INSURANCE

Insurance is an important aid to commerce and industry. Every business enterprise involves large number of risks and uncertainties. It may involve risk to premises, plant and machinery, raw material and other things. Goods may be damaged or may be destroyed due to fire or flood. Some risk can be avoided by timely precautions and some are unavoidable and are beyond the control of a business. These unavoidable risks can be protected by insurance.

Insurance may be defined as form of contract between two parties (namely insurer and insured or assured) whereby one party (insurer) undertakes in exchange for a fixed amount of money (premium) to pay the other party (Insured), a fixed amount of money on the happening of certain event (death or attaining a certain age in case of life) or to pay the amount of actual loss when it takes place through the risk insured (in case of property)

In D.S. Hamsell words, insurance is defined “as a social device providing financial compensation for the effects of misfortune, the payment being made from the accumulated contributions of all parties participating in the scheme”

In simple terms “Insurance is a co-operative device to spread the loss caused by a particular risk over a number of persons, who are exposed to it and who agree to insure themselves against the risk”

Thus, the insurance is

(a) A cooperative device to spread the risk;

(b) the system to spread the risk over a number of persons who are insured against the risk;

(c) the principle to share the loss of the each member of the society on the basis of probability of loss to their risk; and

(d) the method to provide security against losses to the insured

Terminology used in definition of Insurance

Insurer or insurance company – The agency involved in Insurance business is known as insurer

Insured/ Assured – The person who gets his property/life insured is known as insured

Policy - The agreement or contract which is put in writing is known as a Policy

Premium – The consideration in return of which the insurer undertakes to make goods the loss or give a certain amount in case of life insurance is known as premium

Assurance and Insurance

The two words were used synonymously at one time, but there is fine distinction between the two. '**Assurance**' is used in those contracts which guarantee the payment of a certain sum on the happening of a specified event which is bound to happen sooner or later, for example attaining a certain age or death. Thus life policies comes under 'assurance'.

Insurance, on the other hand, contemplates the granting of agreed compensation of the happening of certain events stipulated in the contract which are not expected but which may happen, for example risk relating to fire, accident or marine.

Nature of Insurance

Following are the main characteristics of insurance which are applicable to all types of insurance (life, fire, marine and general insurance).

Sharing of Risks - Insurance is a device to share the financial losses which may occur to individual or his family on the happening of certain events

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

Value of Risk – Risk is evaluated at the time of insurance. There are several methods of valuing the risk. Higher the risks, higher will be premium

Payment on Contingency -If the contingency occurs, payment is made; payment is made only for insured contingency. If there is no contingency, no payment is made. In life insurance contract, payment is certain because the death or the expiry of term will certainly occur. In other insurance contract like fire, marine, the contingency may or may not occur

Amount of Payment of Claim - The amount of payment depends upon the value of loss occurred due to the particular insured risk. The insurance is there upto that amount. In life insurance insurer pay a fixed sum on the happening of an event or within a specified time period.

Example – In fire insurance, if fire occurs and half the property is destroyed, but the whole property is insured, then payment of claim will be made only for that half building that is destroyed not the whole amount of insured.

Insurance is different from Charity - In charity, there is no consideration but insurance is not given without premium

Large number of Insured Person - Insurance is spreading of loss over a large number of persons. Larger the number of persons, lower the cost of insurance and amount of premium and incase lower the number of persons, higher the cost of insurance and amount of premium.

Insurance is different from Gambling - In gambling, there is no guarantee of gain, by bidding the person expose himself to risk of losing. Whereas in insurance, by getting insured his life and property, he protect himself against the risk of loss.

Functions of Insurance

Functions of insurance can be divided into parts;

I Primary functions.

II Secondary functions.

I Primary Functions

1. **Certainty of compensation of loss:** Insurance provides certainty of payment at the uncertainty of loss. The elements of uncertainty are reduced by better planning and administration. The insurer charges premium for providing certainty.

2. **Insurance provides protection :** The main function of insurance is to provide protection against risk of loss. The insurance policy covers the risk of loss. The insured person is indemnified for the actual loss suffered by him. Insurance thus provide financial protection to the insured. Life insurance policies may also be used as collateral security for raising loans.

3. **Risk sharing :** All business concerns face the problem of risk. Risk and insurance are interlinked with each other. Insurance, as a device is the outcome of the existence of various risks in our day to day life. It does not eliminate risks but it reduces the financial loss caused by risks. Insurance spreads the whole loss over the large number of persons who are exposed by a particular risk.

