PRINCIPLES AND PRACTICE OF LIFE INSURANCE (DIM02)

(PG - DIPLOMA)

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Chapter – 1

Basics of Insurance

Objectives

After completion of this lesson you should be able to understand :

- Definition of Insurance,
- Meaning of insurance
- Characteristics of insurance
- Functions of Insurance
- Features of insurance, Wager and Hedging
- Benefits of Insurance to varies parties

Structure

1.1 Introduction

1.2 Meaning and Definition of Insurance

1.3 Characteristics of insurance

1.4 Functions of insurance

1.5 Economic basis of Life and Health insurance

1.6 Essential features of an insurable risk

1.7 Insurance and Wager

1.8 Insurance and Hedging

1.9 Importance of Insurance

1.10 Summary

1.11 Self Assessment Questions

1.12 Reference Books

1.1. INTRODUCTION

The insurance industry occupies an important place among other financial services in the world. Insurance affects people of all types. Not only the individuals but also the various individuals and businesses turn to insurance to manage their risks. Various new policies are being added to the existing to give new coverage. The scope of insurance expansion highlights the growing importance of insurance to the business units and the individuals alike. The idea of insurance is based on social co-operation. The loss suffered by anyone insured is spread among a large number of insured who contributes small accounts of premium.

1.2. MEANING AND DEFINITION OF INSURANCE

The term "insurance" can be defined in both financial and legal terms. The financial definition focuses on an arrangement that redistributes the cost of unexpected losses. That is, the collection of a small premium payment from all exposed and distributed to those suffering loss. The legal definition focuses on a contractual arrangement whereby one party agrees to compensate another party for losses. The financial definition provides for the funding of the losses whereas the legal definition provides for the legally enforceable contract that spells out the legal rights, duties and obligations of all the parties to the contract. Let us have a look at these definitions.

Encyclopedia Britannica, "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".

Allen Z. Mayerson, Insurance is a device for the transfer to an insurer of certain risks of economic loss that would otherwise come by the insured."

Magee D.H., "Insurance has been defined as a plan by which large numbers of people associate themselves, to the shoulders of all, risks attach to individuals."

Justice Tindal, :"Insurance is a contract in which a sum of money is paid by the assured in consideration of insurers incurring the risk of paying a large sum upon a given contingency."

Schultz and Bradwill, "Insurance in its technical sense is a social device which employs the use of pooling technique to eliminate uncertainty."

Thus, insurance may be defined as "a contract between two parties, where one promises the other to indemnity or make good any loss suffered by the latte in consideration for a mount received by way of premium. The characteristics of insurance are :

1. It is a contract for compensating losses.
2. Premium is charged for Insurance contract
3. The payment of Insured as per terms of agreement in the event of loss.
4. It is a contract of good faith
5. It is a contract for mutual benefit.
6. It is a future contract for compensating losses.
7. It is an instrument of distributing the loss of few among many.
8. The occurrence of the loss must be accidental.
9. Insurance must be consistent with public policy.

1.2.1 Parties to Insurance :

In Insurance there will be two parties viz., (1) Insurer and (2) Insured. The agency which is helpful in this arrangement is known as 'Insurer' or the Insurance Company. the person who gets his life or property insured is known as 'Insured' or 'Assured'. The contract in writing is known as 'Policy'. Insurance premium is an amount to be paid by insured either in lumpsum or in installments at regular intervals.

Therefore, insurance is a financial arrangement by which an individual can substitute a relatively small definite cost called premium for a large uncertain financial loss. The predictability of a loss is the base of an insurance system.

1.2.2 Nature of Insurance :

1. **Sharing of Risks : I**nsurance is a co-operative device for division of risk which may fall on individual or his family on the happening of some unforeseen events such as sudden death of earning member, marine, perils in marine insurance, fire in fire insurance and theft in case of general insurance.
2. **Co-operative Device :** Large number of persons share loss arising due to a particular risk and as such insurance is a co-operative device.
3. **Valuation of Risk :** Before insurance contract the evaluation of risk is made by which the insurance premium is determined which form the basis of insurance contract.
4. **Payment made on contingency :** The Insurer is bound to pay to the insured when certain contingency arises. The happening may be due to death, fire marine perils etc.
5. **Amount of payment :** The amount of payment depends upon the value of loss occurred due to the particular risk provided insurance is there upto to that amount.
6. **Large number of insured persons :** to make the insurance cheaper it is essential to insure a large number of persons or property.
7. **Insurance is not gambling :** In insurance, uncertainty is converted into certainty because the insurer promises to pay a definite sum at damage or death.
8. **Insurance is not charity :** Charity is given without consideration but insurance is not possible without premium and thus insurance is not charity.

1.3. CHARACTERISTICS OF INSURANCE

The characteristics of insurance are given below.

1. **Pooling and risk reduction :** It means spreading of losses incurred by the few over the entire group. As a result the average loss in substituted for actual loss. To predict the future losses, exposure persons in large numbers are to be grouped together to apply the

principle of large numbers. For this purpose, there must be large number of exposure persons facing the same kind of perils. In other words, pooling in an insure implies sharing of losses by the entire group, and using the law of large numbers to predict future losses.

2. **Payment of accidental and un-intentional losses :** Insurance covers such losses which are accidental in nature. The insurance must cover all the unforeseen losses which occurs at random. The losses must be the result of accident but not a result of chance. For example, a person may fall while getting down from a bus and one of his limbs, may be broken. Such a loss is the result of accident and hence covered under insurance.
3. **Risk Transfer :** The contract of insurance is one where the risk of one party is transferred to the other who is the insurer and can make good the loss of he insured. Risks of death, theft, illness etc., are all examples, where the risk of the insured can be transferred to the insurer. Thus, insurance is the most common form of a risk transfer.
4. **Principle of Indemnity :** All valid insurance contract are contracts of insurance excluding life insurance contracts. Indemnity means to make good the loss suffered by the insured and to put him back in the same financial position as he was before the occurrence of loss. In the case of household insurance, the insurer pays the actual loss incase of any theft or damage caused to the household appliances covered under the policy. However, the insured cannot claim more than actual loss caused to him.
5. **Insurance and Assurance :** The two terms “insurance” and “assurance” are often used for the discussion of insurance business to mean one and the same thing. But the terms are not synonymous. **Assurance** refers to a contract under which the sum assured is bound to be payable sooner or later. **A contract of insurance** is a contract for compensation for damage or loss as in case of fire or marine insurance. In these types of insurance the insured must suffer a pecuniary loss before he can claim compensation from the insurer. If there is no such loss, the claim does not arise. Contrary to this, a contract of assurance is an out and out contract, e.g., a contract of life insurance. In such a contract the payment of the sum of money assumed is bound to be made either on the maturity of the policy or the death of the assured.

1.4. FUNCTIONS OF INSURANCE

The functions of insurance are of two types. They are : Primary functions and Secondary Functions.

1.4.1 Primary Functions :

(1) Insurance provides certainty : Insurance provides certainty of payment at the uncertainty of loss. The uncertainty of loss can be reduced by better planning. But, the insurance relies the insured from such difficult tasks. There are different types of uncertainty in a risk. In other words, there are uncertainties of happening of time and amount of loss, insurance removes all these uncertainty and the assured is given certainty of payment of loss.

(2) Insurance provides protection : The main function of insurance is to provide protection against the probable chances of loss. In other words, insurance guarantees the payment of loss to the insured in order to protect him from his sufferings. Insurance cannot present the happening of risk but can provide for losses at the happening of the risk.

(3) Risk sharing : The risk is uncertain, and hence the loss arising from risk is also uncertain. When risk takes place, the risk is shared by all persons who are exposed to the risk. In ancient days, the risk-sharing is done only at the time of damage or death. But, today, the risk sharing is done from each and every insured on the basis of probability of risk.

1.4.2 Secondary Functions :

The secondary functions of insurance include the following.

(1) Prevention of loss : The insurance forms hand with institution which are engaged in preventing losses to the society. It is because the reduction in loss causes lesser payment to the assured. Lesser payment results in more savings to the insurer. More savings to the insurer results in lesser premiums to the insured. Lesser premium results in more business to the insurer. Finally, more business results in lesser shared to the insured.

(2) It provides capital : It provides capital to the society. The surplus and accumulated funds are invested in productive channels. The shortage of capital of the society is minimized with the help of investment of insurance. The industry, the business and individual are benefited by the investments of the insurers.

(3) It improves efficiency : Insurance eliminates worried and miseries of losses at death and destruction of property. A protected person from risks can devote his body and mind for better achievement. It improves not only his efficiency but also the efficiencies of the masses.

(4) **It helps economic progress :** The insurance by protecting the society from losses of damage, destruction and death, provides an initiative to work hard for the betterment of the society. The capital which is a factor of economic progress provided by the masses.

1.5 ECONOMIC BASIS OF LIFE AND HEALTH INSURANCE

Any loss due to death or disability of the bread earner of a family leads to termination of the regular income either partly or fully as the case may be . As such, the main object of life insurance is to provide protection to the family by providing income even after the death of the bread-winner.

No doubt people are an important part of the national wealth. Human resource cannot be compared to any marketable assets. Their economic value depends on their knowledge and skills. It is the availability of human capital that makes certain countries more advanced than others in the world. Human capital represents the production potential of an individual. Human capital means the actual future earnings of an individual. The emergence of the concept of human capital or human life value concept acknowledges the importance of professional counseling in the buying and selling of life insurance.

1.6. ESSENTIAL FEATURES OF AN INSURANCE RISK

The risk is the result or effect of any unforeseen event or its happening. The business world is dynamic and full of risks of uncertainties. The future is unpredictable and full of uncertainties. Planning alone cannot solve or protect one against uncertainties. Risks are inherent in all forms of economical, political, social, environmental are business activity. Thereby risks are involved not only in life cycle of human beings but also till the movement the product reaches the consumer. From a practical point of view, the whole process of risk can be classified into :

(a) Financial and non-financial risks

(b) Static and Dynamic Risks

(c) Fundamental and Particular risks

(d) Pure and Speculative Risks

Pure Risks can also be classified further into :

(1) Personal Risks

(2) Property Risks

(3) Liability Risks

(4) Other Risks

Insurers prefer to insure only pure risks. But all pure risks cannot be insured. For risks to be insured the essentials mentioned below are to be satisfied.

1. Since, insurance is based on law of large numbers, it is essential that there must be a large number of similar units which makes prediction of future losses accurate.
2. There must be a proper yard-stick to measure the loss in financial terms.
3. The loss caused must be the result of an accident.
4. The insurer must be in a position to calculate the loss with a reasonable degree of accuracy.
5. The premium fixed for the risk should be affordable.

1.7. INSURANCE AND WAGER

In insurance the assured should have interest in the subject – matter of insurance where as an wager stake is the only interest. A contract of insurance is a contract of indemnity. It is main object is to make good the loss of the insured, where as wager is based on speculation. Insurance contract is based on good faith where as wager is not so. In insurance payment of premium is a must where as in wager no premium is paid. Insurance is based on scientific calculation of risks, where as wager is only a gamble. Insurance contracts are useful to the public where as wagering agreements are of no use to the public.

The statement that “Insurance contracts are wager’s contracts is wrong. In a wagering contract, the parties concerned create the risk and seek to make money on the happening or otherwise of an event while in case of insurance, risk already exists and the purpose of contracts is only transfer the risk. In other words, the essence of gambling is the creation of risk. Therefore, insurance contracts are not wagering or gambling contracts which are void and illegal. When someone bets money on a horse or on the turn of a card, he creates a risk for himself which did not exist before he made he bet. Whether his purpose in so doing is pure enjoyment or whether he estimates that the transaction will result in financial gain, his actin has increased the total amount of uncertainty in the world. On the other hand, insurance does not create risk but transfers a risk which already exists from the one part (the nsured) to another (the insurer) –

Thus, a contract of insurance does not fall within the definition of a wagering agreement which is void and illegal. There are following important differences between a contract insurance and a wagering contract :

1. **Cause of payment :** Insurance contract is not a contract to pay money merely on the happening of a certain event but protects the insured by compensating him for any loss suffered by him due to the occurrence of an event. As against this, in a wagering contract money is paid not as compensation but purely on the happening of a certain event.
2. **Nature of Interest :** In a contract of insurance the assured must have a pecuniary or insurable interest in the subject matter of insurance, but in a wagering agreement neither party has any monetary interest except that is created by the contract itself.
3. **Nature of risk :** In a wagering contract, the risk is not a pre-existing one but is created after the contract is signed, such as betting on tossing of a coin or on the winning of a team in the cricket match or drawing a queen from a pack of 52 cards. But in insurance contracts, risk already exists and the contract is made to protect against the happening of that risk by spreading the same among a large number of people.
4. **Premium of consideration :** In case a wagering contract, no consideration by way of premium is given by the insured to the insurer whereas in the case of an insurance contract there is consideration due to the presence of insurable interest.
5. **Good faith :** A contact of insurance requires the parties to observe utmost good faith but in case of a wagering contract good faith need not be observed.
6. **Legal binding :** Insurance contracts are legally binding agreements and can been forced through the courts, if necessary. On the other hand, wagering contracts are void and unenforceable at law because of their being against public policy.
7. **Social approval :** Insurance contracts have the general approval of the society and are encouraged as they benefit the community as a whole, while wagering contracts are not approved by society.
8. **Calculations :** A wavering contract is a blind contract and there is no yardstick to assess the risk accurately. As against this, all insurance contracts are based on scientific and actuarial calculation of risks and the premium is calculated by taking into account all the circumstances attending on the risk.
9. **Risk in claims :** With nearly every type of insurance contract, claims involve risks of varying degrees. A fire insurance policy, for instance may involve crores of rupees or not even a single paisa. With wagers the amount payable to the winner or payable by the loser is known in advance. Thus, a wager is either won or lost.
10. **Return of premium paid :** Under an insurance agreement, the insurer is liable to pay the money, if an insured even occurs, but is not required to return the premium. But incase of wagering contract, the premium paid is also returned to the winner in addition to the prize money.

Thus a contract of insurance is not an agreement to pay the money merely on the happening of a certain event but to compensate the insured owing to its occurrence. On the other hand, under a wagering contract the winner makes a profit on the transaction. In a wager, neither party need disclose any material information he possesses about the proposed agreement or has any interest in the contract except the financial interest. A wager contract involves gambling and creating of risks, they are illegal contracts. They hamper the pace of economic development of the country. Hence legislation of different countries of the world prohibits bettering and makes it unlawful as under the Indian Contract Act. On the blessings of the State sometimes the government makes it compulsory in different fields such as motor insurance, unemployment insurance sickness insurance etc. It conformity with the socio-economic needs of the economy, the Govt. provides certain tax concessions in the form of income tax relief on the amount paid by way of premium.

1.8. INSURANCE AND HEDGING

Hedging is a process, where risk is transferred to a speculator by purchasing a future contract. Insurance contracts are not hedging, but one similarity that can be drawn between them is that in an insurance contract the risk is transferred without creating any new risks. In other words, risks are insurable in insurance contracts but cannot be insured in hedging. Similarly, the insurer can reduce the risk by the application of large numbers where as in hedging risk can only be transferred but cannot be reduced.

1.9 IMPORTANCE OF INSURANCE

The process of insurance has been evolved to protect the interest of the people from uncertainty. The principles of insurance are becoming more and more useful in the present days. Insurance server not only the interest of individuals but also fulfills the needs of the individual groups. It also transforms our modern social order.

Insurance industry is different from other manufacturing and service industries. The basic difference between insurance products and other products is that consumers interests are actively involved even after the sale of insurance products since their liabilities have to be met by the insurer, no such customer interests is involved in other products except the only commitment is to ensure efficient post sales services.

The activities carried out by insurance companies are paramount importance from the consumer's point of view. The insurance companies are contractually bound to compensate for the potential losses to consumers that may arise in future. The funds at the disposal of the insurers are essentially policy holder's funds. The Insurance business warrants some controls on the business activities of the insurers so that consumer's interests will be protected. Insurance is an essential tool to protect corporate with large spread out business against losses that could devastate the business. Insurance sector plays a vital role in the process of economic development. The importance of insurance can be explained in threefold. It is useful to individuals, business, country and society as a whole. Let us now discuss the importance of insurance.

1.9.1 Uses of Insurance to an Individual :

1. **Insurance provides safety and security:** Insurance provides safety and security against loss on a particular event. In case of life insurance, payment is made either on the death or the maturity period whichever is earlier. It provides security to the family in case of prematured death and payment in old age. Similarly, the property of insured is secured against loss on fire in fire insurance. In other insurance also this security is provided against the loss at a given contingency.
2. **Insurance affords peace of mind:** The security wish is the main motivation. This wish stimulates people to work. If the wish is not satisfied it creates unrest or tension in the people. This in turn reduces the wish to work more. Security removes fear, and uncertainty, automobile accident, damage, death are uncontrollable. It is not in the hands of the human beings. By means of insurance uncertainty in all the walks of life can be eliminated.
3. **Insurance protects mortagaged property:** In case of mortagage of property, the property mortagaged is taken over by the lender. The family of the deceased will be deprived of the uses of the property. At the same time the mortagagee insists to get the property insured to safe guard his interest in the event of damage or destruction of the property. It is because in the event of any damage to the property section copy owner to pay the un- paid loans. Similarly, the mortagagee also gets adequate amount at the destruction of the property.
4. **Insurance eliminates dependency:** At the death of the Head of the family, the difficulties of the family need not be mentioned specially as majority of us are aware of it. Similarly, at the destruction of property also the concerned will suffer a lot. It results not only suffering to the family but also their standard of living will be lowered. The

family may go even to the extent of begging on the roads. The family looks others more benevolent them the Head of the family in the absence of protection against such dependency. Insurance protects them and provides adequate amount at the time of suffering.

5. **Life-Insurance encourages saving:** The element of protection is present in life insurance. Protection element exists only in respect of property insurance. In most of life policies the element of savings re-dominates. These policies combine the programmer of insurance and savings. The saving with insurance has certain advantages.
6. **Life Insurance provides profitable investment:** Individuals unable to handle their own funds have been pleased to find out an outlet for their investment in life insurance. The better ways of investment in insurance can be endowment policies, deferred annuities, multipurpose policies etc. Insurance polices have tax exemptions under Income –tax Act. No single individual can invest regularly in his own capacity with safety and security and profitability. The life insurance provides all these benefits at lower cost.
7. **Life-insurance fulfils the needs:** The life insurance policies satisfy family needs, old-age needs, re-adjustment needs, special needs and the clean – up needs of an individual.

1.9.2. Uses to Business

Insurance is also useful business. The uses of insurance to business are given below.

1. **Uncertainty of losses:** In this age of business, trade, industry and commerce a huge number of properties are used. The property may turn into as his even at a slight negligence. It may be fatal not only to the individual but also to the property or even to the third parties. Renovation and re-construction are possible only with the help of insurance. In the absence of insurance nobody will like to invest huge amounts in business due to uncertainty. No person can be sure of his life and health for a long-time. In such circumstances insurance provides security to the dependants in the event of pre-matured death of the earning member of the family.
2. **Business efficiency:** When the owner of the business in free from uncertainties of risks, he can devote much his time and energy on business. This may result in increased profits. All businessmen both old and the new are guaranteed payment of adequate amount in the event of death or even the destruction of property or goods. Thus, insurance stimulates the businessmen to work-hard by insuring their risks.

3. **Indemnification of Keyman:** Keyman is that particular man whose capital, expertise, experience, energy, ability to control, goodwill make him the most valuable asset in the business. His absence may reduce the income of the business. The death or disability of such a valuable man may cause more serious loss than that by fire or any hazard. The potential loss to be suffered and the compensation to the dependants of such employee require an adequate provision which is met by purchasing adequate life policies. The most suitable policy in this case may be either term insurance policy or convertible term insurance policy.
4. **Enhancement of credit:** Loans can be availed by pledging insurance policies. The insurer advances against policies without any complicated procedure due to certainty of recovery at the death of the insured. The amount of the loan will under no case exceed the cash value of the policy and the interest thereon. Incase of death of the borrower the lender can adjust the proceeds towards the loan and the interest thereon. If the borrower is not willing to repay the loan borrowed with interest accrued there on, the lender can surrender the policy and the loan and the interest get rapid. Insurance properties are the best collateral and adequate loans are granted by the lenders.
5. **Continuity of Business:** In case of partnership firms, the unexpected death of one of the partners may lead to financial crisis and as a result, the firm may be dissolved. In case of business concerns the Joint Life policies will provide sufficient funds to meet such emergencies. Sometimes, each partner can insure individually to the extent of his interest in the business and in the event of his unexpected death not only the interest of the business but also his dependants are protected. In the event of damage of properties of the business, property insurance protects the business properties against any unexpected disasters.
6. **Welfare of employee:** The welfare of the employees is the responsibility of the employer. Therefore, the employer, to protect their interest against any eventuality, undertakes the provision for early death, provision for disability, provision for old age etc. These contingencies are easily met by life insurance, sickness and accident and pension which are provided by group insurance. The group insurance premiums are generally paid by the employer. This is the best way to protect the interest of the employees by the employer. Since, group insurance gives security to the employees, the wish to work more for the concern. This in turn results in increased production. Increased production results in increased profits. Increased profits lead to better facilities to the employees.

1.9.3. Benefits to the country :

(a) Insurance provide funds to the government for providing basic facilities and to develop infrastructure

(b) It has enabled the country to get foreign exchange (49%, FDI is permitted in the insurance sector).

(c) Insurance relieves the government of the burden of supporting a family, in case of the untimely demise of the breadwinner.

(d) Insurance promotes trade and industry by providing risk cover

(e) Insurance companies pay taxes out of profits earned. This is an important revenue source to the government.

(f) Insurance companies are permitted to invest 5% of the funds in the capital market. LIC alone has invested around Rs.28,000 crore in the capital markets. Such investments develop the capital market.

1.9.4. Uses to Society:

The following are the some of the uses of insurance to the society:

1. **Protects the wealth of the society:** Loss of wealth can be protected by the insurance schemes. Life insurance protects against loss of life. The human resource will generate more income if it is properly protected, educated etc. Property insurance protects properties against fire, accidents etc. New types of insurance are invented to protect the property of the society against possible losses. Insurance provides financial security against old age, death, damage, destruction, disappearance of wealth including human wealth. The risk free business and industry enhances the security. Insurance protects the present, future and potential human resource and property resource. Insurance creates security, prosperity, happiness etc everywhere in the world in general and in India in particular.
2. **Enhances Economic growth:** Insurance provides strong mind, protection to property and adequate capital to generate more wealth. Protection is given to section copy cattle, machines, tools and crop through insurance. This type of protection may lead to increased production in agriculture, in industry, in factory etc. Insurance directly provides safety and indirectly provide a number of fringe benefits. Welfare of employees creates a conducive atmosphere to work. In nutshell, insurance meets all the requisites of the economic growth of the country at large.
3. **Reduce inflation:** Insurance reduces the inflationary pressures in ways. Firstly, by extracting money in supply of way of premiums collected and secondly, by providing sufficient funds for production. The above two steps will reduce the inflation. As far

as India is concerned as for as 5% of the total money in supply is collected by way of premiums. The share of premium contributed to the total investment of the country was about 10%. Thus, increased money in supply and decreased production are controlled by insurance business. There are the two main causes of inflation.

The socio-economic significance of insurance has been well realized all over the world and it will be no exaggeration to say that industrial world without insurance is like a car without shock-absorber. A father with a large family to support rests easy because he is insured against death. The farmer with his crop ripening in his field knows that his insurance protects him against financial ruin by flood, rain, fire and winds storms, fog etc. The same is true about businessmen. Therefore, it is safe to believe "Insurance is the shock-absorber of Industry and Individual". The primary function of insurance is to spread the financial losses of insured members over the whole of the insuring community, by compensating the unfortunate few from the funds built up from the contributions of all, including fortunate many who escape losses. Besides, the practice of insurance has many secondary or subsidiary functions which contribute to the welfare of the individual or society. It tends more and more to transform our modern social order, fosters both private and public interest, individual prudence, acts as an accelerator and as stabilizer of economic growth. Insurance has attained so great a popularity and importance these days that it has now become almost a home-world.

Practically, every kind of risk to which human being or property may be liable can be insured against such risks. No trade, commerce and industry can function efficiently without insurance. Insurance spreads the financial losses of insured members over the whole of the remaining insured whose assets are not damaged. Thus, it acts as a middle man for such social co-operation. It is a co-operative devise designed to compensate one against losses because the insurer collects premium from a large number of policyholders and distributes to the victims only.

The life insurance policy affords protection to individuals, windows, dependants, to meet the critical situations. Fire-marine and miscellaneous policies help the development of trade, commerce and industry. From social and economic points some of the advantages of insurance are :

(1) It spreads risks (2) It builds up confidence and removes fears. (3) It is a means of savings (4) It accumulates large funds for national development (5) It promotes international trade (6) It is help in competition (7) Insurance helps in spreading education (8) It provides facility of loan on the basis of insurance policy (9) It solves social problems (10) It reduces prices (11) It forms an important part of the country's invisible exports (12) Insurance reduces

losses (13) It is an accelerator and stabilizer of economic growth (14) It encourages executive efficiency.

1.10. SUMMARY

Insurance is a financial arrangement. It re-distributes the unexpected losses through a legal contract. The law of large numbers helps insurers to foresee losses accurately. Every risk is not an insurance risk. The essentials of insurable risks are :

1. there must be large number of exposure units.
2. the loss occurring must be un-intentional
3. the loss must be measurable
4. the premium must be affordable.

Insurance is different from gambling and hedging. It involves the transfer of the pure risk. Insurance provides a number of benefits. Some of them are :

1. It indemnifies loses.
2. It reduces worry and fear.
3. It prevents losses
4. It enhances credit worthiness
5. It creates employment
6. It offers social benefits and so on.

Economic value of life is the foundation of life insurance. It should not be purchased an indemnity to cover the economic value. Some of the post-death needs to be covered under life insurance planning are :

1. funds to meet the expenses of death
2. funds to meet the expenses of education and marriage of dependent children.
3. funds for meeting the expenses of education and marriage expenses of dependent children.
4. Regular income fund to meet the regular expenses of dependent spouse.
5. Funds for paying off debts.

The evaluation of insurance is a boon to people of all walks of life. If safeguards the people from uncertainty. The system suits well in the present scenario. The importance of insurance can be better understood when we know about its functions. It is useful to individuals, business and also the society. Every sector derives benefit from insurance. It enhances capital formation. It helps the economic growth of the country by its varied activities. Life without insurance cannot exist or survive.

