UNIT – I
Lesson 1
Introduction

LEARNING OBJECTIVES

After reading of this lesson, you will able to understand:

- Nature of Insurance
- History of Insurance
- Meaning of Insurance

1.1 Introduction

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

The Hindu philosophy gives the axiomatic truth, “yat bhavathi tat nasyathi” which mean whatever is created will be destroyed creation inevitably followed by destruction. Risk is therefore inevitable in life. The aim of insurance is to protect the owner from various risks which he anticipates. He who seeks this protection is called the assured or insured and the other person who takes the risk by undertaking to protect the other from loss is called the insurer and this is done for small consideration called the premium.

1.2 Nature of insurance

1.2.1 Insurance is a social device

According to Maclean, "Insurance is a method of spreading over a large number of persons to possible financial loss too serious to be conveniently borne by an individual".

Thus it serves the social purpose: it is "a social device whereby uncertain risks of individuals may be combined in a group and thus made more certain. The small periodic contributions by the individuals providing a fund out of which those who suffer losses may be reimbursed. Thus this institution of Insurance serves two-fold purpose, the immediate, short range and proximate purpose and the far-sighted long-range and remote purpose. The immediate and direct object is to protect the individual assured from any loss or damage to his life or property by distributing the loss among a large number of persons through the media of the professional risk-bearers, the insurers, thus insurance serves also the sociological purpose.

1.2.2 Insurance accelerate the economic growth

The far-sighted and long-range purpose of insurance is to accelerate the economic growth of the nation. The insurers collect the savings of numerous policyholders and these funds are invested in organized commerce and industry. They help the running of giant industries and mobilize the capital formation. By insuring the lives of the workmen, they are relieved of their anxiety and worry and they put their heart and soul in their work. The employer too by insuring the lives of workmen, his machinery, building etc, will have peace of mind and can become carefree. On the other hand the insurers will have large funds available with them which they may utilize in helping the formation of big industries directly or by underwriting securities of those companies which tend to grow the commercial prosperity of the nation. It is said about insurance "There is no denying the fact that growth of industrialization is an adventure in which the triumvirate namely. industry, credit and cover of insurance make a sojourn in each other`s companionship" Insurance thus reduces the fears of the future risks to the individual insured and by capital formation it helps the growth of industrialization, accelerates production, lubricates the machinery of production and distribution and improve the economy of the nation. It mobilizes idle resources, accelerates and stabilizes growth and help in the establishment of a welfare slate.

1.1.3 insurance is a cooperative device

Insurance work with the cooperation of large number of persons who agree to share financial loss arising due to particulars risk insured due to this cooperation an insurer would be able to compensate all the losses. Like any other cooperative devices there is no compulsion here on anybody to purchase the insurance policy. A person purchase insurance policy voluntarily or through publicity or through advice of agent.

1.1.4 Insurance is not a gambling

Insurance and gambling was considered alike because there are uncertainty of events and payment is made when the event occurs. Like gambles the insured is unaware of the time and amount of loss. If the event occurs, the insured like the gambler gains, otherwise they are experiencing the loss. But there are certain differences between the insurance contract and gambling.

In insurance, risks are existing, they may occur at any time. For example, death, old age, fire, marine perils, accident, etc., may occur at any time, if there is no insurance, the person will suffer at the occurrence of these perils, but if insurance is taken against these risks, the insurer will provide a fixed amount or indemnify the amount of loss occurred due to the insured perils. Thus, insurance is protection against these risks.

In case of gambling, the risk does not exist, it is being created for game or amusement while one will suffer and another will gain. In absence of such game, nobody will suffer. In absence of insurance, the property owner will suffer while due to insurance, no party will suffer.

1.3 History of Insurance

1.3.1 Marina Insurance

Marine insurance was the oldest type at insurance the evidence of this can be seen in the early vedic civilizations as well as Mesopotamian civilization when trader collided amount to fulfilling the losses which might be occurred during see

time to any of them but in its modern form it was firstly developed in England and it was imported into it from the cities of Northern Italy 'Where it probably began at about the end of the twelfth century. On the passing of the Bubble Act. 1720 in the same year London Assurance and Royal Exchange Assurance obtained charters and the Act created a monopoly in marine insurance to these corporations by prohibiting other who were incorporated corporations, partnerships and societies from engaging in marine insurance as a business. Even before these corporations were granted the charters, individual merchants used to meet in Lombard Street and effect contracts of marine insurance and they continued as competitors to the chartered companies. It was only during the eighteenth century that marine insurance was started as a specialized business. Coffee-houses were the common meeting places for the businessmen and most important business transactions were negotiated there during the latter half of the seventeenth century and the early eighteenth century. Of such coffee-houses, Lloyd's coffee-house named after its proprietor Edward Lloyd, who opened the coffee-house in the Tower street ct London, became a rendezvous for the ship owners, seamen and merchants. Sometime later, the proprietor of Lloyd's started a business newspaper called Lloyd's List (l734) which is published even today. Slowly it gained influence and found place in the premises of the Royal Exchange and sometime later had its own building adjacent to that and became a world-wide organization.

The Royal Exchange Assurance and the London Exchange from the corporation side and the Lloyds being a common meeting place for the individual underwriters started and developed the marine insurance in England. The corporation's monopoly was repealed after a little over a century that is in 1824, when a few joint stock companies entered the Gild. Many companies were formed after the passing of the Joint Stock Companies Act, 1862. By about this time the steamship was invented and foreign trade improved. As at result the marine insurance also expanded and provided sufficient business both to the joint stock companies and the individual underwriters, who created a world

market for marine insurance. The marine insurance business is today regulated by the provisions of the English Marine Insurance Act, 1906, in England.

