stability of returns along with total profits.
- 14. Today’s consumers are increasingly interested in products to help build wealth and provide for income.
- 15. Product are quickly and easily cloned.



Case Study

General Insurers may not see Many Losses from ‘Phailin’

The general insurance industry is unlikely to see much losses arising from the cyclonic storm Phailin that hit the eastern coast last night, as most commercial installations and ports along Odisha and Andhra are relatively less affected coupled with poor retail penetration in the region, say industry officials.

They, however, said not only the domestic general insurance industry is closely watching the event, but global re-insurers are also having a close tab on the developments in the east coast.

Around 9 pm last night, the very severe cyclonic storm ‘Phailin’ had the landfall in Gopalpur in Odisha. Before the cyclonic storm hit the coast, some people lost their lives even as the authorities evacuated over five lakh (at the last count), from the storm affected areas of the two states.

“Though it’s very difficult to predict the amount of losses that will arise from ‘Phailin’, we don’t expect huge losses from this calamity,” Bajaj Allianz General Insurance managing director and chief executive Tapan Singhel told PTI.

Contd...

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According to sources, key installations like the Paradip Port, Indian Oil refinery, plants of Essar Steel, among others in Odisha and the Vizag Port in Andhra have not faced much damage due to the super storm.

Industry officials also point out that penetration of general insurance industry is poor among individual customers in these regions.

On this, New India Assurance general manager and whole-time director K Sanath Kumar said the industry is closely watching the event.

“We have a close watch on the event. Not only the domestic general insurance industry is following the event closely, but the global re-insurers are also having a close tab as many of the insurance policies are reinsured with them,” Kumar said.

As per reports, Odisha has pegged the initial losses amounting from ‘Phailin’ at ₹ 1,400 crore.

This is the second major natural disaster in this year after the killer Uttarakhand floods in June in which more than 5,000 people had lost their lives.

The general insurance industry has witnessed claims worth ₹ 1,500 crore from the Uttarakhand disaster.

Question

What do you infer from the above case?

Source: http://articles.economictimes.indiatimes.com/2013-10-13/news/42993148_1_tapan-singhel-k-sanath-kumar-odisha

13.5 Summary

- Insurance has always been a politically sensitive subject in India.
- The bigger private players claim that opening up insurance will give policy holders better products and service; the opponents of privatization argue that in a poor country like India insurance needs to have social objectives and newcomers will not have that commitment.
- Many international players are eyeing the vast potential of the Indian market and are already making plans to come in.
- Before market liberalisation, LIC sold mostly savings with premiums being tax-deductible in the hands of the consumers.
- The focus of many of the entrants has been to implement multi-channel strategies, including a significant bancassurance element.
- Out of about 150 general insurance schemes on the global level, only 10 per cent of them are offered by the four subsidiaries of the GIC.
- Earlier life insurance was confined mainly to the cities and better-off segments of society. With a view to spread life insurance to the rural areas, to have control over all the insurance providers in India and to bring them under one roof the Government of India decided to nationalize the life insurance business.
- The entry of private players and their foreign partners has given domestic players a tough time, because the opening up of the sector has not brought in only foreign players, but also professional techniques and technologies.

Notes

- India is a highly populated country and would continue to be so in the near future. New players may tend to favour the “creamy” layer of the urban population.
- Competition in rural areas tends to be “kinder and gentler” than that in urban areas, which can easily be termed cutthroat. Identifying the right agents to harness the full potential of the vibrant and dynamic rural markets will be imperative.
- A substantial shift is likely to take place in the distribution of insurance in India. Many of these changes will echo international trends. Worldwide, insurance products move along a continuum from pure service products to pure commodity products.
- The trend in developed economies where people live longer and retire earlier is now emerging in India too. With the breakdown of traditional forms of social security like the joint family system, consumers are now concerned with the need to provide for a comfortable retirement.

13.6 Keywords

Bancassurance: It is an arrangement in which a bank and an insurance company form a partnership so that the insurance company can sell its products to the bank’s client base.

Liberalisation: Liberalisation refers to a relaxation of previous government restrictions, usually in such areas of social and economic policy.

Mass Marketing: Mass marketing is a market coverage strategy in which a firm decides to ignore market segment differences and appeal the whole market with one offer or one strategy.

Privatisation: It is the process of transferring ownership of a business, enterprise, agency, public service or public property from the public sector to the private sector, either to a business that operates for a profit or to a non-profit organisation.