1.12 SELF ASSESSMENT QUESTIONS

A. Short Answer Questions

1. Definition of Insurance
2. Characteristics of Insurance
3. Parties to Insurance
4. Insurable risk
5. Wagering contracts
6. Insurance contracts.
7. Importance of insurance.
8. Family needs.
9. Special needs.
10. Clean – up needs.

B. Essay Questions:

1. Define Insurance. Explain its characteristics
2. Explain the nature of Insurance.
3. What are the various functions of Insurance?
4. Write a note on essential features of an insurable risk.
5. How is insurance beneficial to society?
6. Explain the functions of insurance.
7. Insurance is able to curtail inflation, so it should be made compulsory. Comment.
8. Explain the benefits of insurance to individuals.
9. Is insurance different from gambling? Support your view with relevant points.
10. Explain the benefits of insurance to society.
11. Explain the benefits of insurance to business.

1.13 REFERENCE BOOKS

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2. Anand Ganguly, Insurance management, New Age International.
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4. Dr.E. Dharmaraj, Elements of Insurance, Simres Publications, Chennai
5. Dr.P. Periaswamy, Principles and Practice of Insurance, Himalaya publishing House

Chapter – 2

Principles of Insurance

Objectives :

After completion of this lesson you should be able to understand:

- Principles related to general insurance contracts
- Importance of basic principles.
- Use of the fundamental principles.
- Validity of insurance contracts with respect to basic principles.

Structure:

2.1 Introduction to the principles of insurance.
2.2 Principle of insurable interest
2.3 Principle of Indemnity
2.4 Principle of Subrogation
2.5 Doctrine of contribution
2.6 Principle of proximate cause
2.7 Summary
2.8 Self-Assessment Questions.
2.9 Reference Books.

2.1 INTRODUCTION TO THE PRINCIPLES OF INSURANCE :

The main object of any insurance is to protect economic value of assets or life of a person. The insurer agrees to make good the loss on the insured property or loss of life that may occur in future. For this, the insured will pay premium as consideration to the insured. A contract is defined as an agreement between two or more parties to perform or obtain from an act with an intention to create legally binding relationship. A contract must satisfy the following essentials to be enforceable:

(i) Offer and acceptance
(ii) Consideration
(iii) Capacity to contract
(iv) Consent of all parties
(v) Legality of object

Insurance is a specialized type of contract and has to satisfy certain additional principles besides the above essentials of a valid contract. The additional principles are:

1. Utmost good faith.
2. Insurable interest.
3. Indemnity.
4. Subrogation
5. Contribution
6. Proximate cause.

These features are based on the basic principles of law and are applicable to all types of insurance contracts. These principles provide guidelines based on which insurance agreements are undertaken. These principles help to interpret the insurance contracts and also help in proper termination of contracts, settlement of claims, and enforcement of rules and so on.

2.1.1 The principle of utmost good faith:

Insurance stems from the doctrine of 'Uberrimae Fides' which is an essential element for a valid insurance contract. In insurance contracts the parties involved must trust one another. They are different from other contracts. The commercial contracts are governed by the doctrine of 'Caveat Emptor' which means 'let the buyer beware'. It is the duty of the buyer to verify good or service and their features. A seller is nut bound to reveal the information unless and until the buyer asks.

But, in case of insurance, the products sold are intangible. So, the law imposes greater duty on the parties to insurance contract than those involved in commercial contracts. The parties involved must have utmost good faith in each other. In other words, the parties to the insurance contract must disclose the material facts to each other. The disclosure of material facts will determine the terms and conditions of coverage of the insurance policy. Any concealment of material facts by the company will affect its normal business.

Hence, as per the principle of utmost good faith, it is binding on the part of the parties, the insured and the insurer, to expressly disclose all the relevant material facts relating to the contract. This doctrine is incorporated in insurance law and both the parties are expected to adhere to a high degree of honesty. Based on such faith the insurer and the insured execute the contract of insurance. Non-compliance by either party or any non-disclosure of the relevant facts renders the contract void.

2.1.2 Representation:

At the time of the insurance contract all the disclosures relating to the polity must be made. The insured should furnish all the facts in the application form. He has to mention his age, income, family history, general health, ailments suffered, criminal records etc.

In case of general insurance, while insuring an asset all facts relating to condition, frequency of usage, wear and tear etc. have to be disclosed by the buyer. The details given by the insurance proposed is a called representation requires full disclosure by the buyer of insurance. If the gaps are left in the application, the insurer may seek classification from the insured. It is gaps are left in the application; the insurer may seek classification from the insured. It is because the frequency of risk is assessed on the basis of the correct facts furnished. The amount of premium is also fixed basing on the severity of risk.

It is the duty of the insurer to explain in detail the terms, conditions, stipulations contained in the application. This avoids any mis-understandings between the insurer and the insured later. However, the information relating to the implied conditions need not be enplaned. For example, for an insurance policy on electric generator, it is not necessary that the power failures are common and the electric generator will be used often. Information relating to the following matters need not be disclosed:

- **(a)** Facts relating to law.
- **(b)** Facts of common knowledge to all.
- **(c)** Facts which can be discovered easily by the insurer.
- **(d)** Facts which could have been revealed by a survey.
- **(e)** Facts which are covered as per conditions of insurance.
- **(f)** Facts which reduce risk.

2.1.3 Implications of concealment or misrepresentation by the insured:

Sometimes, the information furnished by the insured may be incomplete or some information which is a important matter may be concealed. In such cases, it is the option of the insurer whether to incorporate the required changes in the contract and charge a different premium, accept the policy and pay compensation if the facts are of less important and avoid any obligation on its part as per the policy. The insures can stop payment of compensation to the insured provided the insurer can prove that the insured concealed or misrepresentation of facts are intentional to deceive the insurer. Even if the non-disclosure may be un-intentional, it is the option of the insurer to treat the contract as valid or voidable. No compensation is paid in

case of voidable contracts. Concealment of material facts is considered as intentional. In this case also the policy is considered as void.

For example, a person has been suffering from cancer. It is advanced stage and any medical treatment is hopeless. The sufferer buyers an insurance policy by concealing the material facts. He dies after four months. The legal heirs of the deceased claimed for the insured amount. The insurance company can contest and refuse payment of policy proceeds to the legal heirs of the deceased on the ground that material facts which are vital to the contract are concealed.

2.1.4 Concealment in respect of Marine insurance:

The procedure to be followed in case marine insurance is different from other types of insurance. In this case, the buyer of the policy has to fill the form sent by the underwriter of the marine insurance. The buyer of the policy must state all material facts relating to the voyage and the cargo in the application. Generally, the insurer believes the facts provided by the insured. Therefore, it is the duty of the insured to disclose all the facts voluntarily. Even if some of the inform is not furnished by the insured because of lack of his knowledge, is considered un-intentional and the insurer can refuse payment. It is not necessary for the insurer to prove that the non-disclosure of facts by the insured is intentional.

2.1.5 Implication of Non-disclosure by the insurer:

In insurance contracts, it is the insured that has to furnish lot of information about him. But, the insurer is equally responsible to explain through the various stipulations and conditions contained in the contract to the insured. He cannot presume that certain conditions are implied and the insured is expected to know. Any negligence in certain aspects either by the insurance agent or by the company may result in favour of the insured in case of any dispute.

In the case of **LIC Vs. Shakuntalabai**, the insured purchased a policy from the insurance company. Before purchasing the policy, he suffered from indigestion for a few days and undergone treatment from an ayurvedic doctor. It was not disclosed t the insurer. After a few months, the insured died of Jaundice. LIC refuse to accept the claim on the ground of non-disclosure of information. However, the court rejected the plea of the company since the company did not explain this covenant clearly to the insured which amounts to non-compliance of its responsibilities. Thus, their non-disclosure does not amount to invalidation.

2.1.6 Warranty:

Warranties are collateral to the main purpose of the contract. i.e. they are secondary to the main covenants of the contract and form a condition cited by the insurer. Thus, if a person buying medical insurance cites regular all round medical checks and avails a lower premium based on it he has to do it regularly. If he discontinues his medical checkups in some instances, it amounts to breach of contract and the insurer can take refuge in this and deny payment.

For example, a jewellary trader buys burglary insurance for his stock-in-trade on the condition that the jewellary will be kept locked in a safe. He did not keep some of the jewellary in the locker. The burglars broke in and took away the jeweler. In this case the insurer was not liable.

2.1.7 Waiver and Estoppel:

Waiver is the voluntary relinquishment of a known right by the insurance company. It creates a right on the part of the insured to claim this privilege in case of need. By this, the insurance company may provide certain privileges to the insured by which the insured need not disclose certain information. If the same is communicated to the insured by a statement or by an express agreement, the insured need not in future furnish such information which is not previously. In other words, the insurer cannot later ask him to furnish such information at any time.

Estoppel is a stipulation, which prevents the insurer from claiming a right due to its previous acts. Thus, if the insurer has provided concessions to the policy-holder (insured) and the same is followed in practice in course of time, then the insurer cannot enforce this waived commitment in future on the insured, under any circumstances.

The above point can be understood clearly from the case of Wing Vs. Harvey. In this case the agent of the insurer accepted premium on a policy in which certain stipulation in the contract is not followed by the insured. It is decided that since the agent is the representative of the insurance company, the insurance company is held liable for the actions of the agent. It is because, the acceptance of the premium amounts an estoppel in favour of the insured. So, the company cannot deny compensation to the insured.

2.2 PRINCIPLE OF INSURABLE INTEREST

As we know, all risks cannot be insured. To be insurable, the risk must be measurable in terms of money. In addition to this, there must be insurable interest in the asset to be insured. Insurable interest means the policy holder must have monetary interest in the property which he has insured. Any damage of the property must result in financial loss to the insured and there only the insurable interest will exist. There can be no contract of insurance without insurable interest. The owner of a taxi, who depends on its income, stands to lose his income if the taxi meets an accident as his business income will come to an end. Thus, the owner of the taxi has insurable interest in the asset i.e. his car. Hence, the taxicab will become the subject matter of insurance when a policy is purchased on the taxi cab.

1. **Importance of the principle of insurable interest:** There are certain legal requirements which are to be complied for the actual working of the insurance contracts. The principle of insurable interest insured some of there requirements for a valid contract. They are:

   a. **Legal Validity :** The principle adds legal validity without which such contracts would be wagering agreements in nature. **Example:** A and B agrees into an agreement by which A agrees to pay B Rs.50,000 in case the Telugu Actress Kirti Agarwal recovers from her illness before the release of a certain Telugu film. This is a wagering agreement since the principle of insurable interest is absent here. The concerned parties to the agreement do not suffer any loss if she is not recovered from her illness before the release of a particular movie.

   b. **The presence of insurable interest prevents fraudulent practices:** In the absence of this condition many unscrupulous people may buy policies on various properties in which they have no interest and cause loss on it willfully to get the benefit of settlement of claims. This will be a tempting proposition as he does not suffer any financial loss to the property which does not own.

   c. **Insurable Interest :** Insurable interest provides the right to secure and claim compensation to the insured based on the principle of indemnity. The insured can be indemnified only when insurable interest is established. That means a non-owner of the property cannot buy a policy on it when he has no interest in it or even if he has partial interest in the property. **Ex.: A is a taxi driver. B is the owner of the taxi. B employed A as his taxi-driver. In this, A which a taxi driver cannot purchase a**

policy on taxi though his livelihood is indirectly depends on it. In case the taxi meets with an accident, A does not have any insurable interest.

2. **Non-applicability of the principle of insurable interest:** In certain cases, the monetary value in respect of insurable interest is not applicable. Even if one does not suffer any financial loss due to the happening of the event, the insured is entitled to compensation in the following cases:

   (a) **Marine Insurance:** In marine insurance policy is purchased generally for a cargo in respect of particular voyage. The cargo and vessels can be insured separately. The separate policies can be purchased with the separate insurers also. Generally, the agency of the exporter purchases policy for cargo on behalf of the exporter. The absence of insurable interest does not stop them from obtaining insurance.

   As per the law of marine insurance, the buyer is at risk of loss in case the voyage is not successful. He is also at risk of loss in respect of cargo, if it does not reach the destination in good condition and in proper time. In this case, the insurable interest is limited only to the particular adventure.

   (b) **Life Insurance:** As per law, the monetary interest is not mandatory inrespect of life insurance. Though one may not suffer any financial loss due to the death of the concerned person, still one can buy insurance on the life of the person. When insurance is purchased on one's own life, it is assumed that the insurable interest is present to an unlimited extent. However, the policy amount is determined taking into consideration, the proposed policy-holder income earning capacity, age, health, etc.

   On the other hand when insurance is purchased on the life of other persons the insurable interest depends on the natural love and affection present between the contracting parties. Natural love and affection means blood relationships and closeties. The question of insurable interest does not arise in respect of the insurance contracts relating to own life policies, spouse's life and children's life. Insurance contracts in which the instances of monetary interest has to be proved are:

   i. Employer and employee,
   ii. Debtor and Creditor,

iii. Partners, and
iv. Guarantors etc.

3. **Time of existence of insurable interest :** The time when insurable interest is to be present depends on the nature of insurance contracts. For example: In respect of **Property insurance,** the insurable interest must be present at the time of loss as well as at the time of inception of the contract of insurance. In case of **Marine insurance,** the insurable interest is to be present when the event or loss occurs. It's presence is not required at the time of buying the policy. In case of **Life Insurance,** the insurable interest has to be present at the time of inception but is not required at the time of death.

2.3. PRINCIPLE OF INDEMNITY

The term indemnity means to make good the loss. The insured is to be compensated in the event of any loss occurred to him. According to this principle, the insurance companies undertake to compensate the insured on the fulfillment of all the stipulations and conditions that are agreed on in the insurance contract. The insurer charges premium to cover the risk of loss of the insured. As per this principle, the insurer is liable to pay up to the amount of loss and not more than that. In other words, the insured can not make profit out of the insurance contract. When the insurer indemnifies the insured for the full value of the insurance policy, the insurer takes possession of the damaged asset to realise the salvage value.

1. **Importance of the principle of Indemnity:**

(a) The principle of indemnity insures that the insured does not derive any undue benefit from the loss. This point can be understood clearly from the case explained below: Mr. Kumar has insured his car for Rs.8 lakhs. The car met with an accident and was damaged. The loss suffered was valued at Rs.2 lakhs. As per this principle the compensation to be paid is based on the amount of loss i.e. Rs.2 lakhs. If compensation paid to Mr. Kumar exceeds Rs.2 lakhs, he stands to gain from the loss.

(b) The principle of indemnity arms at control of moral hazard also. The insured may secure maximum amount through unfair means. In the process, the insured may inflict loss on the property to seek compensation, or may report to exaggerate the loss or may make false claims and so on. If such claims are accepted by the insurer, the insured makes undue profits. To present such unfair means the insurer fixes the amount of

compensation basing on the market value of the loss or less. Thus, the principle of indemnity helps to eliminate this possibility. This is explained in the following example:

Mr. Sekhar owns a restaurant. He purchased it for 5 lakhs three years ago. He had purchased fire insurance worth Rs.4 lakhs. The restaurant caught fire and the amount of loss suffered was Rs.1,50,000.

The amount of compensation to be paid by the insurance company =

$$\frac{\text{Sum assured}}{\text{Value of insured asset}} \times \text{Actual Loss}$$

$$= \frac{4,00,000}{5,00,000} \times 1,50,000 = \text{Rs.}1,20,000 .$$

2. **Indemnity in practice:** The property may be insured to the full value. In the event of any contingency the full value for which the property insured will not be paid as it will contravene the provisions and implications of the principle of indemnity. As per certain provisions, the amount of compensation paid will be less than the actual loss suffered. They are:

(a) Actual cash value: The actual amount of payment to be made by the insurer for the loss is based on ACV of the property which is insured. ACV is calculated by using the following methods:

(i) Replacement cost loss depreciation: This method takes into account the W.D.V. of the property after taking into consideration the depreciation and inflation in the value of the property order a period of time.

Example: Machinery is purchased for Rs.20 lakhs by Mr. X five years ago. Depreciation is charged on straight line method @ 10% p.a.

ACV = Replacement cost – depreciation.

W.D.V. of machinery after depreciation = Rs.10 lakhs.

Replacement cost = Rs.20 lakhs.

$\therefore$ ACV = (Rs.20-10) = Rs.10 lakhs.

(ii) Fair Market Value (FMV): It is the price that will be determined normally in a free market during a transaction entered into by a willing buyer and a willing seller can be taken as ACV where replacement cost cannot be determined.

The concept of FMV can be understood from the example given below:

X owns a residential property worth Rs.25 lakhs. He purchased it ten years ago. Near the property the municipal corporation is developing a cremation ground nearby. Therefore, its market value reduced drastically. There is only one prospective buyer for the property who is willing to pay only Rs.16 lakhs.

In case of any loss to the property, the FMV will be taken as rs.16 lakhs only by the insurance company.

(iii) Broad Evidence Rule: In this method, the ACV is calculated by applying the scientific techniques like replacement cost less depreciation. FMV, discounting income streams derived from property, taking into account the value of similar property etc.

Other Insurance: If the insured has taken two policies on the same property, then the compensation is paid proportionately by both the insurers according to ACV. Thus, the insured cannot make profit by taking multiple policies for the same property. Ex.: Tech span company owns a ocean going shop valued at rs.52 crores. The ship is insured with three different insurance companies x y z. The amount of insurance underwritten is Rs.8 crores by x, Rs.16 crores by 'y' and Rs.24 by 'z' respectively. The total amount of insured amount is Rs.48 crores. The ship is wrecked by an accident. The insurance company valued the loss at Rs.6 crores.

Liability of Insurance Company =

$$= \frac{\text{Amount under written by the insurer x Amount of loss}}{\text{Total sum assured}}$$

$\therefore$ Liability of insurer 'x' = $\frac{8 \times 6}{48} = \frac{48}{48}$ = Rs.1 crore.

Liability of insurer 'y' = $\frac{16 \times 6}{48} = \frac{96}{48}$ = Rs.2 crores.

Liability of Insurer 'z' = $\frac{24 \times 6}{48} = \frac{144}{48}$ = Rs.3 crores.

(iv) Exemptions to the principle of indemnity: The life of a person is different from property. The principle of valuing property by the above methods cannot be applied to determine the monetary value of the life section copy is determined by certain quantitative factors. The most important factor is the earning capacity of the person insured. Insurable value is the value of policy purchased.

Thus, a life insurance policy is not subject to the principle of indemnity but is a valued policy where the agreed amount in full is paid to the beneficiary in case of loss of life.

2.4 PRINCIPLE OF SUBROGATION

Subrogation means the restitution of the rights of an insured infavour of the insurer against the third party for any damage caused by him in place of the assured after the insurer has indemnified him for the loss. The principle of subrogation is applicable when a third party is responsible for the loss.

In case of any asset which is insured damaged by the third party, then the insured can sue the party who has caused the damage to claim compensation for the loss. The insured can also claim compensation from the insurance company. So, it is left to the option of the insured either to make a claim from the third party or the insurance company where the property damaged is insured. However, he cannot sue both the parties for compensation. In other words, if compensation is paid by the third party then the insurance company will not pay any compensation and vice-versa.

Example: Mr. Ravi owns a Car. If is his by a city – bus while he is going to the office. Here, Ravi can claim compensation from the insurance company. The company in turn sue the bus driver for his negligence. In this case Ravi cannot bring any action against the bus-driver as he is already compensation for the loss.

The principle of subrogation is a corollary of the principle of indemnity and is applicable when damage is caused due t the negligence of another party. The object of principle of indemnity is to make goods the loss suffered by the insured by the insurer. After the payment of compensation the insured is placed in the same financial position as he was before the

accident. If he is allowed to sue the damaging party, the insured will make a profit from the loss, which is against the principle of indemnity.

Catellain Vs. Preston : Preston is the owner of a house property. He entered into a contract to sell his house. The property is insured against fire. Before the transfer of ownership to the purchaser, the property is damaged partly due to fire accident. Preston is indemnified for the loss by the insurance company.

After that the sale is completed and the buyer paid full consideration. Later, the insurer came to know about this and sued Preston on the ground that since he received the full price, he does not incur any financial loss as a result of the accident. Therefore, he has no valid reason for Preston to received payment from the insurer. The court accepted the insurer's stand and there is no valid reason to receive payment from the insurer. The court accepted the insurer's stand and there is no valid reason to receive payment from the insurer. The court accepted the insurer's stand and ordered Preston to return the amount indemnified the insurer.

(1) Importance of the Principle of subrogation:

(a) It prevents the insured from making profit out of damage.

(b) It facilitates the law that the guilty is brought to book and made to pay for the loss.

(c) It helps the insurer too partially of fully recover the amount paid for the loss.

(d) It helps to lower the rates of insurance.

If the insurer indemnifies the insured for the full value of the policy where the asset is damaged. Completely, then the insurance company takes possession of the damaged asset to realise the salvage value.

If the insurer recovers from the third party more amount than what he had paid to the insured, then the surplus has to be paid to the insured after deducting his expenses incurred thereon.

On the other hand if the insured himself takes action against the third party, than the insurer is not liable to pay any compensation to the insured.

(2) Applicability of the doctrine of subrogation: The principle of subrogation is applicable to general insurance only. It does not apply to other insurance contracts like life insurance or health insurance since the principle of indemnity applies to general insurance only. In case of loss of life, the insurance company has to pay the amount of insurance to the legal heirs of the insured or to its beneficiary. In this case the insurer has no right of action against the third party for financial claims.

(3) Limitations of the Doctrine of Subrogation:

(i) It is not applicable to life insurance policies.

(ii) It becomes operative only after the insured has been indemnified.

(iii) It cannot be exercised where the insured is not in a position to take action against the damaging party.

Example: Mr. Blue had insured his colour T.V. It was damaged by his teenage son white who smashed it with a cricket ball in a fit of anger. In this case, Mr. Blue does not want to subject his son to any action. Hence, the insurer is not obliged to make payment for the loss.

2.5 DOCTRINE OF CONTRIBUTION

The object of insurance companies is to insure the risk relating to unforeseen circumstances. In this process, they a create a fund each type of risk. The fund is created out of the premiums. They must make sure that the amount of new risk under – written can be met with the existing pool of funds when they sell new business.

Sometimes, the value of the asset to be insured may be more. In such cases the amount of risk involved to the company will also be more. In such cases the risk involved can be spread over different insurance companies. Generally, insurance companies concentrate more on the number of policies with lower value than limited policies with huge amounts. In such cases, the insurance companies adopt the policy of under – writing high value assets partially. A part of the total value of the asset is taken up by a single insurer and the asset is insured by more than this insurance companies. This practice has certain problems Section Copy of sharing compensation payable to the insured. Such problems are solved with the help of doctrine of contribution.

As per this doctrine of contribution the indemnity provided for the loss occurring on the asset, which is insured with several insurers has to be shared proportionately among them according to the rate able proportion of the loss. The total amount of compensation payable to the insured by all the insurance companies should not exceed the actual amount of loss occurred.

The insured has the right to recover the compensation from any insurance company on priority basis. As per this doctrine, after recovering loss from the first insurer the insured can approach other insurers. If a particular insurance pay the entire loss to the insured, then such insurance company can claim the share of compensation from other insurance companies. This holds good even when there is no prior contract to the effect among them. The right to contribution is based on the principal of equity that burdens should be shared equally.

Requisites to invoke doctrine of contribution:

(a) The insured asset must be common to all the policies.

(b) The risk insured against must be common to all the policies.

(c) The insured owner of the asset must be the same person.

(d) All the policies must be in force during the occurrence of loss.

2.6 PRINCIPLE OF PROXIMATE CASE

When an insurance policy is bought it is issued with respect to some peril, which may result in loss to the policy – holder. No single policy covers various risks. The insurance company is liable to indemnity only the insured perils. Proximate cause means the nearest cause. In insurance, it relates to the immediate cause of the accident which results in loss.

In general insurance there are a number of policies. They include, vehicle insurance, property insurance, fire insurance, burglary insurance etc. If a person has bought fire insurance for his hose, the protection will be from the loss suffered by fire, which may have resulted from the sources mentioned in the policy. If the fire accident occurs due to any other source than which is mentioned in the policy, then the insurer is not liable to pay any compensation to the insured.

For example, if the insured is to be protected against fire occurring due to electric short circuit and the fire occurs due to leakage of LPG Cylinder then the insurance company is not liable to pay for the losses. The details relating to the proximate cause should be mentioned in the insurance contract. Sometimes, certain causes may not be covered by the policy some are assumed by implication though it is impossible to mention whole range of causes. However, payment of compensation depends mainly on the causes agreed on.

1. **Determination of proximate:** Where the mishap occurs as a single event, the determination of proximate cause is simple. On the other hand where the mishap occurs as a chain of events in succession with one event setting off the other, the determination of proximate cause for the damage becomes difficult. In such cases, it is the parties involved must find out the correct reason for the loss, the amount of compensation to be paid etc. It may happen that the actual peril, which has caused the loss in turn, is caused by another peril. In determining proximate cause the sequence of events according to their time of occurrence is not relevant. The deciding factor is the correct cause of loss. So, the determination of 'proximate cause' depends on commonsense.

2. **When the insurer in liable:**

   (a) When the risk is a single event and is insured.

   (b) Where the insured risk occurs first and it is followed by an excluded risk.

   (c) Where the excluded peril causes, the insured peril and the events occurs in a broken sequence, then the insurer has to pay for the loss.

   (d) Where both the perils are occurring concurrently and both the events are independent of each other.

3. **When the insurer is not liable:**

   (a) Where the excluded peril is the cause of the insured peril and they act consecutively.

   (b) Where the insured peril is followed by the expected peril and both cannot be identified from each other.

   (c) Where both the perils are occurring concurrently.

2.7 SUMMARY:

The principles of insurance from the basis of insurance contracts. They help in the formation, interpretation and settlement of claims. Insurance contracts are special contracts. They have the following features. They are: Utmost good faith; insurable interest; indemnity; subrogation; contribution and proximate cause.

Insurance contracts are based on good faith of both the parties to the contract. They are supposed to disclose the material facts required honestly. Protection is given only in respect of the risk that is insured. In the case of property insurance, indemnity is provided by the insurer when loss is incurred due to the occurrence of the insured event. If the loss caused by the third party is compensated by the insurer to the insured, then the insurer steps into the shoes of the insured and will have the full rights on the third party where damage is caused due to his negligence. This doctrine is a corollary of the principle of indemnity known as the right of subrogation.

2.8. SELF ASSESSMENT QUESTIONS:

Short Questions :

1. 1.Insurance Contract
2. Utmost Good faith
3. Indemnity
4. Subrogation
5. Insurable Interest
6. Proximate cause
7. Insurance and warranty
8. Waiver and Estoppels
9. Broad evidence rule
10. Catellian Vs. Preston

Essay Questions

1. Explain the objectives of insurance.
2. What are the implications of non-disclosure by the insurer.
3. What is meant by waiver and estoppel.
4. Explain briefly the general principles of insurance.
5. What is subrogation? Explain its limitations.