In India even during Aryan period there was evidence of the existence of something like marine insurance but marine insurance. as known in the civilized world today, had its origin only in England. Seven marine insurance companies, of which none is in existence today, were started between 1797 and 1810, in Calcutta. Later mostly, composite offices were started. Most or the British offices had branches in India and they acted as world offices. Early monopoly and later increased rates of duties charged on British offices tempted them to form independent offices in the colonies of the common-wealth including India and thus the British offices exercised tremendous insurance in the Indian insurance market. The rules in English law were applied in India with little variations to adapt them to Indian circumstances. After Independence and with the abolition of the Privy Council, of course, the Indian Superior courts including the Supreme Court started drawing authority from the other foreign sources, like the America cue;. But today the marine insurance is regulated by the Indian Marine Insurance Act, 1963 which is a replica of the English Marine Insurance Act, 1906.

1.3.2 Fire Insurance

After marine insurance, fire insurance was next to be organized in England. The Great Fire of London, 1666, was mainly responsible for the establishment of this brunch of insurance. Added to this the effects of Industrial Revolution in England enormously exposed the properties to the risk of fire and the need for fire insurance increased. Again impetus for organized action given by the disaster of Tooley Street Fire, l86l. If the first great Fire originated this branch of insurance the second became responsible for streamlining the organization and blended the two paradoxical principles of competition and collaboration, The Fire officer's Committee consisting of representatives of all insurers was formed. It established for the public benefit a Fire Testing Station with the collaboration of Government Departments and ultimately established the Joint Fire Research Association (1946). The fire offices had enough business both at home and abroad.

In India most of the successful Fire insurance business was only through brokers and branches of foreign companies of Britain. America and even Japan. ‘The Alliance British and Foreign Fire Insurance Co.’ first established an agency office at Madras and probably this agency owes was the first to issue a fire policy in India. Soon the other offices like the ‘Royal Insurance Co.’, ‘The Liverpool and London and Globe’. ‘North British and Commercial Union' started many branch offices at Bombay, Calcutta and other presidency towns slowly the business spread to the other states. During the last century many fire offices were started but were closed down shortly. With nationalization of General Insurance business. Fire insurance became more organized in India.

1.3.3 Life Insurance

Life insurance made its first appearance in England, even before the mortality tables were available, mutual life assurance was prevalent in the 17th century commencing with short-term insurance and all these mutual offices disappeared with the passing of the Bubble Act, 1720. Only ‘Amicable Society’ survived. It was started in 1705 and its business increased by 1757. In 1807, a fresh charter was obtained and the Amicable thereafter transacted life insurance according to modern methods. For a number of decades it was the only society which used to officer whole life assurance. In the meanwhile mortality tables were prepared which made it possible to do profitable and scientific life insurance business. Towards the end of 17th century the requirement of insurable interest was done away with when life business became a gambling. To check this evil. Life Assurance Act, I774 was passed. Then came big joint stock companies which started business on sound and scientific principles. The protective legislation; like Policies of Assurance Act, 1867, the Life Assurance Companies Act, 1870 were passed. The Act of 1867 which regulated the life insurance business was repealed and replaced by Assurance Companies Act. 1909 and the legislation now in force is in the Insurance Companies Acts, 1958-67. In the later years ordinary life business was ex-tended to Accident Insurance and further by industrial and technological advancements to Industrial Insurance Instances of

this branch can be found in Liability Insurance such as Engineering. Motor Vehicles, Aviation Insurances.

In India the known history of life insurance commenced in 1871 with the starting of ‘Bombay Mutual' followed in 1874 by the ‘oriental’, both in Bombay.

1.3.4 Development of Life Insurance in India

Life Insurance in its modern from came to India from England in the year 1818. Oriental life insurance started by Europeans In Calcutta was the first life insurance company on India soil. All the insurance companies established during that period were brought up with purpose of looking after the need of European community and Indian natives were not being insured by these companies. However, later with effort of eminent people like BABU MUTTY LAL seal, the foreign life insurance companies started insuring Indian lives. But Indian lives were being treated as sub-standard lives and heavy extra premiums were being charged on them. The Bombay Mutual Life Assurance Society heralded the birth of first Indian life insurance company in the year 1870, and its covered Indian lives at rates. Starting as Indian enterprise with highly patriotic motive, insurance companies came in to existence to carry the message of insurance and society. However, after independence on the 19°" of January, 1956, that life insurance in India was nationalized. About 154 India insurance companies, 16 none — Indian companies and 75 provident societies were operating in India at the time of nationalization. Nationalization was accomplished In two stages; initially the management of the companies was taken over by mean of an ordinance, and Later, the ownership too by means of a comprehensive bill, the Parliament of Indian passed the life insurance corporation Act on the 19'" of June 1956, and life insurance corporation of India was created on 1s' Sep. 1956 with the objectives of spreading insurance much more widely and in particular to the rural areas with a view to reach all insurable persons in the country , and providing them adequate financial cover at a reasonable cost. Its Headquartered is in Mumbai, which is considered the financial capital of India, the LICI had 8 zonal office and Divisional offices, at Iaest 2048 branches located in different areas. Insurance

sector has merged as most prominent sector in the financial sector services during the recent time particularly in the developing economies like India. The pace of development of insurance sector has accelerated with the process of opening of their economies to the outside world under the WTO regime. Today, in fact, it has comprehensively networked itself in almost all part of the society. The Union government had opened up the insurance sector for private participation in 1999, also allowing the private company to have foreign equity up to 26 percent. The Indian insurance sector was thrown open to the private sector in 2000and the first company to start selling its policies, ICICI prudential, did so on Dec. 12,2000. Today there are 13 private sector life insurance firms together; they have a 26 percent of the market and seven non life ones in the country.

1.4 Definition of Insurance

1.4.1 On the basis of cooperation

Insurance is a co-operative device to spread the loss caused by a particular risk over a large number of persons who are exposed to it and who agree to ensure themselves against the risk.