II Secondary Functions

1. **Prevention of losses :** The insurance companies help in prevention of losses as they join hands with those institutions which are engaged in loss prevention measures. The reduction in losses means that the insurance companies would be required to pay lesser compensations to the assured and manage to accumulate more savings, which in turn, will assist in reducing the premiums

2. Providing funds for investment : Insurance provide capital for society. Accumulated funds through savings in the form of insurance premium are invested in economic development plans or productivity projects.

3. Insurance increases efficiency : The insurance eliminates the worries and miseries of losses. A person can devote his time to other important matters for better achievement of goals. Businessman feel more motivated and encouraged to take risks to enhance their profit earning. This also helps in improving their efficiencies.

4. Solution to social problems : Insurance take care of many social problems. We have insurance against industrial injuries, road accident, old age, disability or death etc.

5. Encouragement of savings : Insurance not only provides protection against risks but also a number of other incentives which encourages people to insure. Since regularity and punctuality of payment of premium is a perquisite for keeping the policy in force, the insured feels compelled to save.

Principles of Insurance

The basic principles which govern the insurance are -

(1) Utmost good faith

(2) Insurable interest

(3) Indemnity

(4) Contribution

(5) Subrogation

(6) Causa proxima

(7) Mitigation of loss

1. **Principle of utmost good faith :** A contract of insurance is a contract of ‘Uberrimae Fidei’ i.e., of utmost good faith. Both insurer and insured should display the utmost good faith towards each other in relation to the contract. In other words, each party must reveal all material information to the other party whether such information is asked or not. There should not be any fraud, non disclosure or misrepresentation of material facts.

Example – in case of life insurance, the insured must revel the true age and details of the existing illness/diseases. If he does not disclose the true fact while getting his life insured, the insurance company can avoid the contract.

Similarly, incase of the insurance of a building against fire, the insured must disclose the details of the goods stored, if such goods are of hazardous nature

A material fact means important facts which would influence the judgment of the insurer in fixing the premium or deciding whether he should accept the risk, on what terms. All material facts should be disclosed in true and full form

2. Principle of Insurable Interest: This principle requires that the insured must have a insurable interest in the subject matter of insurance. Insurance interest means some pecuniary interest in the subject matter of contract of insurance. Insurance interest is that interest, when the policy holders get benefited by the existence of the subject matter and loss if there is death or damage to the subject matter.

For example – **In life insurance**, a man cannot insured the life of a stranger as he has no insurable interest in him but he can get insured the life of himself and of persons in whose life he has a pecuniary interest. So in the life insurance interest exists in the following cases:-

- Husband in the life of his wife and wife in the life of her husband
- Parents in the life of a child if there is pecuniary benefit derived from the life of a Child
- Creditor in the life of debtor
- Employer in the life of an employee
- Surety in the life of a principle debtor

In life insurance, insurable interest must be present at the time when the policy is taken. In fire insurance, it must be present at the time of insurance and at the time if loss if subject matter. In marine insurance, it must be present at the time of loss of the subject matter.

3. Principle of Indemnity : This principle is applicable in case of fire and marine insurance only. It is not applicable in case of life, personal accident and sickness insurance. A contract of indemnity means that the insured in case of loss against which the policy has been insured, shall be paid the actual cost of loss not exceeding the amount of the insurance policy. The purpose of contract of insurance is to place the insured in the same financial position, as he was before the loss.

Example – A house is insured against fire for Rs. 50000. It is burnt down and found that the expenditure of Rs. 30000 will restore it to its original condition. The insurer is liable to pay only Rs. 30000.

In life insurance, principle of indemnity does not apply as there is no question of actual loss. The insurer is required to pay a fixed amount upon in advance in the event of accident, death or at the expiry of the fixed term of the policy. Thus, a contract of a life insurance is a contingent contract and not a contract of indemnity.

. **Principle of Contribution:** The principle of contribution is a corollary to the doctrine of indemnity. It applies to any insurance which is a contract of indemnity. So it does not apply to life insurance. A particular property may be insured with two or more insurers against the same risks. In such cases, the insurers must share the burden of payment in proportion to the amount insured by each. If one of the insurer pays the whole loss, he is entitled to contribution from other insurers

Example – B gets his house insured against fire for Rs. 10000 with insurer P and for Rs. 20000 with insurer Q. a loss of Rs. 15000 occurs, P is liable to pay for Rs. 5000 and Q is labile to pay Rs 10000. If the whole amount pf loss is paid by Q, then Q can recover Rs. 5000 from P. The liability of P &Q will be determined as under:

The right of contribution arises when:

(a) There are different policies which related to the same subject matters;

(b) The policies cover the same period which caused the loss;

(c) All the policies are in force at the time of loss; and

(d) One of the insurer has paid to the insured more than his share of loss.