6. Why the principle of indemnity not applicable to life insurance contracts?

7. Explain the principle of proximate cause.

8. What is Doctrine of Contribution? Explain the requisite to invoke doctrine of contribution.

2.9 REFERENCE BOOKS:

1. P.K. Gupta, Fundamentals of Insurance, Himalaya Publishing House
2. Anand Ganguly, Insurance management, New Age International.
3. M.N.Srinivasan, Principles of insurance law, Universal Publishing Company
4. Dr.E. Dharmaraj, Elements of Insurance, Simres Publications, Chennai
5. Dr.P. Periaswamy, Principles and Practice of Insurance, Himalaya publishing House

Chapter – 3

History and Development of Insurance in India

Objectives :

After completion of this lesson, you should be able to understand:

- Origin of Insurance in India in general,
- Growth of Marine, Fire Insurance.
- Growth of Life Insurance and Other Insurance's.
- Present status of Insurance Business

Structure:

3.1 Introduction
3.2 Marine Insurance
3.3 Life Insurance
3.4 Fire Insurance
3.5 Miscellaneous Insurance
3.6 Present Status of Insurance Business in India
3.7 Summary
3.8 Self Assessment Questions
3.9 Reference Books

3.1. INTRODUCTION

Insurance plays a very important role in modern business. It is one of the important aids to trade. All types of business activities are subject to risks of loss or damage due to unforeseen events. Loss or damage may arise due to fire, theft, natural calamities like flood or earthquake and so on. The employees in office or workers in a factory, or fields are also liable to the risks of injury or loss of life due to accidents in the work place. Business firms can provide protection against these risks through insurance. The idea of insurance is based on social co-operation. The loss suffered by anyone insured is spread among a large number of insured who contributes small accounts of premium.

The word insurance owes it origin from the word insure. A reference of insurance was found in Rigveda with the name Yogakshema more or less related to well being and security of people. Hammurabi and Manu's code had also recognized the advisability of provision for

sharing future losses. Insurance means to secure the payment of a sum of money in the event of loss or damage to either life or property as per the contract made thereof but not as per the actual amount of premium or contribution paid.

The idea of insurance was first conceptualized in the 14th century. The earliest references of insurance were found in Babylonia, France and Rome. The marine insurance is the oldest form of insurance followed by life insurance and fire insurance. Fire insurance originated in Germany in the beginning of the 16th Century. In the 16th century life insurance first started in England. The first life that was insured was of Mr. William Gybbons on June 18, 1653. the first registered office of life was in England with the name Hand in Hand society in 1696. In England in 1866 there was a great fire in which 85 per cent of the house were burnt and property worth sterling 10 crores were damaged. The fire insurance took momentum after this disaster.

In those days, it was used as a tool for protection against financial loss of sea fearers involved in foreign trade. The beginning of the insurance industry took place in the UK at Lloyds coffee house in the Tower street of London. In developing countries, insurance sector has assumed special significance as it has enormous potential to gear up the economy.

In USA the life insurance did not gain momentum until 18th century mainly due to fluctuations of death rate. After 1800 it gained momentum. In India European started the first life insurance company in Bengal Presidency – Orient Life Assurance Company in 1818. Then in 1871 Bombay Mutual Life Assurance Society was established. In 1874 Oriental Government Security Life Assurance Co Ltd. was established. The miscellaneous insurance took the later part of the 19th Century with the industrial revolution in England. The important types of insurance were Accident insurance, liability insurance, theft insurance and fidelity insurance.

Life insurance was started in India in 1818 to provide insurance for English widows when Oriental Life insurance company was incorporated at Calcutta (Kolkatta) followed by the Bombay Life Assurance Company in 1823 and Triton Insurance company for General Insurance in 1850. Insurance regulation formally began in India by passing of two Acts, viz., the Life Insurance Companies Act of 1912 and the Provident Fund Act of 1912. The Insurance Act of 1938 is the first comprehensive legislation which provides the Government to control over insurance business in India.

Milestone in the Insurance Sector

1907	The first company transacted general insurance business was the Indian mercantile insurance company Ltd.
1912	Regulation of the Insurance by the Indian Life Assurance Companies Act
1928	The Indian insurance companies act was enacted
1938	Insurance Act was enacted
1956	Nationalization of Insurance by taking over 245 Indian and foreign insurers and provident societies.
	Life Insurance corporation was formed
1957	General Insurance council framed a code of conduct for fair and sound business practices.
1968	Insurance act was amended to regulate investment and also set up of tariff advisory committee
1972	General Insurance business was nationalized
1999	IRDA Act was passed and paved way for privatization of insurance sector in India
2002	IRDA Act and Insurance Act have been amended.

3.2 MARINE INSURANCE

Marine Insurance is the oldest type of insurance and one of the earliest records of a marine policy relates to a Mediterranean Voyage in 1347. This was followed by life insurance some 300 years later. Marine Insurance was first developed by Merchants of Lombard and Hersa. It soon spread through out Spain, Portugal, France, Holland and England. Lombard Street in London became a prominent centre of marine insurance business.

The Lloyd's Coffee house gave in impetus to develop the marine insurance business. Marine insurance was brought to England from Italy by the Lombard merchants who settled in England and controlled a large portion of British trade in 15th and 16th centuries. Lombards were great traders, and in addition to their goods, the bought with them. There business methods and practices, including insurance. Their place in British commercial history is recorded in the name of Lombard Street in the city of London. The records of British Admiralty Court indicate that marine insurance was in Existence in the Early 1500's.

There are references that marine insurance was practiced in India three thousand years ago, there is no evidence that insurance in its present form was practiced prior to the 12th century. Prof. Moreland has referred that the practice of insurance was quite common during the reign of Akbar to Aulangzeb but the nature and coverage of insurance of this period is not known. In fact, Britishers introduced general insurance, in its modern form, in India. When they opened their branches around 1700.

3.3 LIFE INSURANCE

The first policy providing temporarily life assurance cover for a period of 12 months was issued as early as in 1583 A.D. in England. The Amicable society started granting fluctuating sum on death since 1705 and a fixed sum since 1757. With the development of mortality tables, life assurance acquired a scientific character. The Equitable society founded in 1762 was the first to be established on scientific basis.

In India, two British Companies, the European and the Albert, attempted writing business on Indian lives and failed in 1870. The first Indian Life assurance society was formed in the same year called Bombay Mutual Assurance Society Ltd. It was followed by the Oriental Life Assurance Company Limited in 1874, Bharat in 1896 and the Empire of India in 1897.

The Swadeshi movement of 1905 provided impetus to the formation of several companies such as the 'Hindu stand co-operative', the 'United India', the Bombay Life and the 'National'. The Government began to exercise a certain measures of Control on insurance business by passing the 'Insurance Act' in 1952. The Insurance Act was comprehensively amended as passed as new Act in 1938 for controlling investment of funds, expenditure and management.

By the year 1955, approximately 170 insurance offices and 80 provident fund societies has been registered for transacting life assurance business in India. There was, however, no full guarantee to the policy holders. The concept of trusteeship was lacking. Many insurance companies went into liquidation. There were malpractice in the business.

In 1956, the Government of India decided to nationalize the life assurance business in India. The first step, in this direction was taken by issuing the Life Insurance (Emergency provisions) ordinance, 1956 on 19th January 1956. The Life Insurance Corporation Act was passed by Parliament in June 1956 and came into force on 1st July 1956. The Life Insurance Corporation of India came into existence on 1st September 1956.

3.4 FIRE INSURANCE:

Fire is comparatively a new entrant in the field of insurance. Originally, fire insurance was taken up by German municipalities for providing compensation to the owners of the property, in return for an annual contribution, based on the rent of the premises. Fire insurance did not begin until after the Great Fire of London in 1666 which lasted for four days and four nights and destroyed over 13,200 out of its 15,000 houses and devastated 373 of the 460 acres of the city of London, besides many public buildings. This being the most disastrous fire in human history is known as the “Great Fire” and drew the attention of the public for devising insurance protection against such calamities. Fire insurance office was established in 1681 in England. With colonial development of Great Britan the fire insurance spread all over the world in the present form.

Fire insurance was taken up by in India by the Britishers, Americans and other foreigners. The oldest of these companies is the Sun Insurance office which started its operation in Calcutta in 1710. The General Insurance in India could not progress much for the slow growth of joint stock companies and mechanized production was another reason for the low level of general insurance business.

3.5 MISCELLANEOUS INSURANCE:

The miscellaneous insurance took the present shape at the later part of nineteenth century with the industrial revolution in England. Accident insurance, fidelity insurance, liability insurance and theft insurance were the important form of insurance at that time. Lloyd’s Association was the main functioning institution. Now, insurance such as Cattle Insurance, Crop insurance, Profit Insurance etc., are taking place. The scope of general insurance is increasing with the advancement of the society.

Recent Development :

Insurance sector plays a vital role in the process of economic development. Insurance companies both life and non-life play as financial intermediaries is helpful to the economy like India. The services of the insurance sector lead to efficient and productive allocation of capital resources, prevent losses to firms by encouraging loss preventive measures, facilitate trade, commerce and substitute for government’s social security programs etc.

In terms of growth indicators like gross and net premiums, geographical spread of insurance, class wise distribution, underwriting, reinsurance operations, investment income and

overall profitability the general insurance has grown better. During 1999-2000 the gross domestic premium has increased to Rs.9,522 crore. The premium income originated outside India was Rs.460 crore, the net premium income was Rs.9,364 crore. The class wise distribution of insurance business shows different trends. Fire, miscellaneous and marine insurance accounted for 24%, 66% and 10 per cent respectively in 2005. The net incurred claim ratios were 38 per cent, 97 per cent and 67 per cent during the same period.

Within India, by region wise 40 per cent of the premium written generated from western region being the highest and only 9 per cent being the lowest, generated from eastern region. The northern and southern region have accounted for about 26 per cent and 24 per cent of the gross premium respectively in 1999-2000.

India is the fourth largest economy in the global in terms of purchasing power parity behind only USA, China and Japan. Insurance is Rs.400 billion business in India. The gross premium collection was about 2% of the GDP and growing between [5 to 20% per annum]. The Liberalization of insurance sector has resulted in new opportunities to young graduates in actuarial, fund management and health care related business. The insurance business has large untapped potential. Until 2005 only 22% of the insurable population was covered by insurance. It reflected low per capita premium of $ 9 for India as compared to $ 42 for Thailand. There is a need to reorient the insurance sector in a manner that to fulfils its mandate of providing risk cover. This sector would gain the requisite degree of efficiency and professionalism. Until 2009, 21 life insurers and 22 non life insurers got license from IrDA to do insurance business. The private insurance players established their identities and competing in the Indian market within a short span of time. The private players grow steadily since they have started insurance business. The average size of a life insurance policy has risen to Rs.1.1 lakh for private sector.

The general insurance industry has operations in 30 countries, out of those in 16 countries it is opening directly and in 14 countries through subsidiary and associated companies. Although the total number of insurance products in the general insurance industry are around 175, only a few i.e., 40 to 50 products have dominated the market controlling about 75-80% of the total market. Rest of the products have not been popular as they lack mass base, may be due to poor publicity and marketing, lack of awareness, and high premium rates etc.

The opening up of insurance sector has contributed favourably to insurance growth and a substantial increase in the GDP emanating from insurance. Investment in small savings constituted 20% of the savings of the household sector. Saving in the form of life insurance

funds accounted for 15% the saving contribution of insurance funds was 14% i.e., 2.4% of the GDP at the current market process in 2005-06.

The share of insurance funds in household savings increased from 15% to in 2006-07 to 17.5% in 2007-08 reflecting that households need for insurance products customized to different segments of the households. Savings in the form of life insurance funds increased to 17% in 2007-08 form 14.4% in 2006-07. Postal insurance has marginally increased from 0.3% in 2006-07 to 0.4% in 2007-08 and the share of mutual funds has increased from 5.2% to 7.7% in 2007-08.

The life insurers underwrote the premium of Rs.14320.20 crore during the first quarter of 2007-08 of this the LIC accounted for Rs.7,524.56 crore and the private insurers accounted for Rs.6795.64 crore. Individual business accounted for Rs.10995.90 crore and group business for Rs.3324.30 crore. In respect of the LIC individual business was Rs.5275.71 crore and group business was Rs.2248.85 corre. In the case of private insurers, they were Rs.5720.19 crore Rs.1075.45 crore respectively. The market share of the LIC was 52.55% in the total premium collected and 63.88% in the number of policies underwritten. Under the group insurance schemes 56.13 lakh lives were covered, the LIC accounted for 38.96 lakh and the private insurers covered 12.77 lakh. The life insurers covered 12.50 lakh lives in the socials ector with a premium of Rs.17.10 crore and underwrote 13.53 lakh policies with a premium of Rs.1275.78 crore in the rural sector.

The total number of non life policies issued was 572.20 lakhs in 2007-08, of these 33% was by the private insurers and 67% were by the public insurers. The general insurance companies have under written a total premium of Rs.27823.74 crore in 2007-08. The private insurers have increased their market share over the past few years and in 2007-08 it was 39.51%. Among the public sector insures, New India had the largest market share at 19% oriental insurance, National insurance and United insurance had the market share at 13.69%, 14.40%, 13.44% respectively.

Among the private insurers, ICICI Lombard had the highest market share of 12% followed by Bajaj Allianz with 9%. The highest contribution has come from motor segment was highest which constituted 46% of the total premium. The fire segment constituted 12% in the total premium underwritten; health premium contribution was 18% marine segment has contributed to 6%. The total premium underwritten outside India was Rs.981.36 crore in 2007-08.

The public sector insurers have reported profits on account of the higher investment income. The net profit earned by the public and private sector insurers has declined to Rs.2249.31 crore. The GIC received statutory cession of 15% one ach policy issued by

domestic insurers. It manages of the third party motor pool. The gross premium written by the GIC during 2007-08 was Rs.9315.55 crore. It has recommended dividend at Rs.9.60 per share to the shareholders. The IRDA directed setting up of Indian motor third party insurance pool by all general insurers in India collectively serve commercial vehicle third party insurance business.

The magnitude of the business expansion of the life insurance sector can be gauged from fact that the compound average growth rate (CAGR) stood at over 37% over the last seven years. The penetration and density of the life sector had also gone up from 1.2% to 4.1% and Rs.280 to Rs.1510 respectively between 2000 and 2006. On the life insurance side, the new business premium procured by the tied agency channel amounts to 89% of the total in the year 2006-07. The number of life insurance agents has increased from around 8 lakhs in the year 2000-01 when the sector was opened upto private insurers, to roughly 20 lakhs by the end of the year 2006-07. Out of this the number recruited by the new private insurers is around 9 lakhs, the remaining 11 lakhs being with the public insurer LIC. Among the new channels the corporate agencies had performed particularly well with the prominent share coming from the bancassurance. In the year 2006-07, corporate agents had procured 7.3% of the total new business premium mobilized, two thirds of which had come from the bancaassurance.

Indian insurance market became competitive owing to the entry of private players. Consequently life insurance products face stiff competition from other investment options like Bonds, fixed deposits, mutual funds, and national saving schemes which provide safety, growth and liquidity and tax benefits also. The market share of private life insurance companies has increased since 1999 the insurance sector has been upen up for private sector companies absorbed the market share of 13 per cent during 2003-04 and rose to 26.6 per cent until 2006.

The life and non life insurance market in India were Rs.127213 crores. The global insurance market grew at the rate of 4.9 per cent. The growth in premium underwritten in India and abroad in 2005-06 for life was 28 per cent and non life grew at 16 per cent in 2005.

According IRDA the private non life insurers have corned 27 per cent of the market share of non life business. The ICICI Lombard was the first private non life insurer has earned Rs.1,000 crores premium income with 8 per cent of the market share of the non life insurance business. The New India Assurance has the market share of 23 percent. Among the top insurance companies, the Bajaj Allianz has the largest market share with 7.56 per cent at the end of 2005-06 followed by ICICI prudential with 7.34 per cent.

The general insurance penetration in India is among the lowest in the world. The general insurance penetration (measured as a % of GDP) is also the lowest amongst the various financial services product categories in India and has remained largely stagnant over

the last ten years. There is a paucity of agency channels selling only general insurance. This is due to general insurance not being considered an attractive career option as it is difficult for the agent to make a livelihood from sales of only general insurance products. The person would be required to enter into an agency contract with a general insurance company and to be registered with the Authority. It would be pre-requisite for a person to undertake training provided by the insurance company to qualify as an agent.

Agency training would be the responsibility of the individual insurance company. It is proposed that curriculum for a standard training program is defined by the authority. This program should stress on matters related to legal compliance, laws and regulations, taxation and general code of conduct. Both categories of agents would be required to undertake mandatory training. However, for a person to qualify as insurance agent, the authority will also need to certify the agent through an examination. This examination will be conducted by an independent institute accredited by the authority.

In addition to the mandatory training, each company would be required to develop its own agency education program imparting knowledge of products, procedure for soliciting business, nature of contracts and claims handling. The insurance company will be required to maintain records of such training conducted. There is a need to encourage qualified professionals (trainee) to take up a career in general insurance.

The IRDA has constituted a committee in 2007 headed by Shri N.M. Govardhan to study the manner in which the distribution channels have been functioning, their efficiency, cost effectiveness, their weakness and recommended policy changes for making effective, professional and accountable to serve the interests of the insured.

The insurance industry provides financial intermediation, transferring funds from the insured to capital investment which is prerequisites for economic development and growth, besides generating long term funds for infrastructure development. The contribution of insurance funds to financial savings was 14.2 per cent (2.4 per cent) of the GDP at the current market prices in 2005-06. The life insurance penetration has increased to 2.53 per cent in 2005-06.

India has the privilege of having as much as 25 global insurance giants vying each other to strengthen their position in the not much tapped Indian insurance market. The net incurred claim of non life insurers were Rs.16370 crore in 2007-08. As a ratio of net premium, the net incurred claims of public sector insurers was 90% while it was in the private sector insurers was 72%. The fire segment has exhibited a higher incurred claims ratio cross the industry at 69% the motor segment reported a significant decline in the claim ratio. In the case of the public sector insurers, the incurred claim ratio was the highest in the health segment at 112% followed

by motor and marine segments at 104% and 63$ respectively. In the case of private sector, the incurred claim ratio was the highest in marine business at 100% followed by health segment at 95% and motor segment at 72%.

3.6 PRESENT STATUS OF INSURANCE BUSINESS IN INDIA

The insurance industry of India consists of 53 insurance companies of which 24 are in life insurance business and 29 are non-life insurers. Among the life insurers, Life Insurance Corporation (LIC) is the sole public sector company. Apart from that, among the non-life insurers there are six public sector insurers. In addition to these, there is sole national re-insurer, namely, General Insurance Corporation of India (GIC) Other stakeholders in Indian Insurance market include agents (individual and corporate), brokers, surveyors and third party administrators servicing health insurance claims.

Out of 29 non-life insurance companies, five private sector insurers are registered to underwrite policies exclusively in health, personal accident and travel insurance segments. They are Star Health and Allied Insurance Company Ltd., Apollo Munich Health Insurance Company Ltd., Max Bupa Health Insurance Company ltd, Religare Health Insurance Company Ltd and Cigna TTK Health Insurance Company Ltd and Cigna TTK Health Insurance Company Ltd. There are two more specialized insurers belonging to public sector, namely, Export Credit Guarantee Corporation of India for Credit Insurance and Agriculture Insurance Company Ltd for crop insurance.

3.6.1 Market Size:

India's life insurance sector is the biggest in the world with about 360 million policies which are expected to increase at a Compound Annual Growth Rate (CAGR) of 12-15 per cent over the next five years. The insurance industry plans to hike penetration levels to five per cent by 2020.

The country's insurance market is expected to quadruple in size over the next 10 years from its current size of US$ 60 billion. During this period, the life insurance market is slated to cross US$ 160 billion. The general insurance business in India is currently at rs.78,000 crore (US$ 11.7 billion) premium per annum industry and is growing at a healthy rate of 17 per cent.

The Indian insurance market is a huge business opportunity waiting to be harnessed. India currently accounts for less than 1.5 per cent of the world's total insurance premiums and about 2 per cent of the world's life insurance premiums despite being the second most

populous nation. The country is the fifteenth largest insurance market in the world in terms of premium volume, and has the potential to grow exponentially in the coming years.

3.6.2 Government Initiatives:

The Government of India has taken a number of initiatives to boost the insurance industry. Some of them are as follows:

1. The Insurance Regulatory and Development Authority (IRDA) of India has formed two committees to explore and suggest ways to promote e-commerce in the sector in order to increase insurance penetration and bring financial inclusion.
2. IRDA has formulated a draft regulation, IRDAI (Obligations of Insures to Rural and Social Sectors) Regulations, 2015, in pursuance of the amendments brought about under section 32B of the Insurance Laws (Amendment) Act, 2015. These regulations impose obligations on insurers towards providing insurance cover to the rural and economically weaker sections of the population.
3. The Government of India has launched tow insurance schemes as announced in Union Budget 2015-16. The first is Pradhan Mantri Suraksha Bima Yojana (PMSBY), which is a Personal Accident Insurance Scheme. The second is Pradhan Mantri Suraksha Jeevan Bima Yojana (PMJJBY), which is the government's Life Insurance Scheme. Both the schemes offer basic insurance at minimal rates and can be easily availed of through various government agencies and private sector outlets.
4. The Uttar Pradesh government has launched a first of its kind banking and insurance services helpline for farmers where individuals can lodge their complaints on a toll free number.
5. The select committee of the Rajya Sabha gave its approval to increase stake of foreign investors to 49 per cent equity investment in insurance companies.
6. Government of India has launched an insurance pool to the tune of Rs.1,500 crore (US$ 226 million) which is mandatory under the Civil Liability for Nuclear damage Act (CLND) in a bid to offset financial burden of foreign nuclear suppliers.

3.6.3 Road Ahead:

India's insurable population is anticipated to touch 750 million in 2020, with life expectancy reaching 74 years. Furthermore, life insurance is projected to comprise 35 per cent of total savings by the end of this decade, as against 26 per cent in 2009-10. The future looks promising for the life insurance industry with several changes in regulatory framework which will

lead to further change in the way the industry conducts its business and engages with its customers. Demographic factors such as growing middle class, young insurable population and growing awareness of the need for protection and retirement planning will support the growth of Indian life insurance.

The insurance sector is one of the most competitive sectors in India today. With 28 players in the non life insurance business and 24 life insurance players, the industry has come a long way since the time when there was only one player in the market – Life Insurance Corporation. In 2000, the sector was liberalised by the Government. Over the past 14 years, the sector has not only witnessed increased competitiveness due to the presence of multiple players, but has also seen several product and operational innovations. The Insurance Regulatory and Development Authority (IRDA) being the regulatory authority of the insurance sector in India is the sole authority which frames regulations for the sector, ranging from registration of insurance players to protection of policy holder's interest, thus aiming to regulate and promote the growth of the insurance sector.

The insurance sector is continuously evolving and requires continuous changes in the insurance sector. One of the most recent changes is the proposal to increase the foreign investment cap to 49% from 26% for the sector. This has been a long pending reform which the newly elected government has taken up on a priority basis. In July 2014, the Union Budget presented by the new government stated the intention of hiking the FDI limits. On December 10th 2014, the parliamentary committee recommended raising of the limit to 49%. This bill is waiting for the consent of the parliament. While the NDA says a monitory in the Lok Sabha, this is nor the case in the Rajya Sabha. As a result, it is expected that there could be some friction in this respect to pass the Bill. Nevertheless, the government intends to pass this resolution in this session of the Parliament. Increase in FDI limit will not only give the insurance sector the much needed access to foreign funds, but will also make the sector more competitive and open for growth. Access to international best practices and entry of mature players in the industry will help in the strategic development of the sector.

On the regulatory front, IRDA has recently bought about several changes. In September 2013, the insurance repository was introduced which is a facility to maintain insurance policies online in the demat form. At present applicable only to life insurance policies, the system is expected to be available for other insurance types in the coming years. The insurance repository system is expected to be available for other insurance types in the coming years. The insurance repository system helps in easier maintenance of policies and the risk of losing physical policy documents is also minimized. Another development in the sector is the introduction of new guidelines by IRDA with respect to Unit Linked Insurance

Policies (ULIPS). During the latter part of last decade, ULIP were very popular as agents and insurance players promised high returns and attractive features. However, these plans were notorious for the exorbitant charges and fee structure. As a result, policy holders lost a considerable part of their premium towards such charges. IRDA has brought down these charges in 2010. Recently, IRDA has made the product attractive for investors by reducing the charges further. Regulating a unit linked product was the need of the hour to protect policy holders' interest. Another innovation in the sector is the advent and popularity of online term plans. A term plan bought online from the insurer's website works out to be much cheaper than that bought offline or from the agent. Portability of health insurance policies is another development brought about by IRDA in the recent past in year 2014. The regulator has constantly worked on improving transparency and protecting policy holders, while at the same time bringing about forward looking polices to promote the growth of the sector.

The insurance sector is expected to see changes in the operational as well as ownership levels in future. First, the sector is expected to witness consolidation, especially on the back of the proposed hike in the FDI limit. New players could enter the market, while existing smaller players can be taken over by the larger players. Next, the distribution infrastructure could also witness some changes. New channels could come into play in order to widen the reach of insurance products. Despite growing penetration levels over the past decade, India remains a largely under penetrated market as far as insurance in concerned. Many people continue to view insurance as a tax saving instrument rather than a necessary financial instrument to protect risks. However, it is expected that with growing awareness and financial penetration, this view will change and people will begin to appreciate the importance of buying an insurance cover. Adopting distribution channels such as bancassurance has already gained momentum, and is expected to increase in the coming year.

The range of product offerings is also expected to increase in 2015. Innovation in product offerings, which calls for differentiated products, could become popular, as new companies and international practices come into vogue in the sector. On the regulatory front, IRDA could get more stringent in terms of the due diligence to be undertaken by the players, and also on aspects such as mis-selling.

According to IBEF, the insurance sector is expected to grow at a CAGR of 12% - 15% over the next five years. With India having high savings rate in comparison to many other countries, this should not be a very difficult target to achieve. This shows the enormous potential of the sector. Proactive polices by the regulator and the government, increasing customer awareness, making operation efficient, innovative products and bringing about customer centric products and services will help in taking the sector to the next level of growth.

3.7 SUMMARY

The roots of insurance might be traced to Babylonia, where traders encouraged to assume the risk of the Caravan trade through loans that were repaid only after the goods had arrived safely.