1.4.2 Contractual definition:

Insurance is a contract between two parties where-by one party called insurer undertakes, in exchanges for a fixed sum called premiums, to pay the other party called insured a fixed amount of money on the happening of certain event.

1.4.3 Social device point of view:

Insurance is a social device to accumulate fund to meet the uncertain leaves arising through a certain risk to a person insured against the risk.

According to Mae Gill, “Insurance is a process in which uncertainties are made certain.”

According to john Megi, “Insurance is a plan wherein persons collectively share the losses of risks.”

According to Rock Fell, “Insurance is a source of distribution of loss of few persons into many persons.”

According to Reigel and Miller, “The function of insurance is primarily to decrease the uncertainty of events."

According to William Beveridge, “The collective bearing of risk is insurance.”

DH, Magee has defined. "Insurance as a plan by which large number of people associate themselves and transfer, to the shoulders of all, risks attached to individuals.”

Thomson has defined it as, “Insurance is a provision which a prudent man makes against fortuitous or inevitable contingencies, loss or misfortunes. It is a Form of spreading risks.”

According to Prof. R.S. Sharma, “insurance is a co-operative device to spread loss, caused by a particular risk over a number of persons who are exposed to it, who agree to insure themselves against that risk."

1.4.4 Legal Definitions

According to Chief justice Tindal, "Insurance is a contract in which a sum of money is paid by the assured in consideration of the insurer’s incurring the risk of paying a large sum upon a given contingency" According to Britannica Encyclopedia, “Insurance may be described as a social device whereby a large group of individuals through a system of equitable contributions may reduce or eliminate certain measurable risks of economic loss common to all members of the group.”

In legal terms, insurance is a contractual agreement whereby one party agrees, for a consideration called premium, to compensate another party for losses. Thus, an insurance transaction involves the following;

Insurer: The parry agreeing to pay for the losses of the insured.

Insured: The parry who insured his risk with the insurer.

Premium: The payment to the insurer received from the insured for indemnifying the losses.

policy: Is the contract between the insurer and insured that sets the contractual obligation between the two.

Exposure to loss: The insured’s possibility of incurrence of loss is called the insured’s exposure to loss.

1.5 characteristics of Insurance

The insurance is based upon (ij Principles of Co-operation, and (ii) Principles of Probability. (I) Principle of Co-operation. Insurance is a co-operative device. If one person is providing for his own losses, 1t cannot be strictly an insurance because in insurance, the loss is shared by a group of persons who are willing to co-operate. In ancient period, the persons of a group were willingly sharing the loss to a member of the group. They used to share the loss to a member of the group. They used to share the loss at the time of damage. They llected enough funds from the society and paid to the dependents prevailing from the very beginning up to the of Christ in most of the countries. Lately, the co-operation another form where it was agreed between the individual society to pay a certain sum in advance to be a member of the so The society by accumulating the funds, guarantees payment of tain amount at the time of loss to any member of the society. accumulation of funds and charging of the share from the in advance became the job of one institution called insurer. it became the duty and responsibility of the insurer to obtain quate funds from the members of the society to pay them at happening of the insured risk. Thus, the shares of loss took form of premium. Today, all the insured give a premium to the scheme of insurance. Thus, the insured are cooperating share the loss of an individual by payment of premium in advance

Theory- of Probability

The loss in the shape of Premium can be distributed only on the basis of theory of probability. The chances of loss are estimated in advance to affix the amount of premium. Since the degree of loss depends upon various factors, the affecting factors are analyzed before determining the amount of loss with the help of this principle, the uncertainty of loss is converted to certainty. The insurer will have not to suffer loss as we have to gain windfall. Therefore, the insurer has to-charge only so much of amount which is adequate to meet the loss. the probability tells what arte the chances of losses and what will be the amount of loss. the premium is determined on the basis of loss.

the inertia of large number is applied while calculating the probability. the larger the number of exposed persons the better and the more practical would be the findings of the probability. therefore, the law of large number is applied in the principle of probability in each and every field of insurance the law of large number is essential. These principles keep in account that the past events will incur in the same inertia. the insurance on the basis of past experience present conditions and future prospects fixes the amount of premium. Without premium no co-operation is possible and the premium can not be calculated without the help of theory of probability and consequently no insurance is possible. so, these two principles are the two main legs of insurance.

SELF CHECK QUESTIONS

Class Assignment:

1. Define the term Insurance, Discuss the nature of insurance.
2. Discuss the characteristics of insurance.
3. Differentiate between:
   (i) Insurance contract & wagering contract
   (ii) Insurance & Gambling
   (iii) Insurance & charity

Home Assignment:

1. Describe the evolution and historical development of Insurance.

Lesson 2

Classification and Role of Insurance

LEARNING OBJECTIVES

After reading this lesson, you will be able to understand.

- Various forms of Insurance
- Types of Life Insurance
- Types of Non-life Insurance
- Role of Insurance

2.1 Various forms of Insurance

The earliest traces of insurance in the ancient would are found in the form of marine insurance all other insurance form have evolved from it. The basic principles of insurance are applied to all kinds of insurance with necessary changes. Insurance companies have organized policies based on marker needs, into different groups. Insurance regulatory authorities have recognized the classification of insurance into different groups. Insurances can be broadly classified into life and non-life insurance.

2.1.1 Life insurance

In the life insurance the subject matter of insurance is life of human being. In this insurance contract the subject matter of insurance is life of human being. The insurer pays the fixed amount of insurance claim either at the time of death or at the expiry of certain period. This insurance provided protection as well as investment because certain amount is always returnable to insurer at the time of death or at the expiry of a period. Life insurance is the insurance of human life and is a long-term business.