Reinsurance: It is the transfer of insurance business from one insurer to another. Under reinsurance, the original insurer who has insured a risk insures a part of that risk with another insurer.

13.7 Review Questions

1. Why insurance has always been a politically sensitive subject in India? Explain the role of Narasimha Rao government in case of privatization of insurance sector.
2. Discuss the reasons due to which many international players are eyeing the vast potential of the Indian market.
3. Who are the biggest beneficiaries of the liberalization of the insurance sector and why?
4. Discuss that segment of society to which insurance was confined in previous times.
5. Describe the present scenario of insurance industry in India.
6. Discuss the opportunities in insurance sector today.
7. What are the various challenges present in insurance industry?
8. Briefly discuss the future of insurance sector.

Answers: Self Assessment

1. Coalition
2. Tax-deductible
3. Tariff
4. Indian

5. Regularize	6. Ordinance	Notes
7. Customer-oriented	8. Domestic	
9. Creamy	10. Mass marketing	
11. Finance	12. Reinsurance	
13. Financial solutions	14. Retirement	
15. Innovations		

13.8 Further Readings



Books

- Gulati, Neelam. C. (2011), *Banking and Insurance*, Excel Books.
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- http://www.damodarcollege.org/dhiru_final/roshanvol6.2.html
- <http://www.indiainbusiness.nic.in/industry-infrastructure/service-sectors/insurance.htm>
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Unit 14: Trends in Insurance Sector

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Objectives

After studying this unit, you will be able to:

- Explain the concept of actuarial services
- Discuss some recent trends in insurance sector

Introduction

In the previous unit, you have studied about the privatization of insurance sector and current scenario of insurance industry in India. The unit also dealt with various opportunities and challenges in insurance industry today. It also discussed the way ahead for insurance industry.

In this unit, you will study about the various trends in the insurance sector. The number one priority for insurance carriers today is profitable growth and one of the most effective ways to enable this growth is through the use of innovative technologies. Yet, while they are critical, implementing new technologies can drain budgets and resources. Carriers must judiciously determine which technologies are worth the investment today and which ones deserve a strategic “wait and watch” approach.

14.1 Actuarial Services

Let’s start the unit by first discussing actuarial services. Actuarial service refers to the method by which corporations determine, assess and plan for the financial impact of risk. Actuaries use mathematical and statistical models to evaluate risk in the insurance and finance industries.



Notes In addition to mathematical and statistical methods, actuaries call upon other fields including probability, finance, economics and computer programming to create actuarial models.

Actuarial science is used to evaluate and predict future pay-outs for insurance and other financial industries such as the pension industry.

Actuarial services include the analysis of rates of disability, morbidity, mortality, retirement, survivorship and other contingencies. By using mathematical and statistical modelling, actuaries are able to provide estimates regarding particular events, such as the life span of a life insurance applicant, or the likelihood of a catastrophic, weather-related event for a property and casualty insurance firm. Actuarial services forecast risk and uncertainty and help firms plan for future probabilities and possibilities.



Did u know? An actuary is a business professional, similar to an accountant or an attorney. But unlike those professionals, the actuary's job is to place dollar values on future contingent life events, such as death, disability, longevity, or retirement.

Actuaries study probability and statistics, and obtain education and licensing credentials from several sources, including the federal government.

Here are some of the many things actuaries do:

- Calculate the amount your employer must contribute to the pension plan each year. Actuarial consulting firms are retained by employers for this purpose.
- Calculate the price you should be charged for an insurance premium, for all types of insurance. Actuaries who work for life, health, and casualty companies perform these calculations.
- Determine the amount of risk an insurance company can take on, and reinsure the rest. Actuaries who do this work in the reinsurance business.
- Calculate the amount of lump sum benefit payable to someone terminating from a pension plan. Consulting actuaries perform these calculations.
- Separate the spousal benefit from a pension benefit in a divorce settlement. Suppose one party worked for Boeing for 10 years while married. The other spouse has a 50% interest in the benefit from the Boeing pension plan.



Caution An actuary is needed to place a value on the spouse portion in order to carve the benefit out of the estate.

- Compute the equivalent amount of an estate trust that will be inherited by a series of heirs to the estate.



Example: Suppose a trust pays \$1,000 per month to an heir, with the proviso that any amount remaining upon the death of the heir goes to a second heir. The actuarial value of the second heir's interest can be determined actuarially and sold out of the estate.