The Phoenicians and the Greeks applied a similar system to their Seaborne Commerce.

In London, Lloyd's Coffee House (1688) was a place where merchants, ship owners and underwriters met to transact business by the end of 18th century. Lloyd's has progressed into one of the first modern insurance companies.

Insurance developed rapidly with the growth of British commerce in the 17th and 18th century. Marine Insurance is the oldest type of insurance and one of the earliest records of marine policy relates to a Mediterranean Voyage in 1347. This was followed by life insurance some 300 years later. The Lloyd's Coffee House gave an impetus to develop the marine insurance business.

The first life insurance policy providing temporary life assurance cover for a period of 12 months was issued as early as in 1583 A.D. in England. The American society started granting fluctuating sum on death since 1705 and a fixed sum since 1757, with the development of mortality tables, like assurance acquired a scientific character. In 1956, the Government of India decided to nationalize the life assurance business in India.

The life assurance Act was padded in June 1956 and came into force on 1st July 1956. The Life Insurance Corporation of India came into existence on 1st September 1956.

Fire insurance did not begin until after the great fire of London in 1966 which lasted four days four nights and destroyed over 13,200 out of its 15,000 houses. With colonial development of Great Britain the fire insurance spread all over the world in the present form. The general insurance in India could not progress much for the slow growth of joint stock companies and mechanized production was another reason for the low level of general insurance business.

The miscellaneous insurance took the present shape at the later part of nineteenth century with the industrial devolution in England. Cattle insurance, Crop insurance, Profit insurance, etc., are taking place. The scope of general insurance is increasing with the advancement of the society.

3.8 SELF-ASSESSMENT QUESTIONS

Short Questions :

1. The History of Insurance.
2. Marine Insurance.
3. Lloyd's Association.
4. Fire insurance.
5. Nationalization of Insurance in India.
6. Miscellaneous Insurance.
7. IRDA
8. Life Insurance Corporation of India
9. General Insurance Corporation of India

Essay Questions

1. Describe the origin and growth of Insurance?
2. Explain the need and important of Marine Insurance.
3. Explain the origin and growth of Life Insurance in India
4. Explain the orgin and growth of Fire Insurance and other Miscellaneous Insurances in India
5. Briefly explain the present status of Insurance Business in India.

3.9 REFERENCE BOOKS

1. P.K. Gupta, Fundamentals of Insurance, Himalaya Publishing House
2. Anand Ganguly, Insurance management, New Age International.
3. M.N.Srinivasan, Principles of insurance law, Universal Publishing Company
4. Dr.E. Dharmaraj, Elements of Insurance, Simres Publications, Chennai
5. Dr.P. Periaswamy, Principles and Practice of Insurance, Himalaya publishing House

Chapter – 4

Kinds of Insurance

Objectives :

After completion of this lesson, you should be able to :

- Know the different types of insurances
- develop an understanding of the features, principles and need of life Insurance. Individual and group insurance schemes.
- know the classification and types of individuals life insurance policies.
- Know the types of non life insurance policies.

Structure:

4.1 Introduction

4.2 Life insurance Policies

4.3 General Insurance

4.4 Introduction of General Insurance – Commercial

4.5 Re-Insurance

4.6 Types of Re-insurance

4.7 Summary

4.8 Self-Assessment Questions

4.9 Reference Books

4.1 INTRODUCTION

Insurance is a contract between two parties where in one party called 'the insurer' undertakes in exchange for fixed sum called 'premium' to pay the other party called 'the insured', a fixed amount of money on the happening of a certain event. When such a contract is complete it is known as a 'policy'.

Classification of life Insurance policies:

Life Insurance policies can be classified into the following types:

1. Traditional and Innovative.
2. Individual and Group Polices.
3. With profit and without profit policies.

1. **Traditional and Innovative:** These policies provide benefits of risk cover with or without savings to the insured. Such policies have been in existence since long and

the terms and conditions of such policies and quite inflexible, as they do not come with section copy assurance, whole – life, endowment and money back policies.

Non-traditional policies are new age products. They offer innovative plans, which are designed to suit different types of persons often combined with various options to offer flexibility and choice to buyer of insurance.

2. **Individual and Group Policies:** Individual policies cater to the need of a single person and his family members. Group policies provide insurance cover to group of related persons.

3. **With Profit and Without profit policies:** They are participating policies in which the policy—holder is entitled to participate in the profits. Which is determined through the periodical valuation of assets and liabilities as per statutory requirements. The surplus is usually distributed in the form of bonus, declared after such a valuation and is paid at the time of final settlement.

   These plans are popular in India, because majority purchase life insurance policies for the purpose of savings.

In without profit policies, the insured will not have any share of interest in the share of the surplus of the insurer. They are meant for the coverage of risk. The rate of premium is lower for these policies than that of "with profit plans".

4.2. LIFE INSURANCE POLICIES

Life insurance is a contract providing for payment of a sum of money to the person assured or failing him, to the person entitled to receive the same, on the happening of certain events. The life insurance corporation came into existence with the objectives of assurance of

(a) family protection
(b) provision for old age
(c) tax concession
(d) housing loans
(e) loans advanced for educational purposes and
(f) donations to charitable institutions. To meet the above said objectives, various types of life insurance policies are being issued by the Life Insurance corporation of India

The Life insurance policies can be divided on the basis of

I. Duration of Policy

II. Methods of premium payments

III. Participation in profit

IV. Number of Lives covered

V. Method of Payment of Sum assured.

From the above said basis the following are Life Insurance Policies classified further into :

I. Policies According to Duration :

1. On the basis of Duration of Policies

(a) Whole Life policies

(b) Limited Payment Whole life policies

(c) Convertible Whole Life Policy

2. On the basis of Terms Insurance Policies

(a) Temporary Assurance Policy

(b) Renewable Term Policies

(c) Convertible Term policies

3. On the basis of Endowment Policies

(a) Pure Endowment policy

(b) Ordinary Endowment Policy

(c) Joint Endowment Policy

(d) Double Endowment policy

(e) Fixed Term (Marriage) Endowment Policy

(f) Educational Annuity Policy

(g) Triple Benefit policy

(h) Anticipated Endowment policy

(i) Multi Purpose Policy

(j) Children’s Deferred Endowment Assurance

II. On the basis of Premium Payments

(a) Single Premium Policy

(b) Level premium Policy

III. On the basis of participation in profit :

(a) Without profit policies (or) Non Participating Policies

(b) With profit policies (or) Participating Policies

IV. On the basis of the Number of Persons Assured

(a) Single Life Policies

(b) Multiple Life Policies

(c) Joint Life Policies

(d) Last survivorship Policy

(V) On the basis of Method of payment of Policy Amount

(a) Lump sum policies

(b) Installment or Annuity policies.

1. Term Insurance Plans:

In the term insurance plans the insurer promises the insured to pay the face value mentioned in the policy in case the insured does premature. These are short-term policies. They are subjected to renewal without evidence of insurability at each term. The period of coverage starts from one year onwards.

Features of Term Insurance plans:

(a) Risk if covered only to a specific period. The insured will not get any monetary benefit if services beyond the period of policy.

(b) It has no surrender value as reserves are not accumulated.

(c) The amounts of premium paid on these plans are lower than all other life insurance policies.

(d) If the premium is not paid on time, it will lapse. It will not have any paid up value.

Suitability of plan:

(i) Suitable to those who can not pay higher premiums initially.

(ii) They are suitable for securing coverage for a short temporary period.

(iii) They can be purchased when income is low, can be converted into other types of plans when income is increased.

Limitations of this plan:

(a) No savings are accumulated to the insured.

(b) As these are short-term renewable policies later, the premium becomes prohibitive.

2. Whole –life-plans :

These policies remain valid as long as the policy –holder is alive.

Features of the plan:

(a) Covers risk for the entire lifetime.

(b) Claims can be made only after death of the insured.

(c) Loans can be availed when policy acquired surrender value.

(d) Premiums are higher than tern insurance policies.

(e) Minimum age required is 18 and the maximum is 6 years.

(f) The premium amount to be paid is the same throughout.

(g) The insured cannot claim the money during life time of the policy-holders.

(h) The minimum age of entry 18 years and the maximum age is 60 years.

(i) The policy is also available with payment of premiums limited to a certain pre-determined number of years.

Suitability of the plan:

(i) Suitable to the persons who have earned a reasonably high - income along with substantial savings in the early part of life.

(ii) To leave a legacy to legal heirs.

(iii) To protect the family against prematured death.

(iv) It is suitable for giving donations after their death.

3. Endowment Plan:

Endowment refers to the accumulated value of the investment made under the policy. Thus, Endowment plans promise protection from risk in the event of death of the insured during the policy term as well as assured sum upon the maturity of the policy. In this type of policy the maturity of the policy is usually chosen to coincide with the retirement of the person.

The policy of the term varies from 10 to 30 years. In case of short duration, the premium involved is higher.

Features of the Policy:

It covers the risk for a prescribed time period at the expiry of which the sum under the policy, along with the accumulated bonus is paid back to the assured.

(a) The payment of an endowment at the end of the term has made these policies popular in our country.

(b) It provides old age benefits.

(c) Its premiums are higher and bonus rates lower when compared to the whole life-policies.

(d) They are eligible for loans with in surrender value of the policy.

(e) They can be issued upto the age of 65 years, the maximum age at maturity being 75 years.

Suitability of the product:

(i) It is suitable to the person who is the main earner of income to the family.

(ii) In addition to the coverage of risk of pre-matured death, the policy-holder is paid the insurance amount once the term is expired.

(iii) It is mot suitable to those who look for savings besides life cover.

4. Money back policy

In this case, the policies proceeds are paid to the insured in a number of separate cash payments. The receipt of payments can be as per the available option. Insurance cover is provided sent life in other types.

Features:

Provides for periodic payments of survival benefit at fixed intervals.

(a) In case death, the entire sum assured is paid without deducting any survival benefit amounts already paid.

(b) In case of survival, the sum assured after deducting the survival benefit amount is paid with bonus.

(c) Minimum age limit is 12 years.

Stability of the plan:

(a) Persons interested in periodical payments along with insurance cover can opt.

(b) Variants of such plans exist for children's education and marriage where in the periodical receipts can be used as required.

5. Universal Life Insurance (ULI)

These are innovative in nature. These are familiar in U.S. They suit the present day market dynamics. The policy-holder can take the advantage of the flexibility offered and can act as per the market changes taking place. It is evolved due to the dis-advantages of traditional life insurance polices.

Features of Product:

The premium paid is divided into two parts. One part covers the risk of life and the other part accounts fro savings which is invested in high yielding securities. The frequency of premium payment is flexible. The policy – holder can pay according to his financial conveniences. It provides guaranteed returns.

Advantages of ULI:

(a) Provide double benefits i.e. coverage of risk and high returns.

(b) Provides flexibility in payment of premium.

(c) Returns are higher than traditional policies.

(d) Adequate safety is provided on investments through guaranteed returns.

Limitations of ULI:

(i) Rates of returns may change.

(ii) Clear –cut disclosure is not made in respect on investments made.

(iii) It cannot forecast the amount of premium to be received over a period of time.

6. Other Policies

1. Single premium policies.
2. Continuous premium policy.
3. Limited payment policy.

Key-Man Insurance :

It is an insurance taken by a company on the life of important employee – key – man of the company – against financial loss that may occur from the employee’s premature death. Under this plan, key-man (KM) can be an expert, a Technocrat, a Director, a shareholder and an Executive. The key-man may be defined as an employee whose death would result in a financial loss to the company.

Group Insurance Schemes :

LIC offers life insurance protection under group policies to various groups such as employer – employees, professionals co-operatives, weaker sections of society etc. It also provides insurance coverage to people under certain approved occupation at subsidized rates under social security group schemes. Besides providing insurance coverage which provide funding of gratuity and pension liabilities of the employers.

4.3 GENERAL INSURANCE:

Section 6B of the Insurance Act, 1938 defines general insurance. It means fire, marine or miscellaneous insurance business whether carried on single or in combination with one or more of them. Non life insurance products are other wise called as general insurance products. They are broadly classified as fire, marine (cargo and hull) and miscellaneous (motor, health, liability, personal accident property, rural, engineering, workmen compensation, aviation and crop). Nearly 175 products are under general insurance for the public sector insurance companies but the new players have very less number of products. The policies under general insurance business are of two types:

(a) Personal Insurance policies and

(b) Commercial policies.

1. The Personal Insurance policies offered by General Insurance are:

(a) Personal Accident Insurance: It provides financial protection to the insured, provided he is insured in an accident only. The accident may result in death, total disablement or partial disablement. Everyone of us is exposed to this type of risk. The risk of accident causes lot of insecurity. This feeling of insecurity will have a number of repercussions on us. To protect from the risk of accidents, the General Insurance provides a number of personal accident policies to the public. It covers even certain groups like students, NRI's, Women etc.

In 1980 a new clause is added to personal accident tariff namely education fund. The new clause provides additional compensation to the children of the insured for their education incase of death or permanent total disablement of the insured. It covers a number of perils. It is left to the option of the insured to take cover for one or all of the risks.

(b) Health Insurance: It covers the financial loss arising out of poor health condition or due to permanent disability which results in loss of income.

i. A plan to meet the medical expenses is very essential due to rise in health care costs. It is very section copy of hospitalization. In the US nearly 47% of health care expenses are met by the government through various medical benefit schemes. 19% of the expenditure is taken care by own resources and 35% of health care expenses come from private insurance companies.

Some of the health insurance policies available in India are:

(i) Mediclaim Policy.

(ii) Overseas Mediclaim Policy.

(iii) Raj Rajeswari Mahila Kalyan Yojana.

(iv) Bhagyashree Child Welfare Policy.

(v) Cancer Insurance Policy.

(vi) Jan Arogya Bima Policy etc.

It is still in developing stage in India. The high cost of medical care is likely to contribute to its development in India. It is not recognised as a separate segment in Indian insurance industry. Privatisation of insurance industry is likely to encourage the development of Health Insurance in the country. It has to go a long-way still in India.

(c) Motor-Insurance Policy in India: In India, it is classified as miscellaneous. It comes under tariff category. Persons driving cars may cause injurier to other persons.

Sometimes, the insurer may cause financial loss. Similarly, the owners of all motor cars are also exposed to certain other risks. These include damage to the vehicle due to accidents, collision, theft, fire and so on.

The Motor Vehicle Act came into force in 1939 in India. Compulsory insurance is introduced by the Act to protect the pedestrians and the third parties. Claims for damages may arise due to possession of car, usage and maintenance of car. Motor Insurance policy covers the financial loss arising out of these risks to the insured. It is a contract between the insured and the insurer where the insurer promises to indemnity the financial liability in the event of loss to the insured.

The Act classified Motor vehicles as private cars, motor cycles and commercial vehicles. All India Motor Tariff applies to motor insurance business in India. The claim settlement is made in India by replacement of by payment of repair charges.

(d) **Personal Liability Insurance:** it provides protection against the legal liability, which arises due to personal acts of the insured. The insurance company will pay for legal deference to third party damages to the extent of the policy hunt. Except legal liability, which arises due to automobile accidents and personal liability, most other personal acts are covered under personal liability insurance. In this type the insurance company will defend the insured in case the matter go to Court of law. The matters can also be settled out of court by the mutual consent of the parties involved. It offers very wide coverage.

(e) **Workmen's compensation Insurance:** An employee is exposed to the risk of job related accidents to his workers. According to Workmen's Compensation Act, 1923 the employer is liable to pay compensation. In case of death and disablement (total and partial) involved in a work related accidents.

Under the Act, the employer is required to pay compensation to his workers who are insured during the employment period. He may also be liable to third party injurier caused by an accident irrespective of the person is a workman or a third party. Insurer covers the employer's liability.

In India, the National Insurance Company Ltd., United India Insurance Company Ltd., Oriented Insurance Company Ltd., and the New India Assurance Company Ltd. Offer Workmen's Compensation Policies. The Act does not cover the following: Any accident caused due to War, invasion etc.

(i) A person who is not a workmen under the Act.

(ii) Removal of safety guards intentionally.

(iii) Accidents caused due to consumption of alcohol etc.

(f) Fire Insurance of private property: It is the next to personal accident and health insurance. The property and also all the contents inside are exposed to risk due to fire. Fire insurance comes under tariff class of business. All India Fire Tariff is the revised fire insurance tariff, which came into force in the year 2001.

Fire Insurance is a contract between insurer and insured in which insurer will indemnity the insured against all losses arising out of perils as mentioned in the fire policies.

It covers loss caused due to, fire, lighting property damage, explosion, damage due to storm, damage due to storm, damage due to bush fire, damage due to riots, strikes and so on.

(g) Travel Insurance: it covers travel related accidents also, while traveling outside India, individuals face risks such as loss of baggage, accident involving injurier illnesses required hospitalization treatment.

In India, it is gaining importance among international travelers and their insurance requirements are met by the nationalized insurance companies as well we the new entrants into the General Insurance industry. The coverage includes:

(a) Flight Life insurance, covering only single flight and travel accident.

(b) Lost baggage insurance.

(c) Overseas health insurance.

(d) Trip cancellation and interruption insurance etc.

(h) Golfer's indemnity Insurance: it provides protection against losses or damages to the gold players and to golf equipment. It also provides protection against public liability resulting in death or disability. All golf players or sports persons can insure themselves under golfer insurance policy in order to protect their rights and interests as sports persons.

4.4 INTRODUCTION OF GENERAL INSURNACE – COMMERCIAL:

Personal general insurance is a fast growing sector in India. It's share of contribution in more as far as business is concerned. The income from this sector is low as risk involved is also loss when compared to commercial general insurance. The risk involved in commercial insurance is high. It can be offset partly be re-insurance. So, the return in commercial insurance in high. The financial institutions that provide funds to companies insist on relevant commercial insurance.

The following are some of the Commercial General Insurance policies that deal with firms or companies.

1. **Fire and Allied perils cover:** It provides coverage against damages arising from fire. It makes good the loss arising due to fire. Thus, it brings the business of the insured to normal. To claim compensation under fire insurance, the following conditions are to be satisfied.
   (i) There must be actual ignition (presence of flames)
   (ii) The ignition must be incidental and not deliberate.

   No compensation is paid if the fire occurs due to its own fermentation, damage caused due to heating, theft etc.

2. **All risk Insurance:** There are only two types of property and liability insurance policies. i.e. named perils policies, that cover only those perils that are mentioned in the policy and all risk policies which cover all losses except those excluded in the policy. All risk insurance includes industrial all risk insurance, contractors all risk insurance and erection all risk insurance.
3. **Machinery Insurance Policy:** One of the 4 Ms essential for production is machinery. Production comes to standstill if there is any machinery break down. Therefore, it is very essential to keep the machinery running and get it repaired at the earliest in case of break down. Repairs may involve huge expenditure. It cannot be delayed. These two essentials require the companies to avail machinery insurance cover. The policy covers all the costs involved in putting the machinery to normal position suitable for production process. The producer need not maintain a reserve for unforeseen break down of machinery and can invest this amount elsewhere more productively. It covers almost all the stationary capital equipment.

4. **Boiler and Pressure Plants:** This covers the loss or damage to steam generating equipment's like boilers and other fired and un-fired pressure vessels against the risk of explosion and collapse due to internal pressures that are inherent in all such equipment. It covers damaged caused due to their own explosion. Accidents in generators cannot be avoided totally even under proper care. Hence, a prudent businessman well always opt for such policies.

5. **Burglary Insurance for Business:** This type of cover is essential for business. When its property is mortgaged with any financial institution, the concerned institution will insist for

this section copy type. It covers stock-in-trade; Goods held in trust, Fixtures and fittings, Plant and Machinery etc. It does not burglary cover theft larceny, robbery etc, as the main characteristic of burglary is forceful entry. Next line Ex: If there is cash in safe and is insured the safe should be locked and the keys should not be anywhere near the safe.

6. **Product Liability Insurance:** Liability arises out of fort, statutory low or out of contract. The risk of insurance does not end with production. It is a continuous process even after production. Thus, if any third party is insured due to the insured product, the producer will be liable to pay damages. Product liability insurance covers the damages arising in such cases. The damages payable in such cases is high. Hence, all industries that are exposed to such risks should go for this policy even though it is not mandatory.
7. **Professional Indemnity Insurance:** The counter part of the product liability insurance in the service industry is the professional indemnity insurance. As the product liability gives protection against the liabilities arising due to the product, professional indemnity insurance covers the professionals against all liabilities that may arise due to negligence or failure in providing service. That is why it is called as Errors and Omission Insurance or malpractice insurance.

   It is an important cover. It benefits not only the physicians and surgeons but also clients. Due to the liability involved the surgeons may not dare to treat the patients under critical treatment. In other words, in its absence, the doctor would not be available when he is required most. Oflate, this cover is gaining momentum and is accommodating the other professionals also.
8. **Marine Insurance:** It is the oldest form of insurance. When the Rhodesian merchants introduced the respondentia and bottomry loans in the marine trade based on the uncertainity involved, respondentia loans are loans are given to the captain of the ship against the cargo to ensure the safety of journey. The loans are repaid only when the cargo reached the destination safety. On the other hand bottomry loans are raised against the vessels. High premiums are charged. They are almost similar to the present day marine cargo and hull insurance. Marine Insurance started for the first time in Italy in 12th Century. From there it spread to U.K.
   - **(a)** The Ship.
   - **(b)** Insurable goods and property.
   - **(c)** Third party liabilities incurred by the insurer.
   - **(d)** Expenses incurred to minimize loss.
9. **Crime Insurance:** Crime is one that all countries of the world are making hectic efforts to eliminate. But they are not successful. It is unfortunate to mention that the insurance

companies are not making the required attention in this direction. U.S. insured nearly 10% of the crime loss as per the available statistics.

There are two types of financial protection that are the available against the losses caused by crime. They are fidelity and surety bonds and burglary, robbery and theft insurance. Bonds and insurance are almost similar. For example: If a building contractor is asked to deposit a bond by the owner of any building, it means the surety will pay the damages in case the contractor is not able to complete the project. Hence, to a great extent bonds sound like insurance. Yet it is not insurance. Fidelity bonds deal with assurance of bonafide behaviour by an employee during the course of his employment. The word itself suggests that the surety assures the employer of trustworthiness and honesty of the employee and agrees to pay the damages that arise due to the dishonest acts of that employee.

4.5 REINSURANCE

Re-insurance is the insurance in whole or in part of the risk of liability which an insurer has under taken under a contract of insurance. It is a way of spreading the excess of risk over what the insurer in capable of retaining. This is a way of reducing the net losses he may have to suffer. Where a person takes more than one policy of insurance on the same risk he is said to effect double insurance. Whatever may be the total sum assured on all the policies, he cannot recover from all or any of them more than the amount of the loss. This is because they are all contracts of indemnity. Reinsurance is a means of stabilizing income and losses over a period years.

4.6 TYPES OF RE-INSURANCE:

Re-insurance is of two types. They are:

1. **Facultative:** It is the oldest form of reinsurance. In this the individual risk is to be offered to the reinsurance. He has to assess it and accept or reject it as in the case of original insurance. In involves lot of time. Hence, it is not popular.
2. **Treaty reinsurance:** It is a simple method. In this the insurer enters into an overall agreement with the reinsurer who agrees to grant reinsurance according to the treaty automatically of a proportion expressed as a specified percentage. Such treaties are entered into with a number of reinsures so as to cover the entire excess. As and when

the insurer issues a policy, it is simultaneously reinsured under the treaty. Thus reinsurance protection is available immediately.

General Principles of Re-Insurance:

The general principles of reinsurance common to all branches in insurance, subject to minor variation in individual classes. The reinsurance policy is also a contract of insurance governed by the same doctrines, viz. Insurable interest utmost good faith, indemnity, subrogation and so on.

Insured and the Re-insurer : It is a contract between the insurer and the re insurer. The original insured is not a party to the re insurance contract. If the insurer fails for any reason, the re insurer may have to meet any contractual liability to the insurer which may meet the insurer's liability to the insured. But the insured can not claim it directly from the re insurer. If the re insurer fails, the insured is in no way prejudiced became his right is only against the insurer.

Re-Insurance in India:

By an amendment in 1961 to Insurance Act 1938, it was laid down in Section 101-A that all insurer's doing general insurance business should reinsure atleast a specified minimum percentage not exceeding 30% of the sum assured on each policy as may be specified by the Central Government, with an Indian Re insurer approved by the Central Government who is carrying exclusively re insurance business. It is became that time the Indian Insurers are looking to the global market for obtaining re insurance protection. It results in lot of loss to the foreign exchange resources. To avoid this, Reinsurance Corporation of India was formed.

Double Insurance and Under Insurance : :

Double or multiple Insurance is insurance of the same risk with more than one insurer, for example, a person taking insurance of the same risk on his life with many insurers or more than one policy with the same insurer. Life and personal accident insurance are not contracts of indemnity and hence the insured can realise the sums assured from all the policies.

But other insurance are all contracts of indemnity and so nothing more than the actual loss can be realized from all the policies that have been effected. In non- life insurance therefore, over-insurance by multiple insurance is of no particular advantage.

Under Insurance :

Insurance of property for less than its value is under – Insurance. In marine – insurance if there is under insurance the assured is deemed to be his own insurer for the difference,

between the assured sum and the value of the property. But, in other cases, it is not so unless the insurance is stated to be subject to average.

4.7 SUMMARY :

Life Insurance provides risk coverage to the life of a person. On death of the person, it offers protection against loss of income. It provides other schemes along with pension schemes. Individual plans take care of the individual requirements of persons in different situations in life. The term insurance plans are only the risk coverage schemes.

Other individual insurance schemes like while-life, endowment, universal plans etc. provide accumulation of savings along with risk cover. On death of the insured within the term of the policy the risk cover is paid to the policy-holders of the policy along with the surrender value. If the person survives the maturity period, he is eligible to get the face value of the policy along with bonus if applicable.

General Insurance companies offer both personal and commercial policies to individuals. Personal insurance policies are divided into personal accident and health insurance policies, Motor insurance policies, workmen's compensation insurance policies fire insurance, travel insurance, all risks insurance and Golf Indemnity insurance.

Commercial insurance is insurance that deals with firms or companies. The various policies under this cover are fire and allied perils cover, all risk insurance, liability insurance, Marine insurance, Machinery Breakdown insurance, Machinery loss of profits insurance, Burglary insurance, Boiler insurance and Crime Insurance.

The above two types of insurance covers all most all types losses that occur to human kind and the entire globe. Some of the policies are helping the service sector personnel to a great extent. Yet some of the others which have been gaining importance are yet to developed in India.

Re insurance is a process by which an insurer who has undertaken a liability beyond his capacity, may limit it to an amount he is prepared to assume.