2.1.2 Non Life Insurance

Non life insurance is an annual insurance business with some exceptions. General insurance covers all other categories of insurance other than life. It includes property

insurance, liability insurance, fidelity insurance and all other forms of insurance. In some cases like engineering (general insurance), the policy period for dwellings and contents is more than one year. Under the IRDA Act, I999, life and non-life business have to be done under separate companies. A company is not allowed to do both businesses simultaneously.

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

2.1.3 Marine Insurance: This insurance provides protection against loss of marine. It covers cargo, hull and freight, It cover both ocean and inland risk also. It include Even oil rigs and drilling platforms are covered under this category. Thus, it also covers perils which may arise with the delivery of cargo from godown of importer to the godown of importer.

2.1.4 Fire Insurance: Fire insurance covers risks of fine. The fire insurance does not protect only losses fine but it also provides protection for certain consequential loss also. It covers the movable and immovable assets against fire and allied perils. Few examples are engineering machinery breakdown, loss of profits and project insurance, Liability including employer's liability, Workman's Compensation Act policy, public liability product and professional indemnity policy. Fire insurance, there are certain besides Marine and other insurance which are included under general insurance.

2.1.5 Miscellaneous Insurance

It includes goods, machine, furniture automobile and valuable article etc.

1. **Aviation Insurance:** It covers the cargo and passengers liability travelling by air.
2. **Personal Accident:** It includes health and medical insurance.
3. **Motor Insurance:** It covers the private and commercial vehicles against damages and destruction.
4. **Third Party Liability Insurance:** 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.

2.1.6 Other Forms of Non Life Insurance

Include insurance like, burglary, cash in transit, fidelity guarantee, and export credit insurance, State employees insurance, liabilities of the automobile owners and reinsurance.

2.1.7 Federate Guarantee Insurance

It includes loss arising due to dishonesty, disappearance of the employers it is an essential insurance protection for it seeks to indemnity the employer against direct pecuniary loss that he may sustain through act of fraud or dishonesty by an employee. Thus fidelity guarantee originate in fiduciary relationship where confidence and trust plans a crucial part.

Difference between Life Insurance and Non Life Insurance:

1. General insurance contracts are yearly contracts and are based on the indemnity principle. This makes a difference in the premium calculation, which is also complicated as more variables are taken into account than in life insurance. On general insurance, some policies insures the life and health of person but they are all annual contracts. They are benefit policies unlike other general insurance products; they are not based on indemnity.
2. 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, it may even suffer from loss of value, become obsolete, out-of-fashion or difficult to service, etc. So the calculations are preferably on an annual basis. Whereas in life insurance subject matter is life which does not posses above mentioned features.
3. In 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 dues nor occur. Nu 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.

Difference between Insurance and Assurance

Insurance (Non-Life Insurance		Assurance (Life Insurance)	
1.	The team 'Insurance' is used for non-life Insurance contracts.	1.	The term Assurance is referred to life insurance business.
2.	In the case of insurance, loss due to risk is not certain loss may or may not happen.	2.	Loss due to risk is certain to happen. Death is bound to happen sooner or latter.
3.	Generally goods or property are the subject matter of non life insurance.	3.	Human life is the subject matter of life insurance contract.
4.	Insurance contract is usually for one year.	4.	Life insurance contract is a continuing contract, i.e., long-term contract.

2.2 TYPE 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 -term insurance and pure endowment. All other policies are variations of these two basic policies.

Term insurance

Term insurance is 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.

Endowment Insurance

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: morality rate, interest rare and expenses.

Endowment policies are long term as long as 15, 20, and 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 installment 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 installments for specific needs like children's education and last survivor benefits are also available. The major goal of the insurance business is earning the maximum income out of the life fund and matching the assets with liabilities. The surplus items are distributed among the policyholders in the form of bonus or in case, policies may be offered as a reduction to the premium payable.

2.3 Importance of Insurance in India

The history of insurance dates back to the Industrial Revolution in the west and the consequent growth of sea-faring trade and commerce in the 17th century. It came to India as a legacy of British occupation. General Insurance in India has its roots in the establishment of Triton Insurance Company Ltd., in the year 1850 in Calcutta by the British. In 1907, the Indian Mercantile Insurance Ltd. was set up. This was the first company to transact all classes of general insurance business. In India two corporation were established under separate to deal with the insurance business. The Life Insurance Corporation of India (L.I.C.) established under the said act. It started its function Since September, 1956.

In 1968, the Insurance Act was amended to regulate investments and set minimum solvency margins. The Tariff Advisory Committee was also set up then.

In 1972 with the passing of the General Insurance Business (Nationalization) Act, general insurance business was nationalized with effect from 1st January, 1973. The General Insurance Corporation of India established under General Insurance Corporation of India Act 1972 into four distinct companies. Which are National Insurance Company Ltd., the New India Assurance Company Ltd., the Oriental Insurance Company Ltd. and the United India Insurance Company Ltd. The General Insurance Corporation of India was incorporated as a company in 1971 and it commence business on 1st January, 1973.

The word “Bima was derived from the Persian word Bim.” meaning fear and “Bima” means expense incurred to get rid of fear. The purpose of insurance is to safeguard the interest of people from fear of uncertainty by providing certainty of payment at the time of future contingency.

This millennium has seen insurance come a full circle in a journey extending to nearly 200 years. The process of reopening of the sector had begun in the early 1990s and the last decade and more has seen it been opened up substantially. In 1993, the Government set up a committee under the chairmanship of R.N. Malhotra, former Governor of RBI, to propose recommendations for reforms in the insurance sector. The objective was to complement the reforms in the financial sector. The committee submitted its report in 1994 wherein, among other things, it recommended that the private sector be permitted to enter the insurance industry. They stated that foreign companies be allowed to enter by floating Indian companies, preferably a joint venture with Indian partners.