- Perform an actuarial balance forecast for a Continuing Care Retirement Community (CCRC). A CCRC is a full-time resident facility for retired people, with additional health services provided. Since most residents will live at such a facility for the rest of their lives, an actuary is required to determine the expected future revenues and expenses.
- Assistance with retirement planning and investment education. If you are wondering about which pension option to take upon retirement, or whether to retire now or later, an actuary can help you decide.

Notes



Example: Is it wiser to take a pension of \$2,500/month at age 65 as a life annuity, or take \$2,200 at age 62 with 50% going to your spouse at death? Here, actuaries are called upon to help make these decisions.

- Calculate the value of lost income in event of disability or death. Frequently this value is needed by the court in a wrongful injury or death case.
- Assistance with financial forecasts that involve expected mortality or longevity. Actuaries work for the Social Security system to make long-range financial forecasts for the system.
- Other problems relating to life, death, retirement, remarriage, or other demographic events. Actuaries are skilled professionals who merge knowledge of the economy, interest rates, and demography. If you ever think you might need the help of an actuary.



Task Name ten such organizations which provide actuary services.

Self Assessment

Fill in the blanks:

1. use mathematical and statistical models to evaluate risk in the insurance and finance industries.
2. Actuarial science is used to evaluate and predict future
3. Actuarial services forecast risk and uncertainty and help firms plan for future and

14.2 Recent Trends in Insurance Sector

In this section, we will learn about the recent trends in insurance sector. Before liberalization the Insurance sector was controlled by Controller of Insurance but now the corporate body known as Insurance Regulatory & Development Authority (IRDA) has been formed under IRDA Act 1999. IRDA has taken the following steps to develop the Insurance sector in India keeping in view of the following key indicators.

Policies and Measures to Develop Insurance Market

The Authority has taken a pro-active role in the establishment of a vibrant Insurance market in the country by taking the following steps:

1. The market regulation by prudential norms,
2. The registration of players who have the necessary financial strength to withstand the demands of a growing and nascent market,
3. The necessity to have “fit and proper” person in-charge of businesses,
4. The implementation of a solvency regime that ensures continuous financial stability, and above all,
5. The presence of an adequate number of insurance companies to provide competition and choice to customers all these steps lead to the establishment of a regime committed to an overall development of the market in normal times.

6. Prescribed rural and social sector norms in respect of Insurance business being underwritten by the companies.
7. The companies have also been asked to devise insurance policy to specific sector in the economically weak population.

Notes

Research and Development Activities Undertaken by the Insurance Companies

The insurers have been conducting market research either in-house or through professional agencies:

- (i) To introduce tailor-made products targeted at specific segments of the population so that Insurance can become more meaningful and affordable.
- (ii) Risk assessment studies are being carried out for measuring accumulation of risk of a particular place at any one point of time.
- (iii) Consumer awareness campaigns are being encouraged to improve insurance literacy levels by conducting workshops, distributing literature etc.

Protection of Interests of Policyholders

To protect the interests of holders of Insurance policies and to regulate, promote and ensure orderly growth of the Insurance industry the Authority has taken the following steps:

- (i) A leading consumer activist has been inducted into the Insurance Advisory Committee.
- (ii) In addition to this member, this committee has drawn representation from the industry, Insurance agents, women's organisations and other interest groups.
- (iii) While the Government has taken steps to strengthen the Boards of the State-run companies by inducting representatives from consumer organisation and policyholder.
- (iv) The Authority, on its part, was careful to ensure that all the new private companies registered have a director representing consumer interests on their Boards.
- (v) In addition to this measure all insurers have been advised to streamline their grievance redressal machinery and set benchmarks for efficient and effective service.
- (vi) All insurance companies are adhering to the Insurance Ombudsman scheme formulated by the Government and complaints against insurance companies are being referred to them by the aggrieved policyholders from time-to-time.
- (vii) The Authority is conscious of the fact that the fine print should not take away what the bold print promises and in this regard has come out with the Insurance Advertisement and Disclosure Regulations which ensure that the Insurance companies adhere to fair trade practices and transparent disclosure norms while addressing the policyholders or the prospects.
- (viii) All Insurance intermediaries, before obtaining a licence, or at the time of renewal of licence, are required to undergo compulsory training to ensure that they can service the policyholders better by being well trained and informed.
- (ix) Guidelines have been issued to insurers to file their existing and new products with the Authority. In case of new products insurers are required to submit details of:
 - ❖ Premium rating,
 - ❖ Policy conditions,

Notes

- ❖ Proposal form,
- ❖ Claim form,
- ❖ Underwriting manual, and
- ❖ The system in vogue to review the rates, terms and conditions in future.