Under insurance is the insurance of property for less than its actual value. On the other hand, over insurance means insurance of property for more value than its actual value. In both the cases, the insurance will assess the true value of the property in case of claims made. In case of under insurance the policy holder stands to lose. Similarly, in case of over insurance also the compensation is paid taking into the true value of the property insured. The premiums paid in excess of actual value is a loss to the policy holder a gain to the insurance company. Double insurance is insurance of the same risk with more than one insurer.

4.8 SELF-ASSESSMENT QUESTIONS:

Short Answer Questions :

1. Why are endowment policies popular in our country?
2. Money Back Policy.
3. Whole-life Policy.
4. Re insurance.
5. Double insurance.
6. Under – insurance.
7. Over-insurance.
8. Key-Man Insurance
9. Group Insurance

Essay Type Questions:

1. Explain different kinds of Insurances
2. Explain the different types of Life Insurance Policies.
3. Explain the advantages of Life Insurance.
4. Explain the advantages and limitations of Universal Life Insurance.
5. Explain the methods of Re-insurance.

4.9 REFERENCE BOOKS

1. P.K. Gupta, Fundamentals of Insurance, Himalaya Publishing House
2. Anand Ganguly, Insurance management, New Age International.
3. M.N.Srinivasan, Principles of insurance law, Universal Publishing Company
4. Dr.E. Dharmaraj, Elements of Insurance, Simres Publications, Chennai
5. Dr.P. Periaswamy, Principles and Practice of Insurance, Himalaya publishing House

Chapter – 5

Life Insurance Business in India

Objectives :

After completion of this lesson, you should be able to understand:

- Origin of Life Insurance business.
- Advantages of Life Insurance
- Life Insurance as Protection and Investment
- LIC – its growth and working

Structure:

5.1 Life Insurance Business in India

5.2 Advantages of Life Insurance

5.3 Life Insurance both a Protection and Investment

5.4 Essential Features of Life Insurance

5.5 LIC Business in India

5.6 Summary

5.7 Self-Assessment Questions

5.8 Reference Books

5.1 LIFE INSURANCE BUSINESS IN INDIA

It is a common belief that one of the most difficult products to sell is Life Insurance and one who sells life insurance can sell anything under the sun. There is no gainsaying the fact that selling life insurance is difficult proposition primarily because what is sought to be marketed is an assurance, a belief and a faith.

5.1.1 Definition of Life Insurance :

Life insurance may be defined as a contract in which the insurer in consideration of a certain premium either in lump sum or other periodical payments, agrees to pay to the assured or to the person for whose benefits the policy is taken, a stated sum of money on the happening of a particular event contingent on the duration of human life. Thus, under a whole life Assurance, the policy money is payable at the death of the assured and under an endowment policy, the money is payable on the assured's surviving a stated period of years, for example, on his attaining the age of 55 or his death, should that occur earlier.

J.H. Magee : The life insurance contract embodies an agreement in which broadly stated, the insurer undertakes to pay a stipulated sum upon the death of the insured, or at some designated time to a designated beneficiary.

R.S. Sharma : Life Insurance contract may be defined whereby the insurer, in consideration of a premium paid either in lumpsum or in periodical installments, undertakes to pay an annuity or a certain sum of money either on the death of the nsured or ion the expiry of a certain number of years.

Bunyon's law of life insurance : A contract of Life Assurance is that in which one partly 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."

Meaning of Life Insurance :

According to Sec.(2)(11) of the Insurance Act, Life Insurance business means "the business effecting contracts upon human life.

(a) any contract whereby the payment of money is assured upon death (except death by accident only) or the happening of any contingency dependent on human life;

(b) any contract which is subject to the payment of premiums for a term dependent on human life.

(c) Any contract which include the granting of disability and double or triple indemnity, accident benefits, the granting of annuities upon human life, and the granting of superannuation allowances.".

5.2 ADVANTAGES OF LIFE INSURANCE

1. **Superior to other Form of saving :** Life insurance is superior to other forms of savings because, unlike other savings plans, it affords full protection against risk of death. In case of death, the full sum assumed is made available under a life assurance policy, whereas under other savings scheme the total accumulated saving alone will be available. Any saving is less than the sum assured, if death occurs during early years. It does not serve the purpose which a life assurance policy is intended to serve.
2. **Encourage and Force Thrift :** Most people do not have the will power to continue a long term saving plan. As savings can be easily withdrawn many may not be able to resist the temptation of using it for some less worthy purpose, which may appear important at the moment. Life Insurance provides compulsory saving.
3. **Easy settlement and protection against creditors :** The proceeds of life insurance can be used against the claims of creditors. A policy taken under the Married Women's

Property Act for the benefit of one's wife and children is fully protected from creditors except to the extent of any interest in the policy retained by the insured. It constitutes a trust in favour of the wife/children for which no separate assignment is necessary.

4. **Administers the Legacy for Beneficiaries :** As per the terms and conditions of settlement options, the corporation enables the insured to safeguard the proceeds of a policy in the interest of the beneficiaries. It happens that a provision which a husband or father has made through insurance is quickly lost through speculative or unwise investment or unnecessary expenditure on luxuries. These contingencies can be provided against in the case of insurance as the policy-holder can arrange that in the event of his death the beneficiaries should receive specified lump sum or payment in equal installments selected by the insured.
5. **Ready Marketability and Quick Borrowing :** If the policyholder finds himself unable to continue payment of premiums after a specific period he can surrender the policy for a cash amount. Alternatively, he can tide over temporary difficulty by taking a loan on the policy without delay. A life insurance policy is also acceptable as security for a commercial loan.
6. **Tax Relief :** The Income tax Act allows deduction of certain portion of taxable income of individuals or Hindu undivided families for computing Income tax which is diverted to payment of life insurance premiums. Taking this tax relief into account the assured is in effect paying a lower premium for his insurance.
7. **Estate Duty :** Life insurance is the most practicable way to ensured definite payment on one's death without having resort to conversion of realizable asset at a loss. It affords very satisfactory means of making provision for payment of Estate duty.
8. **Reduces Financial Burden :** Life Insurance reduces financial burden by providing for education of children, marriage of daughter, build a house or starting adventure after retirement.
9. **Peace of Mind :** Life insurance reduces fears about future and provides peace mind and freedom from worries to the policy holders. IN the event of premature death, the dependents get financial support from life Insurance Corporation.

5.3 LIFE INSURANCE BOTH A PROTECTION AND INVESTMENT :

Life Insurance is both a Protection and Investment. There is no other form of economic device which involves both thee elements. The purchase of Life Insurance Policy is usually invested in protecting against risk of premature death as well as saving and investing his

income on a long term basis. This not available in Non Life insurance plan, like fire, marine, accident, burglary, theft and credit insurance. For example, fire insurance does not pay any thing if there is no fire. Thus, it has only the element of protection and not of investment. The same is the case of Marine Insurance. It is only in life insurance that the insurance company promises to pay certain sum either on the happening of death of insured or the period for which the policy is taken. In both the cases the sum assured is recoverable. Thus, Life insurance alone possess both investment and protection.

1. **Element of Protection :** Life insurance has the element of protection which means keeping safe from dangers. In the early death it provides the legal representative a specified sum mentioned in the plan of insurance. Thus, it provides protection by giving income to the deceased family, to those who are left without support and help due to the sudden death of the bread winner.
2. **Element of Investment :** Life insurance provides the best means of savings for investment in future. The accumulated sum of life insurance can provide economic stability in old age when earnings are reduced. The small sum paid to life insurance in the form of premium over a period of 10 or 20 years grow into a large sum which is a great source of confidence. When a person lives up to the maturity of the policy the insurance corporation undertakes to replace income to him and to his dependent. When the specified age is reached, the money is paid back to the policy holder from the accumulated funds. This element of investment is lacking in other policies such as : marine, fire accident etc. In fire insurance the insurer is liable to pay only for damages. The same is the case of Marine Insurance. In all such insurance only protection is given and no money is refunded which was paid by way of premium. Only life insurance has both elements protection and investment.

5.4 ESSENTIAL FEATURES OF LIFE ASSURANCE

The following are the essential features of a valid contract of life insurance.

1. Elements of a valid contract
2. Insurable Interest
3. Utmost good faith
4. Warranties
5. Assignment and nomination
6. Cause is certain

7. Premium
8. Terms of policy
9. Return of premium

Now we shall consider the above features of life assurance.

1. **Elements of a Valid Contract :** Contract of life insurance has the essential elements of a general contract, since the life insurance contract is a contract, as defined in the Indian Contract Act. A valid contract of life insurance comes into existence where the essential elements of agreement (offer and acceptance, competency of the parties, free consent of the parties, legal consideration and legal objectives) are present.
2. **Insurable Interest :** A person cannot insure the life of another unless he has an insurable interest in it. The risk against this policy is the death of the insured. A person has unlimited insurable interest in his own life. A husband is presumed to have insurable interest in his wife's life and vice versa. A survey has insurable interest in the life of the principal debtor to the extent of his claim. In life insurance the insurable interest must exist at the time of the contract of insurance.
3. **Utmost Good faith :** Insurance contracts, however are contracts uberrimae fidei i.e., one base on utmost good faith or the contract of utmost good faith. The insurance is bound to disclose all the material facts and figures known to him but unknown to the insurer. Every fact which is likely to influence the mind of the insurer in deciding whether to accept the proposal or in fixing the rate of premium is material for this purpose. Similarly, the insurer is bound toe exercise the same good faith in disclosing, the scope of insurance which he prepared to grant. In life insurance, age income education, occupation, health family size etc. are some examples of material facts that should be disclosed at the time of entering into the contract.
4. **Warranties :** Warranties are an important feature of life insurance contract. Warranties are the basis of the contract between the proposer and insurer. If any statement, whether of material or non-material facts and figures are untrue the contract shall be null and void the premium paid by him may be forfeited by the insurer. The policy insured will contain that proposer and the personal statement shall form part of the policy and be the basis of the contract.
5. **Assignment and Nomination :** Both the assignment and nomination are essential features of life insurance policy. Assignment of a life policy means transferring the rights of the assured in respect of the policy holder to the assignee. In the case of

the nomination, a person is merely named to collect the amount to be paid by the insurer on the death of the assured.

6. **Cause is certain :** In life assurance policy, the insurer has to pay the insured amount one day or other because the death of the assured or his reaching a particular age is certain to happen.
7. **Premium :** The premium is the price for the risk of loss undertaken by the insurer. In the case of the insurance, premium is usually required to be paid in cash and advance payment of the premium is a condition precedent to the creation of a binding contract of insurance. The amount of premium for payment of insured is paid monthly or on annual installments for a certain period. In life insurance, the premium is calculated on the average rate of mortality and the fixed periodical premium may continue either until death or for a specified number of years. Premium is payable till the maturity of the policy.
8. **Terms of policy :** An insurance policy specifies the terms and conditions or period of time, it covers often the nature of risk against which insurance is sought, determines the period of life of the policy. A life insurance policy may cover a specified number of years or the balance of the insured life.
9. **Return of premiums :** Premium is the consideration for the risk run by the insurers, and if the risk insured against is not run, then consideration fails, the policy does not attach, and as a consequence the premium paid can be recovered from he insurer. The general principle applicable to the claim for the return of the premium is that if the insurers have never been on the risk, they cannot be said to have earned the premium. But where the insurance is avoided by the insurers on the ground of breach of warranty the premium can only be recovered if it is shown there was breach ab iniitio.

The Life Insurance was carried on by the private insurance's before 1956; but since January 19, 1956 the Life business came under the control and ownership of Government. In June 1956, a bill was passed for establishing Life Insurance Corporation of India, which started functioning since September 1, 1956. The Corporation is a body corporate having perpetual succession and a Common seal with powers to acquire, hold and dispose of property and may his name sue and be sued. There will be not more than 15 members including a Chairman thereof. The corporation charged with the main duty to carry on life insurance business. It has one Central Office, 7 Zonal Offices and several divisional and Branch offices.

5.5 LIFE INSURANCE BUSINESS IN INDIA:

The corporation has been established by the Insurance Act, 1956 passed by parliament. According to the provisions of the Act, the Corporation began to function as an autonomous body and has necessarily run on sound business principles. The Government of India nationalized life insurance business in the year 1956. The initial paid up capital of rs.5 crores is wholly contributed by the Central Government to the Life Insurance Corporation of India

5.5.1 Aims of LIC

Life Insurance Corporation of India has come into force with the following aims :

(a) To assure full protection to the policy holders

(b) To encourage and mobilize public savings

(c) Effective utilization of those savings in different forms of investment for national and economic development.

(d) To create liquidity position in public

(e) To motivate saving habits among the public

(f) Provisions for old age and tax concession.

5.5.2 Organization Structure :

To perform the functions of the Life Insurance Corporation of India, a Board of Directors consisting of 15 members is appointed by the Central Government. One of the members is also appointed as the Chairman. The organization structure of Life Insurance Corporation of India has a four tier structure. They are (1) Central Office (2) Zonal Offices (Seven) (3) Divisional Offices (100) (4) Branch Offices (2048 Branches). The central office is to perform the activities relating to investments, framing and administering the rules and regulations of corporation. IN Branch Office almost 90% of the functions relate to policy holders. There are seven Zonal offices and 100 divisional offices, which are established on the basis of geographical areas. They discharge their coordinating functions relate to policy holders. There are seven Zonal offices and 100 Divisional offices, which are established on the basis of geographical areas. They discharge their coordinating functions relating to the Central Offices and Zonal Offices. The Central Offices of Life Insurance Corporation of India is located at Mumbai. There are several executive committees appointed by the Government of India from time to time to review the activities of the Life Insurance Corporation of India.

5.5.3 Role of LIC in National Economy :

The role of Life Insurance Corporation involves all the activities relates to national economy, individual and society. The following are the important areas identified.

1. Investment
2. underwriting
3. Disbursing Loans
4. Subscribing to Debentures and Bonds
5. Socially oriented
6. Shareholding
7. Control
8. Mutual Fund
9. Boosting Industrial Growth
10. Claims and Settlement

1. **Investment :** Life Insurance Corporation is acting as capital market intermediaries. It provides long-term investments in Government Securities, Public sector, Co-operative sector, Private sector and Joint Sector. On the Stock Exchange it is considered a very powerful security holder.
2. **Underwriting :** LIC has been the largest underwriter of capital issues in the India capital market till the year 1978 after which it has reduced its activities in favour of socially oriented projects. During the year 1983 onwards. LIC underwrites firms and prefers large and established companies. It also prefers further issues. As an underwriter, it influences the capital market considerably and is also able to stabilize the market during the downswings or depression periods.
3. **Disbursing Loans :** Since 1970 LIC has disbursing loans for industrial development. One of the major avenues of investment in every year constituted financing through loans. It has given loans for generation and transmission of electricity for agriculture and industrial use, housing schemes, piped water supply schemes and development and road and transport. Out of the total disbursement of all financial institutions to the industry LIC's contribution comes to around 8%.
4. **Subscribing to Debentures and Bonds :** Financial institutions and corporate enterprises requiring burgeoning funds to meet their expanding needs find it easier and cheaper to raise funds from the market by issuing commercial papers. LIC also subscribes to debentures and bonds of various financial institutions and development

banks like IDBI and IFCI. In 1983. LIC subscribed to the Debentures of ICICI of the value of rs.8 crores.

5. **Socially oriented :** A basic feature of financial liberalization and many innovations are the trend towards social orientation. LIC has resorted to socially oriented schemes has big way since 1978. This has brought down its activities in the capital market. The rationale behind this change has been to go in for developmental work. Own your House (OYH) schemes have been given priority. Apart from these schemes, loans for sewerage, road and transport and electricity generation have also been given priority in the recent years.
6. **Shareholding :** By virtue of its shareholding LIC has been recognized amongst the top ten shareholders in one of every three companies listed in the stock exchange on which it has share hold in companies. While LIC has invested in large blocks of equities and in later years in debenture holdings, it had kept away and did not interfere in the decisions of the management in the past.
7. **Control :** In the recent years, LIC has influenced the management to take proper decisions and to tone up the quality of working in the companies financed by it. This is intended to promote confidence in the minds of the public and to exercise control in the corporate sector which often has a very small shareholding. In 1984 LIC dominated Indian industries scene. These changes in the direction of the LIC are bound to exert some pressure on the industry and change the complexion of the Indian industrial scenario.
8. **Mutual Fund :** It has set up in 1989, a Mutual fund for operating various schemes for mobilization of savings from the public particularly from the rural and urban areas and channel these funds to the capital market. The LIC has considerable expertise in investment management by virtue of its earlier operations of funds.
9. **Boosting Industrial Growth :** The corporation helps boost the industrial growth in the country. It helps small scale and medium scale industries by granting loans for setting up co-operative industrial estate and an amount of rs.45 cores has so far been advanced to industrial estates and industrial development corporations. The corporation also makes investment in the corporate sector in the form of long, medium and short term loans to companies/corporations. The total investment made by way of loans upto year 2001 was rs.2812 crores and by way of subscription to shares/debentures was rs.35048 crores. All this makes a distinct contribution towards growth in industrialization and generation of skilled and unskilled employment opportunities in the country.

10. **Claims and settlement :** The settlement of claims constitute one of the important functions of the corporation. Indeed, the payment of claims may be regarded as the primary services of insurance to the public. Proper settlement of claims will be provided on the basis of sound knowledge of law, principles and practices governing, insurance contracts, terms and conditions of standard policies etc.

Progress of Life Business of LIC

The progress of life business of LIC can be evaluated by various indicators such as growth of new business, performance of business in force, progress of number of lives covered, investments, claims settlement and so on.

5.5.4 Privatization of Life Insurance Business :

As part of the wide ranging economic reforms announced in 1991, industrial policy measures were initiated by the Government of India to liberalize the MRTP and FERA regulations. The most important aspect of the MRTP Act was amended to totally remove pre-entry restrictions on establishments of new undertakings and expansion of the existing firms. Important changes were also made in the Foreign Exchange Regulation Act, (FERA) of 1973 in order to encourage foreign investment in India. FERA companies are allowed to have foreign equity holdings upto 51 per cent in high priority areas. FERA companies are granted greeted freedom to operate in India. Since restriction on internal operations have been removed. It means that FERA companies are now treated almost at part with the Indian companies. It is a great motivation to foreign corporate giants to freely operate to India without fear.

As part of the liberalization process, the Government had to review the role of insurance sector and Government's investment in it. Accordingly the Malhotra committee set up to study the insurance sector suggested in 1944 in its reports among other things the privatization of the insurance sector. While praising the work done in achieving many of its objectives, the committee was critical about the low insurance coverge, unresponsiveness to customers needs, poor service, costly insurance cover with low returns, hierarchical management and an excessive lapse ratio policies. It stated that there was a large untapped potential for insurance in the country and this led to the first step being taken towards opening up of this sector to private player. As the results of the committee's recommendation to open up the sector to participation was implemented by the government in 2000. The key element in the reform process was the participation of overseas insurance companies through restricted to 26 per cent of capital.

Private Life Insurers Operating in India :

The Indian insurance sector was opened for private insurance when the Government enacted the Insurance Regulatory and Development Authority Act, 1999 leading to the establishment of IRDA. The main objective of setting up the IRDA was to protect the interest of policyholders and to regulate, promote and ensure orderly development of the insurance sectors. It is also aimed at ending the monopoly of the Life Insurance Corporation (LIC) and General Insurance Corporation (GIC) in the insurance sector of the company. The first private life insurance company was registered with IRDA in October, 2000 and started operations shortly thereafter thereby ending 44 years of public sector monopoly. Since then many more private companies have been registered bringing the total number to a dozen as of July, 2002 all fo which are joint ventures between major business houses or banks in India and renowned international insurance giants. Today after nearly fifty years, the insurance sector is a buyer's market where the consumer has the choice to select from variety of insurers. The table shows the lists of new entrants of insurers are associated with foreign shareholders to sell insurance products in India as on 2002 is given below.

List of Private Life Insurers in India

	Company	Major Local shareholders	Business of Local shareholder	Business of Local shareholders
1.	Allianz Bajaj Life	Allianz	Bajaj Auto	Auto manufacturer
2.	AMP Sanmar	AMP	Sanmar	Diversified Conglomerate
3.	Birla Sun Life	Sun Life of Canada	Birla Global Finance	Diversified Conglomerate
4.	Dabur CGU	CGNU	Dabur	Medical & Consumer Products
5.	HDFC Standard Life	Standard Life	HDFC	Investment & Finance
6.	ICICI Prudential Life	Prudential (UK)	ICICI	Investment & Finance
7.	ING Vysya Life	ING	Vysya Bank	Bank & Other investors

8.	Max New York Life	New York Life	Max India	Diversified Conglomerate
9.	Met Life India	Met Life	Jammu & Kashmir, Bank : Pallonji Group	Bank and Diversified Conglomerate
10.	OM Kotak Mahindra	Old Mutual	Kotak Mahindra	Investment & Finance
11.	SBI Life	Cardiff	SBI	Bank
12.	Tata-AIG Life	AIG	TATA	Diversified Conglomerate

The summarized results of LIC are given below.

LIC of India

Summarised Results

New Business For the year	**2014-15 (Rs. in crore)**	**2013-14 (Rs. in crore)**
INDIVIDUAL ASSURANCE		
Sum Assured/NCO/MSB		
(a) Assurances	4,08,679.65	5,57,709.40
(b) Annuities*	0.00	0.00
(c) Pension*	1,051.04	601.08
(d) Non Linked Health* * *	3,795.02	4,070.59
(e) Linked	0.00	160.55
No. of Policies (in lakh)		
(a) Assurances	199.13	342.10
(b) Annuities	0.29	0.24
(c) Pension	0.24	0.15
(d) Non Linked Health	1.67	2.34
(e) Linked	0.00	0.08

New Business For the year	2014-15 (Rs. in crore)	2013-14 (Rs. in crore)
GROUP SCHEMES:		
Sum Assured (incl. Linked Business)	2,47,447.94	1,76,892.18
Annuities per annum	2,589.29	2,859.31
No. of Schemes:		
Group Insurance (incl. Linked Business)	27,293	25,594
Social Security Group Schemes	5,417	5,292
Group Superannuation	462	465
No. of lives (in lakh)		
Group Insurance (incl. Linked Business)	311.26	347.51
Social Security Group Schemes	205.97	118.87
Group Superannuation	5.49	4.56
BUSINESS IN FORCE At the end of the year:		
INDIVIDUAL INSURANCE		
Sum Assured & Bonus/APA/MSB		
(a) Assurances	4,04,458.04	38,11,781.23
(b) Annuities*	1,344.20	1,271.06
(c) Pension*	1,928.14	1,915.83
(d) Non Linked Health* * *	9,335.07	7,286.17
(e) Linked	64,978.93	78,480.85
No. of Policies (in lakh)		
(a) Assurances	2,776..82	2,796.26
(b) Annuities	7.25	7.09
(c) Pension	16.35	16.67
(d) Non Linked Health	4.00	3.28
(e) Linked	97.77	139.14
GROUP SCHEMES		
Sum Assured	7,08,450.6	6,28,260.73
Annuities per annum	17,665.84	14,890.75
No. of Schemes:		
Group Insurance	1,37,112	1,33,321
Group Superannuation	9,091	8,719

No. of lives (in lakh)		
Group Insurance	1,060.53	1,060.17
Group Superannuation	98.02	93.57
INCOME	**2014-15 (Rs. in crore)**	**2013-14 (Rs. in crore)**
INDIVIDUAL ASSURANCE		
First Year Premium	19,432.44	27,010.36
Percentage Increase over Previous Year	-28.06	-3.21
Renewal Premium	1,52,713.10	1,36,782.80
Single premium & Consideration for Annuities Granted	13,451.82	13,548.16
Individual Pension Schemes		
First Year Premium	48.14	29.90
Renewal Premium	837.85	928.10
Consideration for Annuities Granted	27.30	1,286.21
Group Schemes		
Group Insurance Premium	19,409.17	20,720.27
Group Superannuation Premium	31,699.72	33,775.38
LINKED BUSINESS PREMIUM	1,863.23	2,716.89
Total Premium Income	**2,39,482.77**	**2,36,798.07**
Percentage Increase over Previous Year	1.13%	13.52%
Income from Investments	1,35,483.09	1,18,097.09
Miscellaneous	26,461.00	22,954.01
Total Income	**4,01,426.86**	**3,77,849.17**
Variation due to change in Fair Value of Linked Business (unit fund)	6,119.49	2,193.27
Net Total Income	**4,07,546.35**	**3,880,042.44**

Note: Previous year figures regrouped wherever necessary.

LIC of India : Summarised Results

OUTGO	2014-15 (Rs. in crore)	2013-14 (Rs. in crore)
Payments to Policy-holders		
Claims by Maturity		
Number (in lakh)	224.20	250.63
Amount	83,372.06	85,161.57
Claims by Death		
Numbers (in lakh)	10.25	10.83
Amount	11,029.66	10,289.25
Annuities	5,059.95	4,416.50
Surrenders, etc.	46,563.83	59,651.91
Total Amount	**1,46,025.50**	**1,59,519.23**

Summarised Results

EXPENSES OF MANAGEMENT	2014-15 (Rs. in crore)	2013-14 (Rs. in crore)
Commission etc. to Agents	15,092.10	16,681.29
Salary and other Benefits to Employees	14,523.44	14,705.11
Other Expenses of Management	7,869.25	9,060.79
Total	**37,484.79**	**40,447.19**
Other Outgo		
Other Outgo (Taxes. Transfers to Reserves, etc.)	5,063.04	4,519.91
5% of Valuation Surplus paid to the Central Government	1,803.05	1,634.27
Total	**6,866.09**	**6,154.18**
Total Outgo	**1,90,376.38**	**2,06,120.60**
Policy Liabilities		
Non Linked Business		
Policy Liabilities at the beginning of the year	15,29,212.87	13,29,450.34
Add: Excess of Income over Outgo	2,24,885.60	1,99,762.53
Policy liability at the end of the year	**17,54,098.47**	**15,29,212.87**
Percentage Increase over the previous year	14.71%	15.03%

Linked Business		
Policy Liabilities at the beginning of the year	77,812.11	1,03,652.80
Add: Addition during the year	-7,715.63	-25,840.69
Policy liability at the end of the year	**70,096.48**	**77,812.11**
Percentage Increase over the previous year	-9.92%	-24.93%

*Previous year figures regrouped wherever necessary.