Following the recommendations of the Malhotra Committee report, in 1999, the Insurance Regulatory and Development Authority (IRDA) was constituted as an autonomous body to regulate and develop the insurance industry. The IRDA was incorporated as a statutory body in April, 2000. The key objectives of the IRDA include promotion of competition so as to enhance customer satisfaction through increased consumer choice and lower premiums, while ensuring the financial security of the insurance market.

The IRDA opened up the market in August, 2000 with the invitation for application for registrations. Foreign companies were allowed ownership of up to 26 %. The Authority has the power to frame regulations under section 114A of the Insurance Act, 1938 and has from 2000 onwards framed various regulations ranging from registration of companies for carrying on insurance business to protection of policyholders, interests.

In December, 2000 the subsidiaries of the General Insurance Corporation of India were restructured as independent companies and at the same time GIC was converted into a national re-insurer. Parliament passed a bill de-linking the four subsidiaries from GIC in July, 2002.

Today there are 14 general insurance companies including the ECGC and Agriculture Insurance Corporation of India and 14 life insurance companies operating in the country.

2.4 Importance and functions of Insurance

1. Insurance provide protection

It protect against uncertainty. It share the financial losses which might occur to an individual or his family on the happening of some event like in life insurance it provides safety against losses which might occurred at the time of death or in old age. In non life insurance losses due to fine, marine parity theft, accident destruction of goods and property are provided by insurer.

2. It eliminates uncertainty:

Uncertainty is removed by providing certainty of payment at the time of loss and payment is made on the happening of certain contingency.

3. Insurance Provides Motivation:

The security against future uncertainty provides peace of mind to an individual and he works without fear and peacefully. Thus it motivate people to work more and more happily.

4. Life Insurance fulfill needs of a person:

Like need of family at the time of death of bread corner old age need when a person becomes weaker to earn lively hood. It removes dependency of family at the time of need of money for higher education, marriage of children, for social obligations all the benefits of life insurance encourage people for saving their money. Systematic saving is possible because regular premium is required to be paid. Insurance get protection at the time of need therefore life insurance provides profitable investment by its different types of policies.

5. Insurance help in capital formation: Insurance sector in capital formation in several ways, a few have been enumerated below:

i. It accepts the risk from people and corporate bodies who are exposed to them.
ii. It collects small amounts of premium, which are pooled together to be called an insurance fund. This fund is used for investment purpose.
iii. It organizes compulsory insurance in certain areas as per the provisions of the law
iv. It sells voluntary insurance covers through its sales force.
v. 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 after meeting claims, it distributes it among its policyholders in the form of bonus or reduction in premium.
vi. It follows the principles of Indian Contract Act which helps to prevent its misuse or abuse.

SELF CHECK QUESTIONS

Class Assignment:

1. Explain the various kind of Insurance.
2. Explain how life insurance is different from non-life insurance.

Lesson 3
Essential of Insurance contract

Objectives:

- Features of general contract
- Features of special contract

3.1 Features of general contract

The valid contract, according to Section 10 of Indian Contract Act 1872, must have the following essentialities.

3.1.1 Offer and acceptance

Legal consideration.

Competent to make contract.

Free consent.

Legal object.

3.1.1 Offer and Acceptance

The offer for entering into contract may generally come from the insured. The insurer may also propose to make the contract whether the offer is from the side of insurer or from the side of insured, the main fact is acceptance. Any act that precedes it is an offer or a counter-offer All that precede the offer or counter offer is an invitation to offer, In insurance, the publication of prospectus, the canvassing of the agents are invitations to offer. When the prospect (the potential policyholder) proposes to enter the contract it is an offer and if there is any alteration in the offer that would be a counter-offer. If this alteration or change (counter-offer) is accepted by the proposer, it would be an acceptance. In absence of counter-offer, the acceptance of offer will be an acceptance by the insurer. At the moment, the notice of acceptance is given to other party, it would be a valid acceptance.

3.1.2 Legal Consideration

The promiser to pay a fixed sum at a given contingency is the insurer who must have some return for his promise. It need not be money only but it must be valuable. It may be sums, right, interest, profit, or benefit. Premium being the valuable consideration must be given for starting the insurance contract. The amount of premium is not important to begin the contract. The fact is that without payment of premium, the insurance contract cannot star

3.1.3 Competent to make contract

Every person is competent to contract (a) who is of the age of majority according to the law, (b) who is of sound mind, and (c) who is not disqualified from contracting by any law to which he is subject. A minor is not competent to contract. A contract by a minor is void excepting contracts for necessaries. A minor cannoning a contract 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 ICS effect upon his interests, A person who is usually of unsound mind, but occasionally of sound mind may make a contract when he is of sound mind. An alien enemy, undischarged insolvent and criminals cannot enter into contract. Contract made by incompetent party/parties will be void.

3.1.4 Free Consent

Parties entering into the contract should enter into it by their free consent. The consent will be free when it is not caused by-

(1} coercion, (2) undue influence, (3) fraud, or (4) misrepresentation, or (5) mistake. When there is no free consent except fraud sent was so caused. In case of fraud the contract would be void. The proposal for free consent, must sign a declaration to this effect the person explaining the subject-matter of the proposal to the proposer must also accordingly make a written declaration on the proposal.

3.1.5 Legal Object

In order to make a valid contract, the object of the agreement should be lawful. An object that is (i) not forbidden by law or (ii) is not immoral, or (iii) opposed to public policy, or (v) which does not defeat the provisions of any law, is lawful. In proposal from the object of insurance is asked which should be legal and the object should not be concealed. If the object of insurance, like the consideration, is found to be unlawful, the policy is void.

3.2 Features of special contract

3.2.1 INSURABLE INTEREST

For an insurance contract to be valid, the insured must possess an insurable interest in the subject matter of insurance. The insurable interest is the pecuniary interest whereby the policy-holder is benefited by the existence of the subject-matter and is prejudiced by the death or damage of the subject-matter The essentials of a valid insurable interest are the following:

(i) There must be a subject-matter to be insured.