Caution In addition to this, they are required to furnish certificates from advocates and actuaries that the statements made are true and accurate and are not in violation of any law and that the policy wordings are simple and easily understandable to a policyholder.

Maintenance of Solvency Margins of Insurers

As per provisions of the Insurance Act and the regulations made thereunder, every life insurer is required:

- (i) To maintain an excess of value of his assets over the amount of his liabilities of not less than ₹ 50 crore (₹ 100 crore in the case of a reinsurer) or
- (ii) A sum equivalent based on a prescribed formula, as determined by regulations not exceeding 5% of the mathematical reserves and a percentage not exceeding 1% of the sum at risk for the policies on which the sum at risk is not negative, whichever is highest.

Similarly, every General insurer is required to maintain a minimum solvency margin of:

- (iii) ₹ 50 crore (₹ 100 crore in the case of a reinsurer) or
- (iv) A sum equivalent to 20% of net premium income or a sum equivalent to 30% of net incurred claims whichever is highest, subject to credit for reinsurance in computing net premiums and net incurred claims.

In addition, at the time of registration all the new insurers have been required to maintain a solvency ratio of 1.5 times the normal requirements.

Monitoring of Investments of the Insurers

You must remember that investment income is a key determinant in the calculation of premium rates for any insurance company under the various insurance policies/schemes and for declaration of bonus by life insurers. It is a core function of an insurance company, which cannot be outsourced by an insurer.

In the case of general insurance, investment income compensates underwriting losses, if any, of the insurance company, which in turn enables them to keep their premium rates competitive. Therefore, insurance companies essentially invest these funds judiciously with the combined objectives of liquidity, maximisation of yield and safety.

An investment policy has to be submitted to the Authority by an insurer before the start of an accounting year. Since the insurance companies keep the policyholders money in their fiduciary capacity they are also required to maintain a minimum level of solvency to meet the reasonable expectations of the policyholders.

For this, the Authority has mandated the pattern of investment to be followed by the insurance companies. Investments in Government securities, approved investments and infrastructure and the social sectors have been prescribed in the Insurance Act, 1938.

Health Insurance

Notes

All the new insurance companies have been advised that they will carry out health insurance business not as a stand-alone product but as a combined rider with existing life/non-life policies, and introduce health products in the market. At the moment the health products available is of the standard reimbursement type policy and its variants.

IRDA has recently notified regulations for Licensing of Third Party Administrators (TPA) – Health Services in order to popularize health insurance. Health services rendered by a TPA shall include services in connection with health insurance business. However this shall not include the business of insurance company or the soliciting, directly or through an insurance intermediary including an insurance agent. It is expected that TPAs will bring some sort of regulation regarding standard and quality of treatment, period of treatment and rates.

The Authority is encouraging to business community to come forward to start exclusively health insurance Company. Till date there is only insurer who is exclusively engaged in health insurance business.

Public Complaints

Many customers of insurance companies approach the Authority – both formally and informally for the settlement of their grievances. IRDA follows up for the settlement of these grievances on the complaints on a continuous basis with the insurance companies. Timely attention is given to these complaints and the insurers are advised to settle claims and grievances promptly

A system of grievance redressal has been built in the Authority supervised by one of its senior officers. This system has proved useful to the Authority – not only to see that complaints get attended to but also to give it an idea of the areas of working of an insurer where have to be improved. The experience gained in this regard is reflecting in the regulations made by the Authority.

Functioning of Ombudsman (a Person who Decides the Complaints of an Individual on Insurance Matters)

The institution of Insurance Ombudsman has great importance and relevance for the protection of interest of policyholders and also to build up their confidence in the system.

This institution has helped to generate and sustain the faith and confidence amongst the consumers in insurers. The Insurance Council, which is the administrative body has appointed twelve ombudsmen across the country and have provided them with the necessary infrastructure.

The companies are required to honour the awards passed by an Ombudsman within three months. The awards are binding on the Insurance companies; the customer, however, can resort to in case he decides on the insurance companies; the customer, however, can resort to its case he decides to do so, other methods of grievance settlement.