Outstanding Claims at the end of the year	**2014-15 (Rs. in crore)**	**2013-14 (Rs. in crore)**
Maturity	774.31	1,046.34
Death	214.94	235.56
Total	**989.25**	**1,281.90**
Ratio of Expenses of Management To Total Premium Income		
Commission etc. to Agents	6.30%	7.04%
Salary and other benefits to Employees	6.06%	6.21%
Other Expenses of Management	3.29%	3.83%
Overall Expenses Ratio	15.65%	17.08%
Ratio of Outstanding Claims To Claims payable	1.05%	1.40%
Rate of Interest realised on Mean Life Insurance Fund	8.22	8.08

5.5 SELF-ASSESSMENT QUESTIONS

Short Answer Questions

1. Life Insurance Fund
2. Group Insurance
3. Total Income
4. Total Business in Force
5. Working Results.

Essay Type Questions

1. Define Life Insurance. Explain its advantages
2. "Life Insurance both a Protection and Investment". Explain
3. Explain the essential features of Life Insurance
4. Discuss the privatization of Insurance Business in India.

5. Critically examine the growth and working of the LIC of India.
6. Explain in brief the working results of Life Insurance Corporation of India.

5.7 REFERENCE BOOKS:

1. P.K. Gupta, Fundamentals of Insurance, Himalaya Publishing House
2. Anand Ganguly, Insurance management, New Age International.
3. M.N.Srinivasan, Principles of insurance law, Universal Publishing Company
4. Dr.E. Dharmaraj, Elements of Insurance, Simres Publications, Chennai
5. Dr.P. Periaswamy, Principles and Practice of Insurance, Himalaya publishing House

Chapter – 6

Life Insurance Contract

Objectives :

After completion of this lesson, you should be able to understand:

- Characteristics of a Contract.
- Essentials of a valid contract
- Meaning of Life Insurance Contract.
- Implications and significance of a Proposal Form, Warranties.
- Various conditions applicable to life policy.
- Contract of Indemnity.
- Subrogation

Structure:

6.1 Introduction

6.2 Essentials of a Insurance Contract

6.3 Essential of Insurance Contact

6.4 Warranties in Insurance Contract

6.5 Insurance Documents

6.6 Essential characteristics of a Contract

6.7 Life Insurance Policy

6.8 Right of repudiation is not absolute.

6.9 Restrictions under Sec.45 of the Act.

6.10 Importance of Proposal Form.

6.11 Evidence of Contract.

6.12 Summary

6.13 Self-Assessment Questions.

6.14 Reference Books.

6.1 INTRODUCTION

The contracts of insurance are governed by the same general principles of law as are applicable to other contracts. The contract of insurance is a species of general contract governed by the provisions of Indian Contract Act of 1872.

According to **Patterson**, "Insurance is a contract by which one party, for a compensation called the premium, assumes particular risk of the other party and promises to pay to him or his nominee a certain or ascertainable sum of money on a specified contingency".

According to Section 2 (e), every promise and every set of promises, forming consideration for each other."

According to Section 10 of the Indian Contract Act, all agreements are contracts, if they are made by the free consent of the parties competent to contract, for a lawful consideration and with a lawful object and are not hereby expressly declared to be void."

6.2 ESSENTIALS OF A CONTRACT

Insurance contracts also must satisfy all the essential elements of a valid contract under section 10 of the Indian Contract Act. They are:

1. **Offer and acceptance:** There must be a lawful offer and a acceptance of the offer, thus resulting in an agreement. The adjective lawful means that the offer and acceptance must satisfy the requirements of the Contract Act in relation there to. Offer and acceptance may be oral, written or implied from conduct.

   In insurance contract, the insured makes an offer to the insurance company by filling the prescribed form. If the insurance company is satisfied with information given in the proposal firm may accept it. After acceptance, the insurance company will inform the insured about the premium payable to cover the risk of the insured. Cover note issued to the insured is the acceptance of the company.

2. **Intention to create legal relation:** There must be intention among the parties that the agreement should be attached by legal consequences. Agreements of social nature do not create legal relation. An agreement to attend a marriage function is not an agreement intended to create legal relations. Therefore, it is not a contract.

   In insurance contract, the insured expresses his intention while making an offer and the insurer an accepting the offer express his intention to find both the parties as per the terms and conditions of the insurance policy.

3. **Capacity of parties:** All natural persons competent to contract but the Indian contract Act exempts certain persons like, minors, lunatics, and persons who are incapable of contracting. Thus, all the above mentioned persons are not competent to enter into contract.

In insurance contracts both the insurer and the insured must be capable of a valid contract.

4. **Free consent:** Free consent of all the parties to an agreement is another essential element. Consent means parties must have agreed on the same thing in the same sense. Absence of free – consent arises due to coercion, undue influence, fraud, misrepresentation or mistake. If any agreement is vitiated by any of the four mentioned above the contract becomes voidable and cannot be enforced. The aggrieved party can accept or reject it.

5. **Lawful consideration:** Consideration means something in return. It is the price paid by one party for the promise of the other. An agreement is enforceable when each of the parties gives something and gets something. The something given is the price for the promise and is called consideration. A consideration is valid only when it is not forbidden by law. Agreements opposed to public policy are not valid. Similarly, immoral agreements are also not valid.

6. **Lawful object:** For a contract to be valid, the parties to an agreement must a free for a lawful object. The object of the agreement should not be fraudulent or illegal or immoral or opposed to public policy. If the object is unlawful the agreement is void.

   Ex: House let out for running a brothel. In case of default, the landlord cannot recover the rent through Court of law.

7. **Possibility of Performance:** An agreement to do an impossible act is void. It cannot be enforced, it the act is impossible in itself. Ex: A promise to bring stars from the sky.

8. **Agreement not declared void:** An void agreement does not create any legal rights. It never results in a valid contract. The following are the examples:

   (a) Agreements relating to unlawful objects.

   (b) Agreements without consideration.

   (c) Agreements unrestraint of trade.

   (d) Wagering agreements.

   (e) Agreements to do impossible acts etc.

9. **Other legal formalities:** A valid contract can be made by either word spoken or written. It is always better for a contract to be in writing. Some other formalities are also required for a contract to be enforceable.

   An insurance contract must be in writing. If must be properly stamped and executed by the appropriate authority to make it legally enforceable.

6.3 ESSENTIALS OF INSURANCE CONTRACT:

In addition to the essential elements of valid contract mentioned above, an insurance contract must also satisfy the following essentials:

(a) Insurable interest.

(b) Utmost good faith.

(c) Warranties.

(d) Indemnity.

(e) Doctrine of subrogation.

(f) Proximate clause etc.

All the above mentioned essentials except 'Warranties' are explained in detail in the lesson 'Principles of Insurance.' Hence, Readers are requested to go through lesson 2.

6.4 WARRANTIES IN INSURANCE CONTRACT:

A warranty is a stipulation which is collateral to the main contract. Warranties are conditions which form part of an insurance contract. If there is a breach of warranty, the aggrieved cannot repudiate the contract but can claim damages only.

Warranties are of two types. Express and implied warranties. Express warranties are those which are expressly provided in the insurance policy. On the other hand implied warranties are those which are implied by law.

According to Section 33 of the English Marine Insurance, "A warranty is a promise by the assured to the underwriter that something shall or shall not be done or that a certain state of affairs does or does not exist."

A breach of warranty may be waived by the insurer. When a warranty is broken, the contract will come to an end.

In the following cases a breach of warranty will not affect the validity of a contract:

(a) It is no longer applicable to the contract due to change of certain circumstances.

(b) If it is declared as unlawful by law.

(c) When its non-performance is excused.

6.5 INSURANCE DOCUMENTS

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 give 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.

(a) Proposal Form
(b) Policy Form
(c) Cover Note
(d) Certificate of Insurance
(e) Endorsement

(a) Proposal Forms :

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.

In Marine Cargo Insurance, it is not the practice to use a proposal form, although sometimes it is usual to obtain a questionnaire or a declaration form duty 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 simnple 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 in variably 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.

(a) Proposer's name in full
(b) Proposer's address
(c) Proposer's profession, occupation or business
(d) Previous and present insurance
(e) Loss experience
(f) Sum insured
(g) Other Section's – Signature, date, place et.

(b) Policy forms :

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 itself and it is obligatory for insurers to use these wordings. In fire and miscellaneous insurance, the policy form used is on 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.

(a) Recital clause or Preamble
(b) Operative clause
(c) Attestation clause
(d) Conditions
(e) Schedule

1. **Recital Clause :** The opening section of the policy is termed as Recital Clause because it recites the parties to the contract, and if the insurance is based upon a proposal form and declaration, this is also mentioned.
2. **Operative Clause :** The operative clause sets out the circumstances in which the insurers agree to make a payment or its equivalent to the insured.
3. **Attestation Clause :** This clause governs the signature of the policy and its wording depends upon the practice of the insurers concerned for the execution of documents.
4. **Conditions :** All policies are subject to conditions which are printed on the policy. They are called Express conditions which are necessary to regulate the contract. There are certain conditions implied namely (a) good faith (b) insurable interest etc.
5. **Schedule :** In the schedule will be found certain particulars common to most classes of policies and other peculiar to the type of insurance under consideration. The particulars common to most policies include details of the policy number, first and annual premiums, renewal date, name and address of the parties and the period of insurance, with the date of signature of the policy.

(c) Cover Note :

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 a cover.

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.

(d) Certificate of Insurance :

In motor insurance, in addition to the policy, a certificate of insurance is required by the Motor Vehicle Act, 1988. This certificate provides evidence of insurance to the police and Registration authorities. It contains the essential features of the cover including the terms and conditions.

In Marine insurance, certificate of insurance is issued to provide evidence of cover on shipments insured under cargo open cover or floating policies.

(e) Endorsements :

It is the practice of insurers to issue policies is 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.

6.6 ESSENTIAL CHARACTERISITCS OF CONTRACT:

The following are the essential characteristics.

(a) Offer and acceptance
(b) Capacity to contract
(c) Consideration
(d) Legal object
(e) Free consent.

The life insurance contract is based on a written proposal from signed by the proposer. In most of in contracts the proposer and the insured are one and the same person. After due

verification of the required information furnished by the insured, the insurance company accepts the risk by entering into a contract. The contractual obligations are to be performed in future by the company. The insured also promises to pay premium in future. Thus, it is a contract of promises. The subject –matter is intangible unlike in a commercial contract where the product purchased is tangible. In a commercial transaction the principle of 'Caveat Emptor' applies. It is because the product is available for inspection. But in a Life Insurance Contract, the product to be purchased and sold is the insured himself. The insurance company or the agent cannot find out the adverse factors relating to the insured. It is not possible to know the adverse family history of the insured unless he himself discloses. Thus, the law has recognised this feature as, a 'Principle of utmost good faith'.

In Life Insurance the obligation to disclose material facts starts with the proposal form and ends with the payment of first premium by the insured. Any concealment of material fact by the insured either knowingly or un-knowing vitiates the contract. (Major Chopra Vs. New Zealand Insurance Co.)

6.7 LIFE INSURANCE PROPOSAL

In this, the insured makes a declaration that the statements are true and any untrue statements would entitle the insurer to set aside the contract and forfeit the payments made. Such declaration converts representations into warranties.

This is stated by the Indian Life Insurance Companies in the case of New India Vs. TSR Reddy.

English courts also confirmed this view in the following case:

Joel Vs. Law Union Crown Insurance.

Godfrey Vs. Britannia Assurance Co.

The Indian courts expressed that the declarations made in the proposal form amount to warranty and form the basis of the policy. The cases are:

Brahma Dutt Sharma Vs. LIC.

All India General Insurance co. Vs. S.P. Maheswari.

I was also decided that non-disclosure of material facts is sufficient cause for repudiation.

How Insurance Interest is Determined?

No person can legally effect any kind of insurance unless he has some pecuniary interest in the thing insured. An insurance contract without such interest will be illegal and void. Following conditions determine an insurable interest.

1. It must have a pecuniary basis.
2. It must exist at the time the policy is effected. In any indemnity insurance, life, fire and marine insurance the insurable interest must exist not only at the date of the insurance contract but also at the date of loss at stated above.
3. A husband has personal interest in his wife on the basis of affection.
4. A creditor has interest in the life of his debtor to the extent of his dept. When the creditor pays the premium on his own account he will be entitled not only to the policy money but also to recover his debt from the executors of debtor. On the death of the debtor when, however, the premiums are paid by the debtor or charged to him in account, the creditor must set of his debt against the policy money and account for any balance to the executors of the debtor.
5. A trustee has interest in respect of the interest of which he is a trustee.
6. A surety may insure the life of his principal.
7. A business partner may insure the life of his co-partner to the extent of the capital advanced by the latter.
8. An insurer may insure an assured's life sufficient to support a re-insurance.
9. An employer may have an insurable interest in the life of his employee. A business firm may insure the life of its manager or technical experts etc.

Where does Interest not Exist?

An insurable interest does not exist where it is a mere expectation of future benefit. This is however, quite different from a definite vested interest in a will that cannot be revoked or a trust deed or settlement that is already in existence. A debtor has no such interest in the life of the creditor although the latter has promised not to enforce debt in his own lifetime. The following have no insurable interest :

1. A parent has no insurable interest in the life of his child
2. A child has no insurable interest in the life of his parent.
3. Sisters have no insurable inter4est in each other's lives
4. A debtor has no insurable interest in the life of his creditor.

Mere natural love and affection are not sufficient per se to constitute insurable interest. Similarly, merely moral obligation as distinguished from a legal obligation, will not contribute an insurable interest. In USA an insurable interest is admitted in the life of any relative. Where apart from any legal liability in the matter, there is actual dependence on the relative, lack of insurable interest is a defence which the life office may plead in resisting a claim.

A different situation arises with regard to the insurable interest of a parent who effects a policy of depressed assurance on the life of his child.

The existence of insurable interest is the determining factor as to whether a person paying the premium has the right to so pay the premium on an insurance policy on the life of another.

In the case of Dr.M.S.S. Pandya Vs. Allianz Und Stuttgarter Life Insurance Bank Ltd. and others (AIR, 1941, Lahore 33) the doctor insured the life of his younger brother who was carrying on a money lending business on his own behalf and was not rendering any valuable services to the doctor. The younger brother received maintenance and in view thereof he had to assist his brother as a compounder and render voluntary services of an insignificant and perfunctory nature. No such services were rendered by him as could he enforced in a court of law by the doctor. In the insurance policy he was shown as a money lender carrying on independent business and was not ensured as a compounder rendering service to his brother doctor. It was held that under these circumstances it could not be said that the doctor was in any way dependent on his brother or he expected to receive any substantial advantage from the combined existence of the life of his brother. In insuring his younger brother's life for a sum of Rs.20,000 the doctor was not insuring the life of a compounder but was entering into a wagering transaction hoping to make money if his younger brother disappeared. The policy was issued on the life of his brother and shortly after it was assigned in favour of the doctor who was paying the premiums. This contract of insurance was therefore, held as against public policy and was declared a wagering contract.

6.8 RIGHT OF REPUDIATION IS NOT ABSOLUTE:

Section 45 of Indian Insurance Act 1938 severely limits the freedom given to insurance companies in this respect. The burden of proof is on the insurer. Mere constructive fraud is not sufficient. (LIC Vs. Parvativardhini Amma). The doctrine of warranty does not apply after two years. The case of antedating and postdating is not allowed as they defeat the very oasic purpose. (Sec. 45).

In case of lapsed policy revivals the period of two years is to be counted from the date of commencement of the policy. This section applies even in respect of the death of the insured within two years of commencement of the policy. The date of repudiation is crucial. (Mahesh Shastri Vs. LIC).

6.9 RESTRICTIONS UNDER SECTION 45 OF THE ACT:

It placed certain restrictions on the repudiation of insurance policy. The statutory provisions make a life insurance policy indisputable once the two years period from first premium receipt is over. The period two years is to be calculated from the date of first premium to the date of repudiation. More over, Sec.45 does not mention the word 'Death' at all.

Thus, the insurer can proceed in respect of a policy which is in force even if there is an evidence to prove that the particular policy was obtained by non- disclosure of material facts.

6.10 IMPORTANCE OF PROPOSAL FORM:

It assumes great importance in life insurance contract. The agents confidential Report helps the underwriter to decide whether a particularly policy is suitable for insurance or not. The agent must have verified the bonafides of a proposer in respect of his health, financial conditions etc. Hence, Agent is called first line underwriter. Generally, proposers are secured under medical examination. Panel of Medical Examiners are appointed by the company and the agent refer the proposers to the Medical Examiners. This is to know the medicals status of the proposer. It helps the agent to arrive at the Extra Mortality Rating. Thus, though the medical report is not the basis of the contract, it is the basis of the underwriting.

6.11 EVIDENCE OF CONTRACT

When the proposal is accepted and the first premium along with the consent letter is received, then the insurer issues the FPR. It indicates that the company has gone on risk. This is followed by the issue of the policy document which is the evidence of a contract.

Material fact :

A material fact is one which affects the nature or incidence of risk in a proposed insurance. It is an essential fact which the insurer will take into consideration in deciding whether to accept the insurance proposal for a given risk or not. It is the fact which has a bearing or which is expected to influence the amount of premium. Thus, the material fact depends on the circumstances of a case and the subject-matter of insurance. However, unimportant facts or omissions or misstatements may be execused.

Examples of Material facts :

1. **Life Insurance :** (i) If the proposer suffers from any disease. (ii) If the occupation is a hazardous one (iii) If at any time, proposal had been rejected (iv) If there is family or hereditary disease.

   In the case London Assurance Co. Vs. Marsel an applicant for an insurance policy was asked whether he had applied to any other company for insurance and whether such application has been accepted. He stated that he had insured with two other companies but failed to disclose that his applications were turned down by those companies. And it was held that there was material concealment and the policy was set aside.

2. **Fire Insurance :** (i) If at any time the property had been rejected for insurance (ii) If the property is a damaged one, (iii) Whether any explosive is kept in the property. (iv) Property is used in explosive business.

3. **Marine business :** (i) If the proposed ship is damaged (ii) If the ship is found to be unseaworthy; (iii) If the ships engine is defective.

Matters deemed to be Material facts :

1. **Void :** If the non-disclosure is intentional and fraudulent or if it is misrepresented willfully, the contract is treated as void by the insurer and is avoided without any payment. Such contracts cannot be enforced in the court of law.

2. **Voidable :** If there is any miststatement or misrepresentation which is unintentional, the party of loss can make the contract voidable if he so likes. The insurer can charge higher premium or can cancel the contract. The assured is not bound to disclose nay facts which may come to his knowledge after the contract is entered into.

To what Extent the Assured is Required to Disclose?

It is the duty of the proposer to disclose all the material facts at the time of filling up the proposal form. He is required to maintain good faith till the contract is entered upon. The contract can be avoided if it is found that certain facts were not disclosed. Either the parties, mainly the proposer, cannot defend himself on the ground of omission by carelessness or by mistake or that he did not regard it material to the contract. However, the assured is under no obligation to disclose any facts which may come to his knowledge after the contract is entered into. For the benefit of the policyholders the LIC provides a condition called "Incontestable clause" according to which no policyholders can be called in for any non-=disclosure or misrepresentation after the policy has been enforced for two years. However, in case of fraudulent statements, the insurer is entitled to question at any time and till the expiry of the term of insurance.

The duty of disclosure finishes at the moment the proposal form has been fully and correctly filled up, provided there are no such facts which he considers or expects to be considered material and have not been disclosed.

6.12 SUMMARY

Insurance plays an important rule to all sectors in general and to the human beings in particular. For the provision of protection to life and property, human beings facing the same or similar risks came together and shared in advance the probable future loss that might arise due to specific reasons under specific circumstances during a specific period. This idea of collective protection was practices even in ancient days.

The greatest risk to which human life is exposed is that of death. Though death is certain, the time when it strike is uncertain. This uncertainty given rise to insurance. Insurance cannot avoid this uncertainty but what insurance ensures is the replacement of financial or economic loss if such an event occurs. Insurance cannot post –pone the event. The insured event cannot be brought about earlier.

Thus, Life Insurance satisfies two basic needs. That is economic protection in case of premature death and financial income support to the person surviving.

6.13 SELF-ASSESSMENT QUESTIONS:

Short Answer Questions

1. Define Contract
2. Warranties in Insurance Contract
3. Endorsement of Policies
4. Life Insurance Proposal
5. Evidence of Contract
6. Utmost good faith
7. Characteristics of a general contract.

Essay Type Questions:

1. What are the essentials of a Life Insurance contract?
2. Explain the important documents in Life Insurance Contract.
3. What is Life Insurance Proposal?
4. How Insurance Interest is determined?

5. Explain the evidence in a Life Insurance contract.
6. Explain the differences between a general contract and a life insurance contract.
7. Explain in brief the contract of Life Insurance.

6.14 REFERENCE BOOKS:

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5. Dr.P. Periaswamy, Principles and Practice of Insurance, Himalaya publishing House

Chapter – 7

Classification of Life Insurance Policies

Objectives

After completion of this lesson you should be able to understand :

- Classification and types of individual life insurance policies
- Life term, whole life, endowment, money–back etc.
- Non-conventional policies

Structure

7.1 Introduction

7.2 Different types of policies

7.3 According to premium payment

7.4 Policies according to participation in profits

7.5 Policies according to Number of persons insured.

7.6 Method of Payment of policy amount

7.7 Non-conventional policies

7.8 Summary

7.9 Self-Assessment Questions

7.10 Reference Books

7.1. INTRODUCTION

Life insurance contract provides protection and investment facilities. After insurance, the policy-holders feels a sense of protection because he will be paid a define amount on his premature death or on maturity of the policy. The older the policy, the lesser the element of protection and higher the element of investment and vice-versa.

The policy holders are free to choose the best policies according to their requirements. No single policy is the best policy for all the policy-holders due to variance in cost, elements of investment and protection, availability of the policy etc.

7.2. DIFFERENT TYPES OF POLICIES

The life insurance policies can be divided on the following basis.

1. Duration of policy

2. Method of premium payments
3. Participation in profit
4. Number of lives covered
5. Method of payment of claim

7.2.1 Policies according to duration of policies :

The life insurance policies according to the duration may be :

1. Term Insurance Plans :

In case of term insurance plans the insurance company promises the insured for a nominal premium to pay the face value of the policy in case the holder dies during the term of the policy. There are short-term policies with provision for renewal. The period of coverage is specified which starts from one year.

Features of Term Insurance Policy : The features of term insurance policy include the following.

(a) It provides risk cover for a prescribed period
(b) It has no surrender value
(c) The premium on these policies and less than others
(d) The policy lapses if premium is not paid within grace period
(e) A lapsed policy can be revived during the life time of the assured but before termination period of two years from the due date.
(f) Accident or disability benefits are not covered
(g) The sum assured is paid only in case of death of the insured.

Suitability of the Plan :

(i) It is suitable to those who can not pay higher premium,
(ii) They can be purchased by the bread-winners at young age
(iii) They are suitable for coverage for short periods
(iv) They can be purchased by low-income groups.

Limitations of the plan :

(i) Savings are not accumulated to the insured
(ii) At later stages the premium becomes prohibitive.

2. Whole life Plans : The remain valid as long as the policy-holder is alive.

Features : The following are the important features of whole life plan plans.

(a) It covers risk during life-time of the policy-holder.
(b) Claim amount is payable on death of the policy-holder.
(c) Loans can be availed.
(d) Premiums are higher than term insurance policies

(e) Minimum age is 18 years and maximum is 60 years

(f) Amount premium, is the same through out.

Suitability :

(a) For higher income – group persons with saving habit

(b) To provide protection against pre-mature death

(c) Facilitates to meet children's education, daughter's marriage etc.

Example : Whole life with profit

Limited payment whole life with profits

Single premium whole life

Convertible whole life policy of LIC

Whole life plan of Birla Sunlife insurance.

7.2.3. Endowment Plans :

It is the accumulated value of the investment made. Thus, they guarantee protection from risk in the event of death of the insured. It gives guarantee of the payment of assured sum as maturity. In this type of policy the maturity of the policy is usually chosen to coincide with the retirement of the person. They are issued for the term chosen by the proposer. In this type the assured sum is payable even in case of premature death if the payment of premiums are regular.

Features :

1. It covers risk for a prescribed period
2. These are very popular in India due to lump sum payments at the end of the term.
3. They provide old-age benefits
4. Premiums are payable for the whole-term of the policy.
5. Cost of endowment policy is more than that of the whole life plans.
6. These policies are eligible for loans
7. These policies are issued to people upto 65 years of age minimum age of entry being 12 years.

Suitability : It is suitable for bread-earner of the family.

(i) Insurance amount is paid at the end of the term.

(ii) It is useful to meet the expenses of children's marriage and education

(iii) It means of investment

(iv) It is suitable to person who require investment along with risk cover for life.

Examples :

Endowment with and without profit plans.

1. Limited payment Endowment with profits
2. Jeevan mitra
3. New Janaraksha
4. Bima kiran etc.

7.2.4 Money Back Policy :

Under these plans the policy proceeds are paid to the insured in a number of separate cash payments. The timing of receipt of payments can be as per the available option. As in case of other policies life insurance cover is provided. The premium can be paid by the insured in lumpsum payment.

Features :

(a) It provides for periodic payments of survival benefit at fixed intervals.
(b) On death the full sum assured is paid with the diction of any survival benefits
(c) Bonus is paid as full sum assured
(d) Minimum age is 12 years.

Suitability of Policy :

(a) Person desirous if receiving periodic payments in addition to insure cover can opt for this type.
(b) Variants of such plans exist for children's education and marriage.

Examples :

Money back with profits

New Money Back

Jeevan Surabhi

Money back plan of HDFC Life.

7.3. ACCORDING TO PREMIUM PAYMENT :

7.3.1 Single Premium Policy :

The whole premium is paid at the beginning of the policy. As compared to the annual premium payable it is costly. This type of policy can be afforded by those who got a windfall income and are expected not to continue such return in subsequent years. It is not suitable to other persons because of chances of death where after the subsequent premium are not required to be paid.

7.3.2 Level premium policy :

Regular and equal premiums are paid at a definite interval. This premium is less than the single premium and is convenient to make premium at a regular period. The equal installments may be paid monthly, tri-monthly, half-yearly and yearly. It suits different types of policy holders. Premiums are calculated and charged on annual basis.

7.4. POLICIES ACCORDING TO PARTICIPATION IN PROFITS

7.4.1 Without profit policies :

These policy-holders are not entitled to share the profits of the insurer. These policy-holders get only the sum assured and no bonus is given to them.

7.4.2 With-profit policies :

These policy-holders share the profit the insurer. Since, the policy-holders can share the profit and not the loss, they cannot be treated as co-owner of the insurance business. If there is loss, they do not bonus. The amount of bonus depend as profit after deduction of taxes contingencies profits are not guaranteed. The insurer has to distribute 95 per cent of its profits to he insured as per law. However, the corporation has decided that atleast bonus rate or previous years should not decrease while declaring bonus in the present year.