5. Principle of Subrogation : The doctrine of subrogation is a collorary to the principle of indemnity and applies only to fire and marine insurance. According to doctrine of subrogation, after the insured is compensated for the loss caused by the damage to the property insured by him, the right of ownership to such property passes to the insurer after settling the claims of the insured in respect of the covered loss.

Example – Furniture is insured for Rs. 1 lacs against fire, it is burnt down and the insurer pays the full value of Rs. 1 Lacs to the insured, later on the damage Furniture is sold for Rs. 10000. The insurer is entitled to receive the sum of Rs. 10000.

6. Principle of Causa Proxima : Causa proxima, means proximate cause or cause which, in a natural and unbroken series of events, is responsible for a loss or damage. The insurer is liable for loss only when such a loss is proximately caused by the peril insured against. The cause should be the proximate cause and can not the remote cause. If the risk insured is the remote cause of the loss, then the insurer is not bound to pay compensation. The nearest cause should be considered while determining the liability of the insured. The insurer is liable to pay if the proximate cause is insured.

Example – In a marine insurance policy, the goods were insured against damage by sea water, some rats on the board made a hole in a bottom of the ship causing sea water to pour into the ship and damage the goods. Here, the proximate cause of loss is sea water which is covered by the policy and the hole made by the rats is a remote cause. Therefore, the insured can recover damage from the insurer

Example – A ship was insured against loss arising from collision. A collision took palce resulting in a few days delay. Because of the delay, a cargo of oranges becomes unsuitable for human consumption. It was held that the insurer was not liable for the the loss because the proximate cause of loss was delay and not the collision of the ship.

7. Principle of Mitigation of Loss: An insured must take all reasonable care to reduce the loss. We must act as if the property was not insured.

Example – If a house is insured against fire, and there is accidental fire, the owner must take all reasonable steps to keep the loss minimum. He is supposed to take all steps which a man of ordinary prudence will take under the circumstances to save the insured property

Benefits of Insurance or Role and Importance of Insurance

Benefit of insurance can be divided into these categories -

1. Benefits to Individual
2. Benefits to Business or Industry
3. Benefits to the Society

It can be explained as under -

1. Benefits to Individual

(a) Insurance provides security & safety : Insurance gives a sense of security to the policy holder. Insurance provide security and safety against the loss of earning at death or in old age, against the loss at fire, against the loss at damage, destruction of property, goods, furniture etc.

Life insurance provides protection to the dependents in case of death of policyholders and to the policyholder in old age. Fire insurance insured the property against loss on a fire. Similarly other insurance provide security against the loss by indemnifying to the extent of actual loss.

(b) Encourage Savings : Life insurance is best form of saving. The insured person must regularly save out of his current income an amount equal to the premium to be paid otherwise his policy get lapsed if premium is not paid on time.

(c) Providing Investment Opportunity : Life insurance provide different policies in which individual can invest smoothly and with security; like endowment policies, deferred annuities etc. There is special exemption in the Income Tax, Wealth Tax etc. regarding this type of investment

2 Benefits to Business or Industry

(a) Shifting of Risk : Insurance is a social device whereby businessmen shift specific risks to the insurance company. This helps the businessmen to concentrate more on important business issues.

(b) Assuring Expected Profits : An insured businessman or policyholder can enjoy normal expected profits as he would not be required to make provisions or allocate funds for meeting future contingencies.

(c) Improve Credit Standing : Insured assets are easily accepted as security for loans by the banks and financial institutions so insurance improve credit standing of the business firm

(d) Business Continuation – With the help of property insurance, the property of business is protected against disasters and chance of closure of business is reduced

3. Benefits to the Society

(a) Capital Formation : As institutional investors, insurance companies provide funds for financing economic development. They mobilize the saving of the people and invest these saving into more productive channels

(b) Generating Employment Opportunities : With the growth of the insurance business, the insurance companies are creating more and more employment opportunities.

(c) Promoting Social Welfare : Policies like old age pension scheme, policies for education, marriage provide sense of security to the policyholders and thus ensure social welfare.

(d) Helps Controlling Inflation : The insurance reduces the inflationary pressure in two ways, first, by extracting money in supply to the amount of premium collected and secondly, by providing funds for production narrow down the inflationary gap.