(ii) The policy-holder should have monetary relationship with the subject-matter.

(iii) The relationship between the policy-holders and the subject-matter should be recognized by law. In other words, there should not be any illegal relationship between the policy-holder and the subject matter to be insured.

(iv) The financial relationship between the policy-holder and subject-matter should be-such- that the policy-holder is economically benefited by the survival or existence of the subject-matter and/or will suffer economic loss at the death or non existence of the subject matter.

The subject-matter is life in the life insurance, property ant goods in property insurance, liability and adventure in general insurance. Insurable interest is essentially a pecuniary interest, i.e., the loss caused by the happening of the insured risk must be capable of computation or an anxiety, would be the ground of the insurable interest. The event

insured should be one that if it happens the party sufficient financially and if it does not happen, the party is benefited by the existence. But a mere hope or expectation, which may be frustrated by the happening of some extent, is not an insurable interest.

3.2.2 UTMOST GOOD FAITH

The doctrine of disclosing all material facts is embodied in the important principle 'utmost good faith' which applies to all forms insurance, Both Darties.0f.the insurance contract must he of the same mind (ad idem) at the time of contract. There should not any misrepresentation, non-disclosure or fraud concerning the material facts. In case of insurance contract the legal maxim 'Cave Emptor' (let the buyer beware) does not prevail, where it is regarded the duty of the buyer to satisfy himself of the genuineness of the subject-matter and the seller is under no obligation to supply information about it. But in insurance contract, the seller, i.e., the insurer will also have to disclose all the material facts. The contract must disclose all the material facts truly and fully.

3.2.3 Material Facts

A material fact is one which affect the judgment or decision both parties in entering to the contract Facts which count materially are those which knowledge influence a party in decide whether or not to offer or to accept such risk and if the risk is acceptable, on what terms and conditions the risk should be accepted These facts have a direct bearing on the degree of risk in relation he the subject of insurance. In case of life insurance, the material facts or factors affecting the risk will be age, residence, occupation health, income, etc., and in case of property insurance, it would use design, owner and situation of the property.

3.2.4 Full and True Disclosure

The utmost Good Faith says that all the material facts should be disclosed in true and full form. It means that the facts should be disclosed in that form in which they really exist, There should be no concealment, misrepresentation, mistake or fraud about the material facts There should be no false statement and no have have truth nor any silence on the material facts.

3.2.5 Duty of Both the Parties

The duty to disclose the material facts lies on both the parties, the insured as well as the insurer, but in practice the assured has to be more particular, about the observance of this principle because he is usually in full knowledge of facts relating to the subject—matter which, despite all effective inspections of the insurer, would not be disclosed.

Facts need not be disclosed by the insured

The following facts, however, are not required to be disclosed by the insured:

(i) Facts which tend to lessen the risk.

(ii) Facts of public knowledge,

(iii) Facts which could be inferred from the information disclosed.

(iv) Facts waived by the insurer.

(v) Facts governed by the conditions of the policy.

3.2.6 PRINCIPLE OF INDEMNITY

As a rule insurance contracts except personal insurance are contracts of indemnity According to this principle, the insurer undertakes to put the-insured, in the event of loss, in the same position that he occupied immediately before the happening of the event insured against. In certain form of insurance, the principle of indemnity is modified to apply. For example, in marine or fire insurance, sometimes, certain profit margin which would have earned in absence of the event, is also included in the loss. In true sense of the indemnity, the insured is not entitled to make a profit of his loss.

Uses

(i) To discourage over insurance

The principle of indemnity is an essential feature of an insurance contract, in absence whereof this industry would have the hue of gambling and the insured would tend to effect over-insurance and then intentionally cause a loss to occur so that a financial gain could be achieved. So to avoid this

intentional loss, only the actual loss becomes payable and not the Assured sum (which is higher in over-insurance). If the property is under-insured, i.e., the insured amount in less than the actual own insurer for the amount if under-insurance and in case of loss shall share the loss himself.

(ii) To avoid an Anti-social Act

If the assured is allowed to gain more than the actual loss, which is against the principle of indemnity, he will be tempted to gain by destruction of his own property after getting it insured against risk. He will be under constant temptation to destroy the property. Thus, the whole society will be doing only anti-social act, i.e., the persons would be interested in gaining after destruction of the property. Sc, the principle of indemnity has been-applied where on the cash-value of his loss and nothing more than this, though he might have insured for a greater amount, will be compensated.

(iii) To maintain the Premium at Low-level

If the principle of indemnity is not applied, larger amount will he paid for a smaller loss and this will increase the cost of insurance and the premium of insurance will have to be raised. If premium is raised two things may happen-first, persons may not be incline to insure and second, unscrupulous persons would get insurance destroy the property to gain from such act. Both things would defeat the purpose of insurance. So, principle of indemnity is help to help them because such temptation is eliminated when only actual loss and not more than the actual financial loss is compensated provided there is insurance up to that amount.

Conditions for Indemnity Principle

The following conditions should be fulfilled in full application principle of indemnity.

(i) The insured has to prove that he will suffer loss on the insured matter at the time of happening the event and the loss is actual monetary loss.

(ii) The amount of compensation will be the amount of insurance. Indemnification cannot be more than the amount insured.

(iii) If the insured gets more amount than the actual loss. The insurer has right to get the extra-amount back.

(iv) If the insured gets some amount from third. party after being fully indemnified by insurer, the insurer will have right that all the amount paid by the third party.

(v) The principle of indemnity does not apply to personal insurance because the amount of loss is not easily calculable there.