7.5. POLICIES ACCORDING TO THE NUMBER OF PERSONS INSURED

7.5.1 Single life policies :

In this type only one individual is insured. It is not necessary that the policy should be issued on one’s own life, it may even be in the life of other’s. The policy amount is payable when the assured even occurs.

7.5.2 Multiple Life policies :

In this type, more than one life is insured. It is of two types. i.e., Joint Life policy and last survivorship policy. In Joint life, it covers tow or more lvies and the policy amount is payable on the first death. It is beneficial in case of partnership firms.

7.6. POLICIES ACCORDING TO THE METHOD OF PAYMENT OF POLICY AMOUNT

The policy amount may be paid in lumpsum or in installments.

7.6.1 Lump-sum policies :

When the sum assured is paid in lumpsum at the events insured against.

Installment :

The policy amount is payable in installments It is beneficial to those whose earning capacities are reduced to minimum in old age. It may be helpful during that time. He may continue to get up to a fixed period or upto death or both.

7.7. NON-CONVENTIONAL POLICIES

Life insurance corporation of India has introduced several non-conventional policies to meet the requirements of the population. The conventional policies provide protection to primitive death or living too long, but majority are interested in investment. Several new policies are being designed from time to time to meet these requirements. Some of them are :

(1) LIC Mutual fund : The corporation promises the investors to provide high returns along with safety and security of investment. LIC mututal fund entered the Indian capital market in the year 1989. In the beginning it proposed five schemes. Out of which three are close ended viz., Dhanashree 1989; Dhan 80CC (1) and Dharvarsha. The other two are Dhanarakshna 1989 and These two are open ended schemes.

The corporation gathered nearly Rs.375 crores in its initial operation from nearly 1.5 lakh investors. Other schemes launched by LIC mutual fund are having very good response from the public.

(2) Jeevan Akshay : In return for purchase price paid by the purchaser monthly pension will be paid during the life time of the purchaser of the pension. Post dated monthly cheques are sent in advance for the whole year. Pension cheques are payable at par.

On the death of the pensioner, the amount invested by the employee along with an additional bonus is returned to the nominee or his legal heirs. The minimum amount to be invested is Rs.10,000. There is no minimum limit.

The minimum age of entry is 50 years. No restriction on maximum age. It guarantees a return which no other investment guarantees. The rate of return is guaranteed even when the rate of interest falls in future. These policies offer a number of tax benefits to the investors.

(3) Jeevan Dhara : The payment of annuities under Jeevan Dhara has to start one month after the completion of the deferment period. To enable the annuities to get the payment on the due date, the annuity cheque has to be posted atleast two weeks earlier. Since, their payments are centralized at Zonal Officer, the master records for

payment of annuities have to reach the Zonal machine department in advance to process the payments. Building of master records will be more difficult when there are gaps in premium payments. This is another reason for the withdrawal of policies under SSS.

(4) Jeevan kishore : These policies are suitable to children of 1 (last birthday) and 12 (last birthday). This can be proposed by the father or mother provided they have their own income. If father is not alive mother can propose. If parents are not alive then the legal guardian can propose. Risk is covered after two years of the commencement of the policy. The policy shall vest in the Life Assured on the policy anniversary falling an or immediately following his or her attaining majority.

On maturity or an premature death of the holder the sum assurmed together with additional bonus will be paid. In case of death of a child before the date of commencement of risk, the premium paid will be refunded.

(5) Jeevan Chhaya : It was introduced in the year 1991. It was a combination of Jeevan Mitra and Money back plans. Couples having a child can avail this plan provided the age is less than one year. It provides financial assistance for educational purposes. Either father or month on each one of them can take policies under this plan individually.

The premiums are paid till the death or completion of the term of the policy. One fourth of the sum assured at the end of (n-3), (n-2), (n-1) and nth year. (where n is the term of the policy). Bonus for the full-term on the full sum assured on the date of maturity. In addition to the above fixed benefits, one additional sum assured will be payable on death of the policyholder. On death of the insured, the payment of future premiums is waived. Some of the other policies include, with profit pla Jeevan Kishore, Jeevan Sukanya, Children Money Back plans etc.

7.8. SUMMARY

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

Life insurance provides risk coverage to the life of a person. On death it offers protection against loss of income and compensates the little holders of the policy. The companies offer variety of services to suit the people in various walks of life. Individual

insurance plans and the conventional policies and non-conventional policies will take care of the insurance requirements of persons in different situations in life.

7.9 SELF ASSESSMENT QUESTIONS

A. Short Answer Questions

1. Whole life plans
2. Endowment plans
3. Money back policy
4. Jeevan Akshay
5. Jeevan Kishore.

B. Essay Questions:

1. Desribe the peculiarities of the Life Insurance Policies.
2. What is a term insurance plans? What are the various forms of term insurance?
3. Whole life insurance is nothing but extended term insurance. Explain
4. Explain briefly the importance of non-conventional policies with examples.

7.10 REFERENCE BOOKS

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Lesson – 8

Pension Plans and Annuities

Objectives

After completion of this lesson you should be able to understand :

- Meaning of pension plan
- Meaning of annuity
- Pension plan.
- Group Insurance schemes

Structure

8.1 Introduction

8.2 Pension Plan

8.3 Situation in India

8.4 Situation in USA

8.5 Definition of annuity

8.6 Classification of Annuities

8.7 Features of Annuities

8.8 Principle of Annuities

8.9 Group Insurance Schemes

8.10 Salient features of Group Insurance Schemes

8.11 Reasons for low-cost

8.12 Types of Group Insurance policies

8.13 Summary

8.14 Self-Assessment Questions

8.15 Reference Books

8.1. INTRODUCTION

Annuities and pensions mean the same thing in India. These policies provide safety and security to individuals. These policies provide income to individuals after retirement. Life Insurance policies provide protection against loss of income in case of premature death where as annuities provide financial support after attaining old age.

8.2. PENSION PLAN :

In Modern days, many schemes provide regular pensions to employees after their retirement age as per the law at the age of 58 years o 60 years as the case may be. It may continue even after his death, may be for a specified time or during the life time of his legal successor wife as chosen. The deferred annuity plan provides for pension. The pension plan can be purchased through the employer or individually. In case of non contributory plan, participation is must by all the eligible employees in specified categories. The existing employees in other categories may be given the option for joining the scheme.

LIC Pension Scheme :

The LIC has many low cost social security schemes. The new pension plan is being floated by LIC viz., Varishta Pension Bima Yojana, the guarantee of an assured return of 9%. Any person who is 55 years or more can invest a lump sum in this plan and get life time monthly pension ranging from a minimum of Rs.250 to a maximum of Rs.2,000. It is significant because the aged persons could guarantee a minimum post retirement income.

The scheme will be suitable for those seeking advantage of voluntary retirement scheme. The tax exemption upto a maximum of Rs.5 lakh has been announced, even when the amount is taken in installments. For senior citizens the income tax exemption ceiling has been raised from Rs.1.3 lakh to Rs.1.53 lakh.

Investment :

The LIC has huge investble funds and its main source is the premium collected from policy holders. The LIC grants loans to Governments, stock exchanges securities and special deposits with Governments. The LICs investment pattern shows that 86 per cent of the investment on stock exchange securities, 14 per cent has gone for loans, and one percent. The overseas investment of the LIC shows that 84 per cent of the investment on stock exchange securities and 12 per cent on loans. The LIC has tie up with 31 banks and 100 brokers to improve its life insurance business.

Claims settlements of LIC

If policy holder has died due to unnatural death like accident, suicide etc., then LIC in addition to the above, may call for additional details depending on the merits of the case. In case the death claim arises within 2 years from the date of the policy, the LIC will admit the claim only after routine investigations are conducted by the LIC authorities. Because of this investigation, the settlement of claim may slightly be delayed. In case of death, agents ma help their best to the family in obtaining death certificate and other certificates required for

settlement of claim. Follow up regularly till the claim is settled. With this, you will earn an undying loyalty of the family members of the deceased and improve the chances of getting additional business. Normally, claims should be settled within a period of 15 days from the receipt of all requirements/clarifications from the claimant. If settlement of claim is delayed beyond 30 days after the receipt of all the requirements, such claim should be settled along with penal interest at 8% per annum for all the delayed period.

8.3. SITUATION IN INDIA

When you observe the situation in India, the position of financial planning to lead a safe and comfortable life after retirement is alarming when compared to other advanced countries of the world. It is because, of the family system policy of the government and so on.

8.4. SITUATION IN ADVANED COUNTRIES

For example, in United States, the post retirement income comes from social security, employer supported financial plans, one's own savings etc. These three sources are like three legs of a tripod an which the entire retirement security depends. Thus, the average American is in better position than this counter part in the third world countries as far as post-retirment security is concerned.

8.5. DEFINITION OF ANNUITY

Annuity insurance is insurance whereby insurer agrees to pay a certain fixed sum by monthly payment either at the expiry of the specific period or earlier if death occurred to the insured. The Annuity insurance such as single premium to immediate or deferred annuity insurance and educational annuity insurance is undertaken by the LIC.

General annuity business means the business effecting contracts to pay annuities on human life but does not include contracts under pension business. A contract providing for regular periodic payments during a specified period is an annuity contract. If the specified period is fixed without regard to the duration of any life is called Annuity Certain. If it is related to life, it is called as life annuity. The annuity is a reverse of the life insurance principal. When a person purchases a life insurance contract he agrees to make premiums to he insurer and in return the insurer agrees to pay a specified sum to the beneficiaries in case of death of life assured or on maturity. If a person buys an Annuity contract he pays to the insurer a specified

capital (purchase price) either by installments or by a lump sum and in the return the insurer promises to make a series of payments to him as long as he lives.

A pension is also an annuity when the annuity is provided by the employer to their employees or dependent in consideration of the service rendered, it is generally called pension. The necessity for pension has arises mainly because of two reasons, viz., improvement in longevity and break up of joint family system.

These are the periodical receipts by an individual from an insurance company. These are the returns from a lumpsum investment made in installments over a number of years, which are accumulated and invested for appreciation in value. The amount is paid to the investor as fixed sum either annually, half-yearly or monthly over the period of his life.

8.6.CLASSIFICAITON OF ANNUITIES

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1. **Immediate annuity :** In this case the annuity payment starts as soon as the first premium is paid. The premium payment is comparatively high under this when compared to other policies.
2. **Deferred annuity :** The policy holder receives the payment after certain period. He pays the annuity premium in installments. Generally the amounts of premiums are less as this methods gives an opportunity to the insurance company to invest the premiums and earn income and thus reducing the cost of annuity to the annuitant.

8.7. FEATURS OF ANNUITIES

These schemes creates a fund. It ensures the insurer to make periodic payments throughout the life of the person depending on the options exercised by him. The options available to the annuitant are :

Based on the mode of payment :

1. Single premium annuity, and
2. Annual Installment payments.

Based on the duration of receipt of payments

1. Life annuity fund
2. Annuity certain

Based on the number of beneficiaries :

1. Joint Life annuities

Based on certainty of returns :

1. Fixed annuities
2. Variable annuities

8.8. PRINCIPLES BEYOND ANNUITY SCHEMES :

They work on the pooling system of large groups of persons. Since, the savings by a single individual cannot generates sufficient income on its own to provide for his life time requirements, a higher income can be provided to him through this technique. Insurance companies base their pension operations on the theory of large numbers. In a large group of insured subscribing to the scheme die earlier while others live long. The fund consists of accumulated investments including the share of those died earlier. So, the survivors derive benefit out of the premiums paid by the decreased. Thus, a higher income in the form of annuity is received.

Uses of Annuities :

1. Either on maturity or on retirement, the person receives commuted value equal to 1/3 of the fund.
2. The balance of the fund will be useful to make regular pension payments.

The annuity schemes are to be analysed on the following basis.

1. Safety of investments
2. Profitability
3. Liquidity and
4. Capital appreciation.

Comparison of Annuity and Life Insurance :

Relationship :

Annuities are simply another means of insurance and are based on the same principles. Technically, both types of contracts are closely related since both employ the pooling technique and premiums in each case are computed on the basis of probabilities of death and survival as reflected by mortality tables.

Differences :

From economic standpoint, Life Insurance and Annuities have been regarded different from each other. The main points of difference between the two, are the following :

1. In Life insurance, the policy holders pay premiums regularly until death or maturity which ever is earlier. The insurer pays the amount upon death or maturity. But in annuity, the annuitant usually pays a lumpsum in the beginning known as the purchase

price or consideration and after a stipulated period of time the insurer starts paying the annuity to the annuitant until death.

2. While life policies are generally taken for the benefit of the dependent of the insured, the annuity is taken usually for one's own benefit.
3. While in life insurance a lumpsum payment is usually given upon death, in an annuity the payment stops at death.
4. While life insurance contract is a protection against living too long.
5. While the insurer gains on the longer life of the insured as he is required to pay premium for a longer period, the annuitant looses on the longer life.
6. While certain life policies provide the facility of loan on the security of the policies, the facility of taking loan is denied in the case of annuities.
7. While a life insured gets an income tax exemption on the premiums to some extent, no such relief is granted in the annuities.
8. While life insurance policies are universally becoming popular, few people choose the annuities.
9. While the funds gradually get accumulated in life insurance through premium receipts, these get liquidated by maturity payment in case of annuities.
10. While longevity and morality are taken as base for premium computation in life insurance, in annuities no consideration is made of these factors.

Advantages of Annuity Contracts :

1. Annuities are useful to those persons who do not have dependents or do not want to leave anything for others but want to use the accumulated savings during their lifetime. Again, some persons want to maintain a particular standard of living till their death without seeking any financial help from others.
2. The character of guaranteed periodical specific sum of money till the annuitants survival, resembles with Endowment policy. In Endowment plan the amount stated on the policy is paid after endowment period if the policy survives. Therefore, annuity for life is nothing but a pure endowment. As it is paid till death, it appears like a pension. The price demanded by the insurer for such annuity is called purchase price but not premium.

The LIC issues annuity contract or policies in which the payment is being made half-yearly, quarterly, monthly in addition to annual payment. Thus annuity would mean not only annual but also half yearly, quarterly and monthly payments by the insurer.

8.9. GROUP INSURANCE SCHEMES

These are specially designed policies. These are issued to a large group of people through a single policy known as Master Policy.

In this system, the employer secures a group policy from an insurance company for the benefit of its employee. The employer generally pays the premium wholly or partly. The insurer provides cover for a large group under a single contrite.

Members of professional bodies like bar council, Engineers association, Medical association etc. can be covered under the group insurance schemes. LIC has contributed a lot to the Group insurance Schemes. They provide death benefits to employees. A rural group life insurance scheme was also introduced as a social security cover. In all these schemes the master policy holder is the employer or president of the association, trade union on the government. In this the contract is between the master policy holder and the insurer. All claims are made to the master policy-holder who inturn pass on the benefit to the beneficiaries.

8.10. SALIENT FEATURS OF GROUP INSURANCE POLICIES

1. Insurance coverage is provided to a large segment of the population especially for these who cannot afford individual insurance, which is costlier. The extent of coverage depends on the terms of the contract.
2. The cost of insurance is generally borne by the employer as it is the employer who purchases the policy
3. The period of cover will be for one year which renewable.
4. In India permanent group insurance policies are not available
5. The group should be open group with new entrants coming into the group at regular periodic intervals in the place of exists from group.
6. The benefits are available to both the employer and the employee.
7. No medical examination is required.

8.11. REASONS FOR LOW COST OF GROUP SCHEMES

Group insurance policies are cheaper than individual insurance because of the following reasons.

1. They are similar to term insurance which can be renewed on yearly basis.
2. No medical examination is conducted since general health of the whole organization becomes homogeneous
3. The risk is spread over the group as a whole.
4. Here the whole group is treated as on underwriting unit.
5. These policies are eligible for tax benefits.

8.12. TYPES OF GROUP INSURANCE POLICIES

1. **Group term insurance :** These are popular in India. In this earlier the group or employer buys the policy on behalf of members or employees. The coverage period is one year. The premium is less. It is simple in process. In case of death or disability of the member his beneficiaries are eligible to make claim. These are availed by corporate, associations, various organizations, employers, welfare groups etc.
2. **Group Gratuity scheme :** Payment of Gratuity is statutory obligation of the employer. Gratuity is paid under the Act to an employee an termination of his employment or on his retirement or resignation or death or disablement. To get the benefit of gratuity under the Act are must render atleast five years of continuous service. The employee gets 15 days salary for each year of completed service subject to a minimum of Rs.3.5 lakhs. It may be paid out of the Gratuity Trust Fund of the company approved by the Income Tax department. It also provided through insurance companies.
3. **Group super-annuation scheme :** This scheme is introduced by an employers for providing a study source of income as pension to retiring employees. These are offered by insurance companies to the employers as group plans covering employees, the employer wishes to cover. These schemes are implemented by the employer to provide a sense of security among the employees and serve as a means for employee retention. These schemes cover only the senior employees. This benefit can be extended either through the fund created by the employers and approved by the income – tax authorities. It can also be provided through a trustee managed arrangement.

8.13. SUMMARY

Pension plans provide annuity payments periodically to an individual as returns from the investments made by him. The premiums can be paid either in installments or as a lumpsum amount. Pension plans provide regular income.

Group insurance policies cover a homogeneous group of people who are homogeneous in their characteristics. The benefit is provided under low cost premiums. The premium payer may be the employer or a representative body of the group.

8.14 SELF ASSESSMENT QUESTIONS

A. Short Answer Questions

1. Definition of annuity
2. Pension plan
3. Classification of annuities
4. Features of group insurance

B. Essay Questions:

1. What is annuity? Explain its features.
2. How do you classify annuities?
3. Compare annuity and life Insurance
4. Define annuity. Explain annuity situation in India and in USA.
5. Explain the salient features of Group insurance
6. Explain the various types of group insurance policies.

8.15 REFERENCE BOOKS

1. P.K. Gupta, Fundamentals of Insurance, Himalaya Publishing House
2. Anand Ganguly, Insurance management, New Age International.
3. M.N.Srinivasan, Principles of insurance law, Universal Publishing Company
4. Dr.E. Dharmaraj, Elements of Insurance, Simres Publications, Chennai
5. Dr.P. Periaswamy, Principles and Practice of Insurance, Himalaya publishing House

Lesson – 9

Premium Determination

Objectives

After completion of this lesson you should be able to understand :

- Importance of premium determination
- Use of probability theory
- Use of mortality tables in Life Insurance Business
- Method of computation of premium

Structure

9.1 Probability Theory

9.2 Mortality Tables

9.3 Life Insurance and Mortality Table

9.4 Method of computation of premium

9.5 Steps for Calculation of Installment Premium

9.6 Self-Assessment Questions

9.7 Exercises

9.8 Reference Books

9.1 PROBABILITY THEORY

Pooling of risks is the underlying feature of insurance. Insurance companies try to make a group or pool of homogeneous exposures with a view to reduce the losses arising from that exposure. It is most advantageous when the losses are uncorrelated. When the group agrees to bear the loses in some proportion, the burden on a given member is reduced.

Probability theory reveals that the possibility of occurring and not occurring an event is out of the chances. In insurance practice, the probability theory indicates that chance of death of a person out of a group of persons. There are three methods in determining the probability and these are : (1) Certainty method; (2) Simple probability method; and (3) Compound probability method.

1. **Certainty Method :** Under this method the probability of certainty is expressed by one. It refers to the chance of occurring an event i.e., death is certain or one hundred per cent. Generally certainty is taken as the basis of a comparison.
2. **Simple probability Method :** Simple probability is when events are mutually exclusive or when only one event is present the probability is known as simple probability. For

instance, if at the age of 45 years 2 persons die out of 10,000 persons. The probability of death of a person, who is 45 years can be expressed as 2/10,000 = .02 per cent or = 0.0002 of units. Generally probability is related with one which can be expressed in the decimals. Like wise if more than one person and death rate of each person is to be calculated separately by u sing simple probability method. For instance, if there are two persons aged 55 years and 60 years the causes of death of one person only can be expressed as probability of death of first person plus probability of death of second person.

3. **Compound Probability Method :** The occurrence of events insured against cannot wholly be prevented but the uncertainty of financial loss through such occurrences can be eliminated by distributing the loss over a group. According to the law of compound probabilities the product of simple probabilities equals the probability that two events will happen at the same time only when the two events are mutually independent. The happening of the one must have no effect upon the occurrence or non occurrence of the other. If the law were valid irrespective of this qualification such absurd results the following might be obtained.

The accuracy depends on two factors and they are the date and units taken. For instance suppose that probability of death were computed on the basis of population statistics and death registration returns. Population census are taken by the government once in 10 years. Thus, if death rates were to be computed for the year 2014 the last actual count of population would be for the year 2010 and the population for 2014 would have to be estimated. Future mortality will be measured on the basis of past mortality data. These data of the part will be an approximate measure of the law of mortality.

9.2 MORTALITY TABLES

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 talk have died. Mortality table is a records of past mortality put into such form as can be used in estimating the course of future deaths. There are two sources from which the mortality tables in existence today have been obtained

1. Population statistics obtained from census enumerations and the returns of deaths from registration offices.
2. The mortality statistics of insured lives.

An insurance company wants a measure of the mortality occurring among insured lives and it is probable that this may differ from that of a specific population group. Insured lives are subject to special influences affecting mortality and these factors must be taken into consideration.

The peculiar features of the mortality table are two columns of the number living and the number dying at designated ages. It is presumed that a group of 1,00,000 persons come under observation at exactly the same moment as they enter upon the tenth year of life. Of this group 749 die during the year leaving 99251 to begin the eleventh year. The table proceeds in this manner to records the number of the original 1,00,000 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.

Insurance policies are written at all times of the year and on lives at various ages. It is practically that a record be kept of all insured lives show at each age the number of persons under observation, and of those observed for one year at least the number who have died. Death rates may be computed for each separate age to the maximum limit of life if only the data are collected as required.

Since the probability of dying at age 10 is .007 there will occur 700 deaths during the year among the 1,00,000 starting at age 10, this leaves 99300 of the group to begin age 11 and this latter number dies at the rate of 8 per thousand (.008) making 794 deaths during the year. In this way the original 100000 are reduced by deaths year after year until all have died. In the mortality table the two columns denote yearly probabilities of death and of survival represent the final form of the actual statistics of dying among insured lives.

For example, a man is desired to insure 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 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. As per the table 81,822 persons are living at age 35, and 732 die before the end of the years. Therefore 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 1469. The probability of dying within two years is therefore 1469/85822. Like wise the total number of deaths within five years is 732+737+743+749+756 or 3716, and the probability of dying within five years is that 3716/81822.

The chance of living one year following age 35 will be a fraction of which the denominator is 81822 and the numerator will be the numbers who have lived one year following the specified age. It is the number who are living beginning age 36, or 81090, and the

probability of survival for one year is therefore 81090/81822. This is a validity of the law of certainty. The chance of living one year following age 35 is 81090/81822. The sum of these two fractions equals 81822/81822 or 1 which certainty and the certainty represents the sum of alls separate probabilities in this case two the probability of death and the probability of survival.

For instance, if the probability of death of A at the age of 45 years is 0.0002 and the probability of death of B at the age of 45 years is 0.0003, the compound probability is calculated when we know the probability of death of any of these persons will be 0.002 x 0.003 = 0.00000006. In the insurance calculation, simple probability method is used to calculate death rate of one person.

Probability Estimate :

Probability is estimated by both prior basis and the posteriori basis. Probability is estimated based on knowledge not derived by experiment. It is otherwise known as deductive reasoning whereby the estimation is based to particular from general. It is useful to correct the defects of experimental probability whereby the probability is not expected to give 100 per cent accurate results.

The death rate after 40 year will not decline but it will increase and there is fluctuation in mortality which has been calculated on the basis of experiment which is to be verified by interpolation or graphical method. Hence a priori probability is a very appropriate measure of probability.

Rating in Life Insurance :

The process of rate making n life insurance involve the logical steps of risk classification pricing using mortality tables and adjustments.

Methods of Risk Classification in Life Insurance : the two methods commonly employed in the classification of risks are :

(a) Judgement Method : The underwriter studies all the features of the life to be insured and on the basis of analysis of various factors takes a decision. Under this method, the company depend upon the combined judgement of those in the medical acturial and other areas who are qualified for the work to make underwriting decisions. The judgement method of rating functions effectively when is only one unfavourable factor to consider whether the decisions to be made is simply whether to accept the proposed insured at standard rates onto reject him or her entirely. However, situations where multiple factors are involved or a proper substandard classification is needed, then this method cannot be efficiently applied.

(b) Numerical Rating : In this method, a large number of factors, which influence mortality, are taken in account. For various factors, debits (additions) or credits (subtractions) are

made to the scores. The numerical ratings vary from company to company – 75 to 500 illustratively, as rating increases, the quality of risk diminishes. A rating in the range of 75-125 is generally considered as standard and over and above 125 substandard. An underwriter has to take into account the nature and combined effects of extra risks, e.g., impairments jointly causing additional extra risks. IN these cases some additions are made to the arrived rates calculated independently.

In pricing of life insurance products, the main factors used in rating are (a) mortality, (b) expenses and (c) Interest. The first step to rate is to identify the risk class.

Treatment of Substandard Life Insurance Risks :

The three broad classifications of substandard risks are :

(a) **Increasing Extra Risk :** This category reflects the extra mortality risks caused due to impairments with the increase in age. Persons with extra weight are likely to have blood pressure or heart problems as they grow older.

(b) **Constant Extra Risk :** This group reflects the lives with hazard that remain constant through life. These hazards do not create variations in mortality as such, e.g., permanent total disablement – lost of limbs.

(c) **Decreasing Extra risk :** These lives represent cases where the extra risk decreases with passage of risk since the consideration of proposal. A person who has just been operated for a problem becomes normal over a time period. At the time of proposal, the risk was substandard but with passage of time, it has become a simple risk.

The popular methods of treating substandard risk are :

(a) **Increase in premium :** Increase in normal premium (multiple table extra) is the most common method adopted by the insurance companies for treatment of substandard risks. Under this method, premiums can be treated as follows.

(i) the proposer's age is increased by a few years (e.g. 3- 5 years) which results in increases in premium or

(ii) a special mortality table is developed for each substandard classification that reflects the experience of each and asset of gross premium is computed for the classification.

(b) **Flat extra premium :** In situation where the extra risk is expected is constant, a flat extra premium may be changed. The policy remains standard one for all purposes including dividends and non-forfeiture values.

(c) **Other methods :** The other methods of refund are :

(i) Limited death benefit equal to refund of premium if death occurs in the earlier years.

(ii) A lien (contingent debt) may be created as the policy such as that upon the assured dies in the lien period, the lien amount shall be deducted from sum payable under the policy.