The Insurance Ombudsman is empowered to receive and consider complaints in respect of personal lines of insurance from any person who has any grievance against an insurer.

The complaint has to be writing, and addressed to the jurisdictional Ombudsman within whose territory a branch or office of the insurer complained against is located. The complaint can relate to any:

- (a) Grievance against insurer.
- (b) Partial or total rejection of claims by the insurer.

Notes

- (c) Dispute in regard to premium paid or payable in terms of the policy.
- (d) Dispute on the legal construction of the policy in so far as such dispute relate to claims.
- (e) Delay in settlement of claims.
- (f) Non-issue of any insurance document to customers after receipt of premium.


The limit of an Ombudsman's powers is at present prescribed as ₹ .20 lakhs. The insurance Ombudsman Scheme is complementary to the regulatory functions of IRDA, which has been mandated to take all necessary steps to protect the interest of the policyholders. The institution of ombudsman has evoked a good deal of public appreciation as is evident from media reports and performance appraisal made by the Authority.

14.2.1 Current Trends of the General Insurance Market

Let's discuss about the current trends of the general insurance market. Despite there being over 30 players, the market is still under penetrated. In the general insurance sector, the penetration level is just about 0.65%. The coming year will assume a significant position in the history of Indian insurance industry. It denotes completion of a decade of open-market; ending of oligopoly and entry of private sector insurance companies; and the regime of a new development oriented regulatory authority—the IRDA (Insurance Regulatory and Development Authority).

The market continues to attract new capital; barring a handful of mega-risks, there is more than adequate capacity to cover all the risks within the market. Post de-tariffing, competition for the existing pie intensified and premium-rates in all classes took a dip. However, insurers are chasing premium and booking losses and working up unviable combined ratios. It is felt that the bottom has been reached and an upswing in the rates is inevitable.

At present, the general insurance market has 20+ players already and some more large international ones are expected to enter shortly.



Notes Companies today are coming up with new ideas to stand out and they are offering the existing and prospective customers, new technology platforms that would streamline the business and would also be beneficial to them.

The industry is going through a challenging phase now because of the general economic slowdown and this phase is expected to continue for some time. According to industry experts, the market will grow by 18% a year and is expected to reach ₹ 900 billion by 2015.

Despite there being over 30 players (in both general and life), the market is still under penetrated. In the general insurance sector, the penetration level is just about 0.65%. In India, the urban market is the major contributor for general insurance. Though the rural market does not have any significant contribution to this sector, it is growing rapidly over the past few years and is slowly becoming a huge potential market for general insurance in India. To capture the rural market, companies are adopting strategies to increase awareness levels among the people. This, they are achieving through increasing the distribution levels and access points. Business generation through multiple distribution channels is the main agenda for these companies. Some of them are even adopting the cutting-edge technologies like e-marketing and institutional marketing for deeper penetration in the rural market.

On the property and liability insurance segments—niche marketing and competition for small and medium size companies would be the challenge for the next two years. Project-insurance sector will continue to be the major work-horse; with continued economic development spurring

investment in power sector, manufacturing and other industries, roads and buildings. Insurers with right technical support and adequate capacity would be able to benefit from this segment.

Brokers and agents—who upgrade their technical competence—are expected to play an increased role. Hence, it would be wise for insurance companies to support competent brokers and agents. These much needed intermediaries with help from insurers and re-insurers would have to take up a major challenge of educating the under informed customers in risk-management and risk improvement; accept more reasonable policy deductibles and seek better policy coverage.



Caselet

Insurance for NRI Workers

Workers going abroad for jobs will get an insurance cover of a minimum of ₹ 2 lakh from December 25 under the Pravasi Bhartiya Bima Yojna by paying a “fair and reasonable” premium.

The scheme was announced by Prime Minister Vajpayee on the occasion of Pravasi Bhartiya Diwas in January this year and was prepared in consultation with the external affairs ministry.

New Indian Assurance Co. Ltd., Bajaj Allianz General Insurance Co. Ltd. and ICICI Lombard General Insurance Co. Ltd. came forward for the purpose.

Source: http://articles.timesofindia.indiatimes.com/2003-11-17/india-business/27200545_1_death-or-permanent-disability-insurance-scheme

According to labour ministry sources, in the event of death or permanent disability, the scheme involves payment of the amount to the nominee or legal heir of Indians, who go abroad for employment after obtaining clearance from the Protector of Emigrants (POE).