Type of Insurance

Insurance cover various types of risks and include various insurance policies which provide protection against various losses.

There are two different views regarding classification if insurance:-

I. From the business point of view; and

II From the risk points of view

I. Business point of view

The insurance can be classified into three categories from business point of view

1. Life insurance;
2. General Insurance; and
3. Social Insurance.

1. **Life Insurance:** The life insurance contract provide elements of protection and investment after getting insurance, the policyholder feels a sense of protection because he shall be paid a definite sum at the death or maturity. Since a definite sum must be paid, the element of investment is also present. In other words, life insurance provides against pre-mature death and a fixed sum at the maturity of policy. At present, life insurance enjoys maximum scope because each and every person requires the insurance. Life insurance is a contract under which one person, in consideration of a premium paid either in lump sum or by monthly, quarterly, half yearly or yearly installments, undertakes to pay to the person (for whose benefits the insurance is made), a certain sum of money either on the death of the insured person or on the expiry of a specified period of time.

Life insurance offers various polices according to the requirement of the persons -

- Term Assurance
- Whole Life
- Endowment Assurance
- Family Income Policy
- Life Annuity Joint Life Assurance
- Pension Plans
- Unit Linked Plans
- Policy for maintenance of handicapped dependent
- Endowment Policies with Health Insurance benefits

2. **General Insurance:** The general insurance includes property insurance, liability insurance and other form of insurance. Property insurance includes fire and marine insurance. Property of the individual and business involves various risks like fire, theft etc. This need insurance Liability insurance includes motor, theft, fidelity and machine insurance

Type of General Insurance policies available are -

- Health Insurance
- Medi- Claim Policy
- Personal Accident Policy
- Group Insurance Policy
- Automobile Insurance
- Worker's Compensation Insurance
- Liability Insurance
- Aviation Insurance
- Business Insurance
- Fire Insurance Policy
- Travel Insurance Policy

3. Social Insurance: Social insurance provide protection to the weaker sections of the society who are unable to pay the premium. It includes pension plans, disability benefits, unemployment benefits, sickness insurance and industrial insurance.

II Risk Points of View

The insurance can be classified into three categories from Risk point of view

1. Property Insurance
2. Liability Insurance
3. Other forms of Insurance

1. Property Insurance: Property of the individual and business is exposed to risk of fire, theft marine peril etc. This needs insurance. This is insured with the help of:-

(i) Fire Insurance

(ii) Marine Insurance

(iii) Miscellaneous Insurance

(i) Fire Insurance: Fire insurance covers risks of fire. It is contract of indemnity. Fire insurance is a contract under which the insurer agrees to indemnify the insured, in return for payment of the premium in lump sum or by instalments, losses suffered by the him due to destruction of or damage to the insured property, caused by fire during an agreed period of time. It includes losses directly caused through fire or ignition. There are various types of fire insurance policies.

- Consequential loss policy
- Comprehensive policy
- Valued policy
- Valuable policy
- Floating policy
- Average policy

(ii) Marine Insurance: Marine insurance is an arrangement by which the insurer undertakes to compensate the owner of the ship or cargo for complete or partial loss at sea. So it provides protection against loss because of marine perils. The marine perils are collisions with rock, ship attack by enemies, fire etc. Marine insurance insures ship, cargo and freight.

The following kinds of marine policies are -

- Voyage policy
- Time policy
- Valued policy
- Hull Policy
- Cargo Policy
- Freight Policy

(iii) Miscellaneous Insurance: It includes various forms of insurance including property insurance, liability insurance, personal injuries are also insured. The property, goods, machine, furniture, automobile, valuable goods etc. can be insured against the damage or destruction due to accident or disappearance due to theft.

Miscellaneous insurance covers

- Motor
- Disability
- Engineering and aviation risks
- Credit insurance
- Construction risks
- Money Insurance
- Burglary and theft insurance
- All risks insurance

2. **Liability Insurance:** The insurer is liable top pay the damage of the property or to compensate the loss of personal injury or death. It includes fidelity insurance, automobile insurance and machine insurance.

The following are types of liability Insurance:-

- Third party insurance
- Employees insurance
- Reinsurance

3. **Other forms of Insurance:** It include export credit insurance, state employee insurance etc. whereby the insurer guarantees to pay certain amount at the happening of certain events.

The following are other form of Insurance-

- Fidelity Insurance
- Credit Insurance
- Privilege Insurance