3.2.7 DOCTRINE OF SUBROGATION

The doctrine of subrogation refers to the right of the insurer to stand in the place of the insured, after settlement of a claim, in so far as the insured's right of recovery from an alternative source is involved. If the insured is in a position to recover the loss in full or in part from a third party due to whose negligence the loss may have been precipitated, his right of recovery is subrogated to the insurer on settlement of the claim. The insurers, thereafter, re-cover the claim from the third party. The right of subrogation may be exercised by the insurer before payment of loss.

Essentials of Doctrine of Subrogation

(i) Corollary to the Principle of indemnity: The doctrine of subrogation is the supplementary principle of indemnity. The latter doctrine says that only the actual value of the loss of the property is compensated, so the former, follows that if the damaged property has any value left, or any right against a third party the insurer can subrogate the left property or right of the property because if the insured is allowed to retain he shall have realized more than the actual ineip1e of indemnity.

(ii) Subrogation is the Substitution: The insurer, according to this principle, becomes entitled to all the rights of insured subject-matter after payment because he has paid the actual loss of the property. he is substituted in place of other persons who act on the right and claim of the property insured."

(**iii) Subrogation only up to {he amount of payment:** The insurer is subrogated all the rights, claims, remedies and securities of the damaged insured property after indemnification, but he is entitled to get these benefits only to the extent of his payment, The insurer is, thus, subrogated to the alternative rights and remedies of the insured, only up to the amount of his payment to the insured. In the same way if the insured is compensated for his loss from another party after he has been indemnified by his insurer he is liable to part with the compensation up to the extent that the insurer is entitled to. In one U.S, case it was made clear "If the insurer, having paid the claim to the insured, recovers from the defaulting third party in excess of the amount paid under the policy, he has to pay this excess to the insured though he may charge the insured share of reasonable expenses incurred in collecting.

(iv) The Subrogation may be applied before Payment: If assured got certain compensation from third party before he fully indemnified by the insurer, the insurer can pay only the part of the loss.

(v) Personal Insurance: The doctrine of subrogation does apply to personal insurance because the doctrine of indemnity not applicable to such insurance. The insurers have no right action against the third party in respect of the damages, For example, if an insured dies due to the negligence of a third party dependent has right to recover the amount of the loss from the party along with the policy amount. No amount of the poll would be subrogated by the insurer.

3.2.8 WARRANTIES

There are certain conditions and promises in the insurance contract which are called warranties. According to Marine insurance Act, “A warrant is that by which the assured undertakes the some particular thing shall or shall not be done, or that some conations shall be fulfilled, or whereby he affirms or negatives the exigence of a particular state of facts." Warranties which are mention in the policy are called express warranties. There are certain warranties which are not mentioned in the policy. These warrant are called implied warranties. Warranties which are answers to the question are called affirmative

warranties. The warranties fulfilling certain conditions or promises are called promissory warranties.

Warranty is the Very important condition in the insurance contract which is to be fulfilled by the insured. On breach of warranty as insurer becomes free from his liability 'therefore insured must have to fulfill the condition and promises during the insurance contract whether it is important or not in connection with the risk. The contract can continue only when warranties are fulfilled. If warranties are not followed, the contract may be cancelled by the other to other reason than the waiving of warranties. However, when the Warranty is declared illegal and there is no reverse effect on the contract, the warranty can be waived.

3.2.9 Proximate Cause

The rule is that immediate and not the remote cause is to be regarded. The maxim is sed cause proxima non-remote specluturc, ie., see the proximate cause and not the distant cause. The real cause must be seen while payment of the loss. If the real cause of loss is insured, the insurer is liable to compensate the loss; otherwise the insurer may not be responsible for loss, · But, proximate cause is not a device to avoid the trouble of discovering the real cause or the common sense cause. Proximate cause means the active efficient cause that sets in motion a train of events which brings about a result, without intervention of any force started and working actively from a new and independent source.

The determination of real cause depends upon the working and practice of insurance and circumstances to losses. A loss may not be occasioned merely by one event. There may be concurrent causes or chain of causes. They may occur in a sequence or in broken chain. Sometimes, certain causes are excepted by the insurance contract and the insurer is not liable for the accepted peril.

The efficient cause of a loss is called the proximate cause of the loss. For the policy to cover the loss must have an insured peril as the proximate cause of the loss or also the insured peril must occur in the chain of causation that links the proximate cause with the

loss. The proximate cause is not necessarily, the cause that was nearest to the damage either in time or in place, but is rather the cause that was actually responsible for loss.

Determination of Proximate Cause

(i) If there is a single cause of the loss, the cause will be the proximate cause and further if the peril (cause of loss) was insured insurer will have to indemnify the loss.

(ii) If there are concurrent causes, the insured perils and excepted perils have to be segregated. The concurrent causes may be first, separable and second, inseparable. Separable causes are those which can be separated from each other. The loss occurred due to a particular cause may be distinguishing known. In such a case, if any cause is excepted peril, insurer will have to pay up to the extent of loss which occurred due to insured perils. If the circumstances are such that the perils are inseparable, then the insurers are not liable at all when there is excepted peril.

(iii) If the causes occurred in form of chain, they have to be observed seriously.

3.2.10 ASSIGNMENT OR TRANSFER OF INTEREST

It is necessary to distinguish between assignment of (a) subject-matter of insurance, (b) the policy, and (c) the policy matter when payable.