Newer pricing methods need to be developed for commercial lines. Underwriters should give up the old tariff-based approach and develop experience-based and actuarial-supported models for pricing. Most of the large risks have already well developed risk-management departments and deploy ERM (enterprise risk management) techniques; with the right pricing, and capacity, this segment still offers good pickings. The SME (small and medium enterprise) sector (property) needs careful cherry-picking and the right marketing approach would yield dividends.

Catastrophe risk management system has to become robust as the insurance spreads in the semi-urban and rural areas. With increased penetration, rapid economic development in rural areas, insurance companies will face losses from events like floods and catastrophes in the interiors which hitherto have not produced significant insurance losses. It is vital for insurers to monitor their aggregate exposures closely and buy adequate catastrophe protection. Choices of India-specific cat-modelling software tools are now available and most of the insurers are using these tools. With increased awareness in this area, insurers are buying more and more catastrophic cover; notably the cover being purchased has increased from 100 years to 250 years return period cover.

Health insurance is a lucrative segment; it is poised to record a massive growth in India in the coming years. Half of the country’s population is expected to come under the health insurance umbrella in the next seven years, according to an Ernst & Young study. A mere 12% of the population is currently covered by healthcare. According to an Economic Times report, the government’s proposal to scale up the foreign direct investment (FDI) in the insurance sector from 26% to 49% will boost the healthcare business. In the coming years India might witness more standalone healthcare companies too as they will have an edge in the future market scenario, says an industry expert.

Notes

The recent development in the general insurance sector is the activities by the insurance regulator. The IRDA has been very stringent and has been keeping a close-watch on the functioning of all the insurance companies. The latest regulation from IRDA is on health insurance portability. In the future, general insurance industry will be very much in the limelight than any other industry facing recession now.

Online selling of insurance policies to discerning customers, who access the internet, will gain momentum. Typically motor, travel and health policies will be sold more online. Many insurers have already realised this and are creating separate verticals to exploit this segment. The interplay of technology and telecom solutions will be a major factor determining the growth of the industry in the future.

Till recently, micro-insurance on the lines of micro-finance, is thought to be a magic word and insurers planned to bring retail products to suit this segment. Another area of opportunity is the government initiatives in health and PA covers for the populace. Rashtriya Swasthya Bima Yojana (RSBY) schemes and group PA covers sponsored by state and central governments are providing huge opportunities to insurers. While these schemes provide volumes, pricing and claims management is critical for success.

The Indian customers are demanding and expect best in class service levels so the entire insurance industry will have to work towards becoming more customer-centric in the areas of product development, policy issuance as well as claims settlement. They would need to constantly do market research to update their products, services and processes to keep up with the changing needs of their customers.

Completion of 10 years under new regime opens up new opportunities to those private sector insurance companies which started in 2001. According to law, they will become eligible to raise capital from public and make IPOs (initial public offerings). Obviously, the promoters would want to skim the cream; but timing of an IPO is crucial and more importantly, to present the right financials and a strong-balance sheet is imperative.

The public sector companies will definitely face an extremely competitive situation from the private sectors and the private sectors will in turn have to prove their competency to gain an edge over the public sectors and to grab a major piece of the market pie. Another major development in the future would be the number of private insurers in the space. This is expected to grow as various foreign companies have announced intentions to establish joint ventures. Given the low level of penetration in some segments, this trend towards foreign participation is likely to continue for some time. So, India will witness a major competition in the general insurance market and this definitely indicates a tough but exciting road ahead for the existing and upcoming players.

One major problem affecting the industry, like in all developing economies is the shortage of trained insurance professionals and technicians at all levels. So companies that are able to recruit and grow talent that continue to provide innovative insurance solutions for the underserved Indian market will be the ones that will rise and shine in the general insurance industry. The market is large and set for rapid growth but the ones that take the required calculated risks, have the right technical expertise, do not blindly go after market share and are customer-centric in their approach to the market will be the ones to benefit from this growth and become one of the biggest and best run insurance companies in the world.

Self Assessment

Fill in the blanks:

4. A leading consumer activist has been inducted into the Insurance Committee.

5. have been issued to insurers to file their existing and new products with the Authority.
6. income is a key determinant in the calculation of premium rates for any insurance company.
7. The companies are required to honour the awards passed by an within three months.
8. Underwriters should give up the old approach.