Marine and life policies can be freely assigned but assign under Era and accident policies are not valid without the prior sent of the insurers—except changes of interest by will or operation of law. Moreover, assignments under fire and accident policy must be made before the insured parts with his interest. One has lost the interest, the policy is void and cannot he assigned. The life policies can be assigned whether the assignee has insurable interest or not. Life policies are frequently change assigned or otherwise dealt with, for they are valuable security A marine policy is freely assignable unless it contains terms clearly prohibiting assignment. It assigned either before or loss. A marine policy may be assigned by endorsement there too.

in other customary manner. In practice, at marine cargo policy is frequently endorsed in blank and becomes in effect a quasi-negotiable instrument. Thus, it will be appreciated,

adds considerably to the convenience of mercantile transactions as the policy can be negotiated through a bank along with other documents of title. Assignment in fire insurance cannot be recognized without prior consent of the insurer, change of interest in fire policies (unless by will or operation of law) are not valid unless and until the consent of the insurer has been given. The tire policies are not in the nature of assignment nor intended to be assigned from one person to another without the consent of the insurer. Assignment in tire insurance constitutes a new contra

3.2.11 RETURN OF PREMIUM

Ordinarily the premium once paid cannot be refunded. However, in the following cases the refund is allowed.

(I) By Agreement in the Policy the assured may pay full premium while effecting the insurance but it may be agreed to return it wholly or partly in the happening of certain events. For example, special packing may reduce the risk.

(II) For Reasons of Equity

(i) Non-attachment of risk. Where the subject-matter insured or part thereof, has never been imperiled for example, term insurance with returnable premium where premium is returned to the policy-holder if death does not occur during period of insurance.

(ii) Undeclared balance of an open policy. The policy may be cancelled and premium may be returned for short interest allowed provided there was no further interest in the policy.

(iv) Where the assured has no insurable interest throughout the currency of the risk, the premium is returnable provided the policy was not attached by way of wagering.

(v) Unreasonable delay in commencing the voyage entitle the insurer to cancel the insurance by returning the premium.

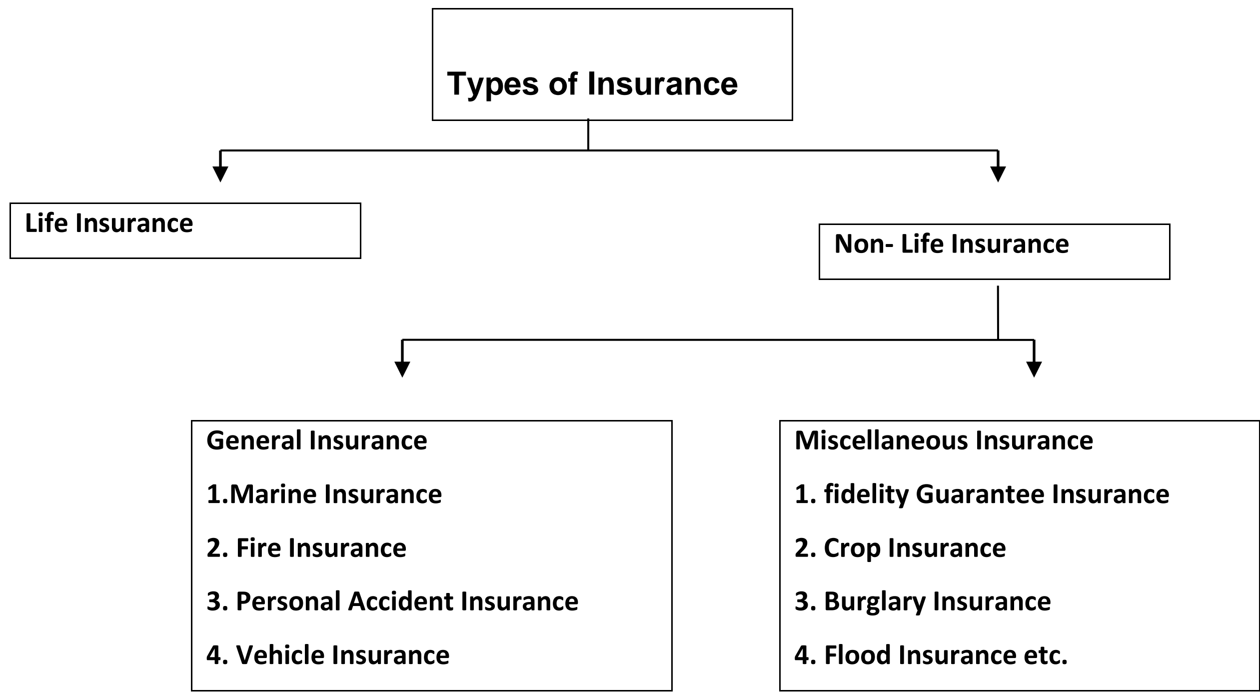
3.2.12 Over-insurance by double insurance

If-there is over-insurance by double insurance a proportional part of the several premium is returnable provided that if the policies are taken at different times and any earlier policy has at all time born the entire risk or if a claim has been paid. On the policy in respect of the full insured thereby, no premium is returnable respect of that policy and when double insurance is affected knowingly by the assured no premium is returnable.

Distinction between the Insurance Contract and Wagering Contract

Insurance Contract		**Wagering contract**	
1.	Insurable interest is the subject matter in the contract of Insurance.	1.	In a Wagering contract, the interest in the asset or event is limited. Parties are interested in knowing only for the purpose of winning or losing upon the future events.
2.	Insurance of Contract is essentially based on principles of indemnity.	2.	In a Wagering contract there is no question of indemnity because no risk is covered.
3.	Insurance contract of is legally enforceable.	3.	A Wagering contract is void because it is not recognized by the law.
4.	Contract of Insurance is based upon the principles of good faith i.e., full disclosure of material facts required by both the parties to contract.	4.	There is no question of disclosure of material facts as it is not required by either party in a Wagering contract.
5.	Risks and Premium are fixed on the basis of scientific methods.	5.	No such calculations are made in the Wagering contract.

CLASSIFICATION OF INSURANCE



SELF CHECK QUESTION

Class Assignment:

1. Explain the essentials of valid contract.
2. Explain in detail, with example the principle of insurance.
3. Does the non compliance of insurance principles lead to the contract becoming void? Explain.