Notes



Case Study

Insurance Cover for Overseas Students

A private general insurance company has launched a policy for Indian students studying abroad or planning to do so. The policy pays for expenses incurred by the immediate family member if they visited the insured student in case of emergency or if the student had to visit them in similar circumstances.

The 'Student Suraksha - Student Overseas Travel' policy provides cover against unforeseen expenses such as hospitalisation, accidental death, permanent disablement and dental treatment. It has additional covers such as personal liability, bail bond, sponsors' protection, study interruption, loss of passport and checked-in baggage loss.

It includes worldwide cover for students from 30 days to 2 years without any medical or health check-up requirements. The policy can be bought by an individual between the age of 16 and 35, who is a full-time registered student of an education course outside India.

Question

Express your opinion on the insurance cover for overseas insurance.

Source: http://articles.timesofindia.indiatimes.com/2013-03-25/news/38009483_1_overseas-students-study-interruption-private-general-insurance

14.3 Summary

- Actuarial service refers to the method by which corporations determine, assess and plan for the financial impact of risk.
- Actuarial science is used to evaluate and predict future pay-outs for insurance and other financial industries such as the pension industry.
- Before liberalization the Insurance sector was controlled by Controller of Insurance but now the corporate body known as Insurance Regulatory & Development Authority (IRDA) has been formed under IRDA Act 1999.
- In the case of general insurance, investment income compensates underwriting losses, if any, of the insurance company, which in turn enables them to keep their premium rates competitive.
- An investment policy has to be submitted to the Authority by an insurer before the start of an accounting year.
- IRDA has recently notified regulations for Licensing of Third Party Administrators (TPA) – Health Services in order to popularize health insurance.

Notes

- It is expected that TPAs will bring some sort of regulation regarding standard and quality of treatment, period of treatment and rates.
- A system of grievance redressal has been built in the Authority supervised by one of its senior officers.
- Project-insurance sector will continue to be the major work-horse; with continued economic development spurring investment in power sector, manufacturing and other industries, roads and buildings.
- Catastrophe risk management system has to become robust as the insurance spreads in the semi-urban and rural areas.
- Newer pricing methods need to be developed for commercial lines. Underwriters should give up the old tariff-based approach and develop experience-based and actuarial-supported models for pricing.
- The recent development in the general insurance sector is the activities by the insurance regulator. The IRDA has been very stringent and has been keeping a close-watch on the functioning of all the insurance companies.
- Online selling of insurance policies to discerning customers, who access the internet, will gain momentum.
- The Indian customers are demanding and expect best in class service levels so the entire insurance industry will have to work towards becoming more customer-centric in the areas of product development, policy issuance as well as claims settlement.

14.4 Keywords

Actuarial Service: Actuarial service refers to the method by which corporations determine, assess and plan for the financial impact of risk.

Insurance Broker: An insurance broker sells, solicits, or negotiates insurance for compensation.

Insurance Policy: The printed form, which serves as the contract between an insurer and an insured.

Investment Income: It refers to income coming from interest payments, dividends, capital gains collected upon the sale of a security or other assets, and any other profit that is made through an investment vehicle of any kind.

Micro-insurance: A micro-insurance plan provides protection to individuals who have little savings and is tailored specifically for lower valued assets and compensation for illness, injury or death.

14.5 Review Questions

1. Explore the meaning of actuarial service. Give some examples of what actually actuaries do.
2. Discuss the policies and measures to develop insurance market.
3. Explain the research and development activities undertaken by the insurance companies.
4. Describe the concept of protection of interests of policyholders.
5. How will you monitor the investments of the insurers?

6. Explain the recent trends in health insurance.
7. Briefly explain the functioning of Ombudsman. Discuss current trends of the general insurance market briefly.

Notes

Answers: Self Assessment

1. Actuaries
2. Pay-outs
3. Probabilities, possibilities
4. Advisory
5. Guidelines
6. Investment
7. Ombudsman
8. Tariff-based

14.6 Further Readings



Books

- Gulati, Neelam. C. (2011), *Banking and Insurance*, Excel Books.
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- <http://www.nios.ac.in/media/documents/VocInsServices/m1-1f.pdf>
- <http://www.aliactuary.com/actuary.htm>

LOVELY PROFESSIONAL UNIVERSITY

Jalandhar-Delhi G.T. Road (NH-1)

Phagwara, Punjab (India)-144411

For Enquiry: +91-1824-300360

Fax.: +91-1824-506111

Email: odl@lpu.co.in