(iii) A proposal may be declined by the insurer if there is increasing extra risk.

(iv) Restrictive clauses may be imposed an exclusions under the policy

(v) The insurance cover may be reduced by amount and/or time or the plan may be changed.

(vi) Another option from insurance company is to defer the cover till the extra risk is over.

9.3 LIFE INSURANCE AND MORTALITY TABLE :

In life insurance, certain assumptions have to be made by the insurer about the interest rates, mortality rates and the expenses which will be incurved in the year to come for the purpose of fixing the premium rates or assessing the liabilities under the insurance contracts. It is important to a correct estimate of these factors as otherwise the results deducted from the assumptions made may not be reasonably close to the actual experience of the insurer. He depends upon the mortality experience of the insured lives observed in the recent past s a basis for estimating the probabilities of survival and deaths.

If it is observed that out of 1000 lives all aged 25, 20 die within one year, i.e., before attaining the age 36, the observed mortality rate at age 35 works out to $\frac{20}{10,000} = 0.002$ and is denoted by q_{35}. The mortality rates at various ages are determined in the same manner.

A mortality table represents a record of mortality observed in the past and is arranged so as to show the probabilities of death and survival at each separate age. A large number of persons are selected at a particular age and number of deaths is observed each and every year. Each year's number of living is the previous year's number of living minus previous year's number of dying. As the persons go on dying year after year, the number of living goes on shrinking. When the last person dies, it is reduced to zero and the mortality table ends there.

The following are the two major mortality tables.

(a) LIC (1970-73) Ultimate Table.

(b) H^m Table (Makehan Gruaduation)

Construction of Mortality Table :

The main objective for having a mortality table for an insurer is to work out the probabilities of deaths and survivors to enable him to make a reasonably accurate estimate of his liabilities under the insurance contracts and also to calculate premium to be charged. The

past experience from which the table is constructed will never be exactly reproduced in future. There will be fluctuations in different directions at different ages but on the whole the estimates in respect of mortality rates may be close to the actual experience. So, the mortality table should be constructed to represent the past experience as accurately as possible. The following are the two methods of construction of mortality table.

(a) **On General Basis :** In this method, we select a large number of persons at an attained age. The attained age means the age nearer to the birth date. For example, persons of age 14 years 6 months to 15 years 6 months will be treated as the age of 15 years. The selected persons of this attained age will be observed each and every year and the number of deaths will be recorded during the year. The observation will be continuing till all the persons selected are dead. Preparation of such table is very difficult, because it requires a long period to construct the table and constant watch on the selected persons is practically impossible. A lot of money and manpower will be required to record number of deaths every time. To avoid these difficulties, death rate is calculated on yearly basis.

Mortality Table (on Generation Basis)

Age	Number of Living	Number of Deaths	Mortality Rate	Survival Rate
25	987095	1263	0.00128	0.00872
26	985832	1252	0.00127	0.99873
27	984580	1250	0.00127	0.99873
28	983330	1268	0.00129	0.99371
29	982062	1286	0.00131	0.99869

(b) **On Yearly basis :** In this method, the death rate is calculated for every age. Separate sample is taken for each age. The number of death during the age is recorded and the mortality rate is calculated. By this method, we can construct the mortality table within the duration of one year. For example, 5000 persons are taken at age 25, 4000 persons at age 26, 6000 persons at age 27, 10,000 persons at age 28 and 3,000 persons at age 29. The number of deaths observed at these ages is 10, 165, 18, 60 and 15 respectively. The following table summarizes the mortality rates at the above ages.

Age	Number of Living	Number of Deaths	Mortality Rate	Survival Rate
25	5000	10	0.002	0.998
26	4000	16	0.004	0.996
27	6000	18	0.003	0.997
28	10000	60	0.006	0.994
29	3000	15	0.005	0.995

9.4 METHOD OF COMPUTATION OF PREMIUM :

Premium is the amount paid by the Life assured to the insurer for the risk accepted under a Life Insurance Policy. Premium is a monetary value of risk, contingent upon the duration of life and accepted by the insurer or the consideration against the payment of which the insurer has undertaken the risk.

Premium can be a single lump sum amount or a small amount spread over a specified years. The small amount payable for a specific period is known as level premium. The monetary cost of the risk is based on mortality rate. The cost of premium is calculated on basic premium. The IRDA has named the premium as Office Yearly Premium. It means that regular premium payable in a policy by a policy holder to secure basic benefits under the policy.

New premium is based in the mortality and interest rates. The gross premium includes the net premium and loading. Loading is the process of adding the expenses to net premium. These expenses include the expenses that vary with the amount of policy such as stamp fee and medical examiner's fee business such as salaries and establishment charges. Single premium is paid in one lump sum while the level premium is paid periodically in installments, i.e, yearly, half yearly, quarterly or monthly. Firstly, net single premium (NSP) is calculated and other premium are based on this calculations.

This is the simplest type of contract whereby payment is made only when the life assured dies within the term specified. Nothing will be paid if the death does not occur daring the designated term. This is called term assurance or temporary assurance. The premium is received in advance3 and will not be returned if the life insured survives. The death claims will be paid at the end of the year in which the death occurs and not at the end of the term.

Premium Calculation Methods :

Premium table shows the annual premium for `.1,000 sum assured for every age and every term of the policy. Each type of policy has separate table.

1. Find out the tabular premium which is quoted in published premium rates for the age (near, next or last birthday). The premium is given per `.1,000 sum assured.
2. Deduct the adjustment for the sum assured
3. Make adjustment for mode of payment of premium
4. Add extras
5. Multiply by the sum assured.

Paid up value :

Paid up value of a policy is the amount of sum insured is considered reduced due to discontinuing the policy after some period. The insured person has paid premiums for a minimum number of years and the policy has acquired surrender value, but he is not in a position to pay the further installments of premium and discontinues the same. The insurance policy becomes a policy for the reduced (paid up) the amount. It is important to note that the life insurance policy remains in full force but its value is reduced to the paid up value,

Sub section (2) of the section 113 of the Insurance Act, 1938 states that a policy which has acquired surrender value shall not lapse by non-payment of further premiums and it shall be kept alive to the extent of paid-up sum assured which will also include all the bonuses vested in the policy.

The paid up value is calculated by the following formula.

$$\text{Paid up value} = \frac{\text{No. of premiums actually paid}}{\text{No.of total premiums}} \times \text{Sum assured}$$

Yearly Premium rates for 1000 sum assured Terms of Policy

Age	5 Years	6 Years
25	201	170
26	201.25	170
27	201.25	170
28	201.50	170.30
29	201.50	170.30
30	201.70	170.30

The tabular premium for a policy of `.1,000 for duration of 6 years for a policy holder aged 27 years is `.170 annually. Similarly a person of 29 years, it will be `.170.30 for 6 years.

Rebates

From the above, premium for a policy of `.1 lakh (aged 27 years) will be

$$\frac{Rs.170 x 1,00,000}{1,000} = Rs.17,000 \text{ annually.}$$

For large sum assured

The rebate in tabular premium increases with increase in the sum assured and is either a percentage or tabular premium or at a flat rate, for example.

(i) for sum assured above `.50,000 rebated at Re.1 per thousand

(ii) above 1 lakh to `.1.5 lakh rebated t `.2 per thousand.

For Mode of Payment of Premium :

If the life assured pays his premium quarterly, it means that the insurer is required to deal it 4 times and half yearly modes of payments are allowed rebates on concession these can be,

Yearly `.2 per thousand or 3% of the tabular premium

Half year Re.1 per thousand or 1.5% of the tabular premium

Extra premium :

Extra premium means the compensation for the higher risk than average which are applicable in hazardous occupation, adverse health of the life assured, adverse family history, and temporary health risk such as pregnancy.

Rider Premium :

Insurers give an option to the policy these add on benefits are called policy riders or rider benefits. The addition of all premiums charged for these rider benefits are called as Rider Premium.

1. Premium Calculation :

Illu.1 :

(i)	**Age of life assured**	**26 years**
(ii)	**Table endowment**	**For 7 years**

(iii)	**Sum Assured (S.A.)**	**`.2 lakhs**
(iv)	**DAB extra**	**`.1 per thousand**
(v)	**Health extra**	**`.1.50 per thousand**
(vi)	**Mode**	**Yearly**
(vii)	**Rebate for yearly mode**	**3% of premium**
(viii)	**Rebate for large sum assured**	**`.2 per thousand S.A. (`.2 lakhs)**

Solution :

(a)	Tabular premium for 7 years policy age 26 years	`.1,50,000 (after 10.1 -5)
(b)	Less for large SA	
(c)	Less for mode (3% or `.15)	(-) 4.50
(d)	Add DAB extra	(+) 1.00
(e)	Health Extra	(+) 1.50
	Net Premium	146.00
	Total Premium	`.29,200

Rider Premium : If there is a rider premium for premium waiver benefit, the same should also be added after (e) above in 10.2

Surrender value :

As per section 113(1) of the Insurance Act, 1938 a policy acquires surrender value after premiums have been paid for three consecutive years. To this surrender value will also be added the surrender value of all bonuses that have vested in the policy upto the date of surrender.

It is also, the responsibility of the insurer to show on the back of the policy either.

(i) Surrender value guaranteed under the policy by a formula, or

(ii) Surrender value at the close of each year or at the close of every three years till maturity.

Bonus :

A policy issued under a profit plan does not participate in the profit disclosed in valuation for the period in which it was made a paid up and in subsequent valuations.

Calculation of Paid-up Value :

Illu.2 :

Sum assured	**`.20,000**
Mode	**Yearly**
Type of policy	**Endowment for 20 years**
Date of commencement	**1-10-93**
Due date of last premium paid	**1-10-98**
Premiums paid	**6 years**
Premiums payable period	**20 years**

$$\text{Paid up value} = \frac{6 \times 20{,}000}{2-} = 6{,}000$$

In case of with profits policy the vested bonus is added to `.6,000. The rate of bonus per thousand sum-assured for valuation as an 31-3-1994, 31-3-1996 and 31-3-1998 being `.20, `.25, and `.26 the total bonus accrued comes to

20 x 2 x 25 x 2 x 26 x 2 = `.142 x 20 = `.2,840

Paid up value under anticipated endowment assurance

The proportionate paid up value arrived at as in the case of endowment assurance is to be reduced by any survival benefit payments made already.

Term Assurance : Paid up value will not be allowed under this plan.

3. Calculation of Surrender Value :

Illu.3 :

(i)	**Sum assured**	**`.25,000**
(ii)	**Plan and term of policy**	**Endowment for 50 yea`**
(iii)	**Type of policy**	**Endowment**
(iv)	**Date of commencement**	**5-11-1996**
(v)	**Mode of payment**	**Quarterly**
(vi)	**Due date of last premium paid**	**5-8-2000**
(vii)	**Vested Bonus**	**Nil**
(viii)	**Date of calculation of surrender**	**10-8-2000**

No. of years premium paid

(a) Due date of last premium paid 5-8-2000

(b) Minus date of commencement of policy 3 years 9 months 5-11-1996

Add : Duration corresponding to modes of premium

(c) One month for monthly mode 3 months of or quarterly mode 6 months for half yearly mode 12 months for yearly mode.

(d) Total number of years premium paid 4 years

Paid up Value :

$$\frac{\text{No. of years premium paid x Sum assured}}{\text{No. of years premium payable}} = \frac{4}{50} \text{x Rs.25,000 = Rs.2,000}$$

Vested Bonus

Assume there is no vested bonus

Duration

(a) Date of calculation of surrender value 10-8-200

(b) Minus – Date of commencement of policy

$$\frac{5-11-1996}{\text{5years - 9 months - 3 days}}$$

(c) Nearly half year duration

Surrender Value factor

(a) For term 50 and duration 4 years

Surrender value factor is 14.8% under endowment policy

$$\text{S.V} = \frac{\text{Paid up value (inclusive of vested Bonus, if any) x S.V. factor}}{100}$$

$$= \frac{\text{Rs.2,000 x 14.8}}{100} = \text{Rs.296.00}$$

Illu.4 :

(a)	**Tabular premium for 7 years**	**`.1,50,000 (after 10.1-5)**
	Policy age 26 years	
1.	**Sum assured**	**`.1,00,000**
2.	**Plan and Term of policy**	**Endowment for 20 years**
3.	**Date of commencement of the policy**	**10-8-2002**
4.	**Mode of payment**	**Half yearly**
5.	**Due date of last premium paid**	**10-8-2010**
6.	**Vested Bonus**	**To be calculated**

7. Date of calculation of surrender value 1-9-2010

No. of years premium paid

(a) Due date of last premium paid

(b) Minus date of commencement of policy 10 – 8 – 2002

0 – 6 – 18

Add : Duration corresponding to half yearly

Mode of payment of premium 0 – 6 – 0

0 – 6 – 18

(d) Total number of years premium paid 8 ½ years

Paid up Value :

$$\frac{\text{No. of years premium paid x Sum assured}}{\text{No. of eyars premium payable}}$$

$$= \frac{17}{2} \text{x} \ \frac{1}{20} \text{x Rs.1,00,000 = Rs.42,500}$$

Vested Bonus

(i) Premium have been paid for 8 ½ years

(ii) Therefore bonuses will be added for not more than 8 ½ years. Let us assume that bonuses came to `.11,320

Vested Bonus = `.11,320

Add : paid up value of assured sum = `.42,500 + 11,320 = `.53,820

Duration :

Date of calculation of surrender value = 1-9-2010

Date of commencement of the policy = 21-10-18

i.e., 8 yea` (nearest half year duration)

Surrender value factor

For plan endowment assurance and term 20 years with duration 8 years. Surrender value factor is 50.8%

$$\text{SV} = \frac{\text{Rs.53,800 x 50.8}}{100} = \text{Rs.27,340.60}$$

(Surrender value is rounded up to next higher 10 paise)

Important notes :

For factor or surrender value, every insurer prepares surrender value books from where with reference of duration against Term of policy factors can be easily noted.

Determination of Duration :

Duration in the context of surrender value is always nearest to half years as shown in the above example. However, some more illustrations are given for proper understanding.

(a)	5 years and 2 months 29 days	5 years
(b)	5 years and 3 months	5 ½ years
(c)	5 years and six months	5 ½ years
(d)	5 years and 8 months and 29 days	5 ½ years
(e)	5 years and 9 months	6 years
(f)	6 years and 2 months and 29 days	6 years

Calculation of Premium :

Term Insurance :

It is very simple type of contract whereby payment is made when the life assured dies within the specified term. The term may be two or five or seven years. It is otherwise called das temporary insurance. The premium is paid only once in a single sum at the beginning of the policy.

The probability of death

Let us assume that the rate of return on investment is 4%

The single premium for each eyar will be calculated as follows

Number of death x Amount of claim x present value of Re.1 = Present value of claims

How to calculate Net premium :

Assume that a proposer age 18 year. Term 10. Premium `.500 per month. Mode : Yearly, Basic premium 500 x 12 = `.6,000 = Less yearly mode rebate 2% (120) – `.2,880 + DBA `.125 (500 x 250 = `.1,25,000 @ Re.1 per 1,000 S.A.). Net premium payable = `.6,005.

How to calculate Maturity Sum assured (MSAS)

Example, Proposer's age : 18 years; Term : 20 years, yearly basic premium : 12,000 (Net premium payable after mode rebate+ DAB will be 12,010)

Basic MSA is 28,106 (see Age 18 Term 20) for a premium of `.100 per month.

`.12,000 x 28,106 = 2,81,060

(Note : MSA has to be calculated on the basic premium 100 x 12 before Mode Rebate and DAB)

Assumptions in Calculating of Premium :

Factors affecting the calculation of premium

Method of computing premiums for different types of policies and annuities.

Various methods of Loading :

Premium covers two types of costs to the insurers – expected loss and cost of doing business. The expected loss is known as pure premium and cost of doing business is known as loading. The pure premium is computed by dividing the total expected loss by the number of exposures.

For instance, the insurer is expecting to pay `.8,50,000 in motor vehicle insurance to some insured persons against loss and there are 500 cars in the insured group. The pure premium per loss per car is Rs.1,700 (i.e., 8,50,000/500). The loading covers the expenses of agent's commission, expenses of insurance, taxes and fees and allowances for the profit. The sum of pure premium and loading is known as Gross premium.

Loading is expressed as a percentage of gross premiums. It can be mentioned as follows.

Gross premium = Pure premium + loading as percentage of gross premium

GP = PP + % L (GP) or GP = % L (GP) = PP or GP = (1-% L (PP) or GP = PP/1 - %L

For instance, a loading is 20% and from the above.

The pure premium is `.1,700. Therefore, Gross premium is 1700/1-0.2 = 2125

The pure premium of `.1,700 represents the loss cost. The gross premium is the ratio of loss cost and (1-loading %) and the ratio between the loss cost (PP) and gross premium is termed as loss ratio.

Loss ratio (1-loading %) = pure premium/gross premium

In order to determine loss cost it is necessary to estimate two factors, viz., and frequency of occurrence and severity of loss. The expected cost of loss is a function of both frequency and severity of loss.

9.5 STEPS FOR CALCULATION OF INSTALLMENT PREMIUM

The following are the steps in the calculation of installment premium.

1. Find out the tabular premium per thousand sum assured for the relevant age, table & term.

2. Calculate rebate for mode of payment (percentage Rebate)
3. Find out the technology
4. Reduce large sum assured rebate
5. Find out the balance
6. Multiple by SA/1000 and find out the total
7. Add extra premium for the eligible SA
8. Add health extra premium, if any, on full sum assured
9. Add occupational extra premium if any, on full sum assured.
10. Add any other extra premium like age extra if any, on full sum assured.
11. Divide by frequency of mode to obtain premium instalment (for half yearly divide by 2; for quarterly divide by 4; and for monthly/SSS divide by 12)
12. Round off the nearest rupee (50 paise and less to be ignored)

Let us now go through some illustrations.

Illu.1 : S.A. `.50,000/date of maturity `.24-12-2036 term 30 yea`

Date of birth 28-6-1979 mode of rebate yearly 1.50 per thousand half yearly Rs.1.00 quarterly nil.

Monthly mode 5% extra. S.A. Rebate `1.50 per thousand for `5,000 and above.

Tabular premium for age nearer birthday 26 `26.46, 27.08, 28 `28.15

Solution :

Date of maturity = 24 12 2036

30

DOC = 24-12-2006

DOB Less - 24-12-1979

- 0 5 27

Age near birth day = 27 years

Tabular premium = 27.08

Less S A Rebate = - 1.50

= 25.58

25.58* (50,000/1,000) = 12.70

Quarterly premium = `1279/4 = 319.75 = 320

Illu.2 : Calculate half yearly premium on the basis of the following data.

Date of birth 28-6-1978, date of maturity 24-12-2041 S.A. `1,00,000 term 35 years.

Tabular premium for age next birthday – age 27 `27.46, for age 28, `27.83 and for aged 29, 28.37

Rebate 5% extra for monthly, less `1 for half yearly `1.50 for yearly, S.A. `1.50 for sum assured `50,000 and above.

Solution :

Date of maturity	24-12-2014
Less term	35
DOC	24-12-2006
DOB less	- 28-06-1978
	0-5-28

Age next birth day = 28 + 1 = 29 years

Tabular premium	28.37
Less : S.A. Rebate	1.50
	26.87
Less : model rebate	1.00
	25.87

25.87* (`1,00,000/1000) = 2587

Half yearly premium = `2597/2 = 1293.50

Illu.3 : Given the following information indicate which of the four options given below would be correct premium to be deducted form the salary of a person born on 28-6-1984 who has taken an endowment policy on his life.

On the basis of the following data sum assured `40,000/term 35 years, date of maturity 24-12-2047.

Tabular premium for age nearest birth day 27 `27.46 per thousand

Tabular premium for age nearest birth day 28 `27.83 per thousand

Tabular premium for age nearest birthday 29 `28.37 per thousand

Premium adjustment – 5% extra for monthly mode `1 less for half yearly mode and `1.50 less for yearly mode.

SA Rebate `1.50 less for `50,000 and above.

Solution :

Date of maturity	24-12-2047
Less term	35
DOC	24-12-2012
DOB less	- 28-06-1984
	0-5-28

Age next birthday = 28 years

Tabular premium = 27.83

27.83* (40,000/1,000) = 1113.2

Monthly premium = 92.766 = 92.80

Important steps in calculation of surrender value :

LPP + Months (from Mode) = FUP

FUP – DOC = No. of years of premium paid

Convert the no. of years paid to No. of premiums paid

Calculate reduced sum assured = $\frac{\text{No. of premium paid}}{\text{No. of premium payable}} \times \text{S.A.}$

Bonus is always declared per 1,000 SA

Calculate vested bonus (V.B) $\frac{\text{Bonus(declared)}}{1000} \times \text{S.A.}$

Paid up value = reduced S.A. + Vested bonus

Surrender value = $\frac{\text{S.V.Factor x paid up value}}{100}$

Loan = $\frac{90 \times \text{Surrender value}}{100}$

9.6 SELF ASSMENT QUESTIONS

Short Answer Questions

1. Probability Theory
2. Certainty Method
3. Simple probability Method
4. Compound probability Method
5. Mortality tables

Essay Questions

1. Explain probability theory and its importance in Life Insurance Business
2. What are Mortality tables? Explain its importance in Life insurance policies
3. Discuss various methods of calculation of Life Insurance premium

9.7 EXERCISES :

1. 2000 persons all age 50 years are insured from `1,00,000 for 1 year. If the rate of mortality (q_{50}) is 0.004, calculate the NSP of this term assurance.

(i) if the insurer earns no interest

(ii) if the insurer earns interest at 6%

[Ans.: `377.35]

2. Consider a group of 10,000 persons all aged 35 seeking an amount of `1,00,000 to their families in case of death during the next 10 years.

X	35	36	37	38	39	40	40	42	43	44	45
L_x	10,000	9972	9941	9907	9869	9827	9780	9728	9671	9608	9538
D_x	28	31	34	38	42	47	52	57	63	70	75

Calculate the Net single premium for their term assurance, if :

(i) the insurer earns interest @ 6% p.a.

(ii) the insurer earns no interest

[Ans.: `4620]

3. Given the following rates of mortality, what is the probability that a person aged 65 will die between ages 69 and 70?

Age	Rate of Mortality
65	0.035
66	0.040
67	0.045
68	0.050
69	0.055

[Ans.: `0.04623]

4. Using the LIC (1970-73) ultimate table, compute the following probabilities.

(i) Probability that a life aged 40 survives 10 years;

(ii) Probability that a life aged 40 dies within the next 10 years

(iii) Probability that a life aged 40 dies after 10 years.

[Ans.: (i) 0.0548; (ii) 0.0452; (iii) 0.9548]

5. From the following data, find the number of livings at age 43.

X	Lx	dx	Qx
40	-	400	0.006
41	-	-	0.007
42	-	-	0.008
43	-	-	-

[Ans.: `65277]

6. Calculate the net annual level premium for a double endowment assurance of `100 for a person aged 60 years, the assured benefit being `100 in the case of his death before attaining age 63 and `200, if he survives to age 63. Use the following mortality table and 5% rate of interest.

X	60	61	62	63	64	65
L_x	1000	980	958	933	900	860
D_x	20	22	25	33	40	45

[Ans.: `59.69]

7. The end premium of an endowment assurance of `1000 per a person aged 30 for a term of 25 years is `30.97. Calculate the office premium making the following provisions.

(a) Initial expenses at 40 per `1,000 sum assured.

(b) Renewal expenses at 8% of Office premium

(c) Constant expenses of `2.50 per `1,000 sum assured.

(Given $a_{40:241}$ = 15.64)

[Ans.: `39.16]

9.8 REFERENCE BOOKS

1. P.K. Gupta, Fundamentals of Insurance, Himalaya Publishing House
2. Anand Ganguly, Insurance management, New Age International.
3. M.N.Srinivasan, Principles of insurance law, Universal Publishing Company
4. Dr.E. Dharmaraj, Elements of Insurance, Simres Publications, Chennai
5. Dr.P. Periaswamy, Principles and Practice of Insurance, Himalaya publishing House

Lesson – 10

Claims and Loans

Objectives

After completion of this lesson you should be able to understand :

- The method of settlement of claims
- Loans against policies

Structure

10.1 Settlement of Claims

10.2 LIC's Steps to Hasten the Claim Settlement

10.3 Loans Against Policy

10.4 Policies under which loans cannot be granted

10.5 Conditions for Granting of Loan

10.6 Requirements to be obtained for loan

10.7 Self-Assessment Questions

10.8 Reference Books

10.1 SETTLEMENT OF CLAIMS

Claim by Maturity:

The processing of maturity claims is undertaken by Divisional Office normally about two months before the date of maturity. The Corporation sends a Maturity Intimation to the policy-holder informing him about the requirements of the settlement of claim and requesting him to send the original policy and last receipt of insurance premium paid. His age stands already admitted under the policy, the form of Discharge (Form No.3825) to be executed by him, is also enclosed with the Maturity Intimation to be signed by one witness. Every attempt is made by office to settle claim on or before the date of maturity where the requirements are received in time.

10.1.1 Requirements for Settlement of Maturity Claim:

1. **The Policy Document:** It must be submitted unless it is in the custody of L.I.C. as security for loan. If the Policy or any Deed of Assignment or Reassignment is lost by the policy-holder, claim will be settled in its absence by an Indemnity Bond (Form No.3815) from the Policy-Holder and a reliable surety of sound financial standing acceptable to the Corporation. Surety is waived if the Sum Assured of Paid-up Value

is Rs.5,000 or less. If the policy or any Deed of Assignment or Re-assignment is lost and the Sum Assured or paid up Sum Assured is above Rs.5,000 the policy-holder is required to intimate loss of the policy to the office and submit particulars of Surety (in Standard Form) who is prepared to join him in execution of the Indemnity Bond. Surety particulars from can be obtained from the office.

2. **Age Proof:** School Certificate, Municipal Birth Certificate etc. must be submitted if the age has not been admitted and Sum Assured or Paid-up Value is above Rs.15,000. Where the Sum Assured or Paid-up Value if Rs.15,000 or less, age proof is normally waived.

3. **Deeds:** if any assignment or re-assignment was executed by a separate Deed or Deeds it must be submitted.

4. **The Form of Discharge (Form No.3825):** Issued by the office it should be returned by the policy-holder duly signed over a 100 paise revenue stamp and attested by witness.

10.1.2. Requirements for settlement of Claim by Death

1. **Intimation of Death:** The first requirement of the Corporation in the case of Death Claim is an 'Intimation of Death' either from the Nominee or Assignee or the deceased Life Assured's nearest relative. The letter of intimation of death should contain the following information:

(i) A statement that the life assured is dead;
(ii) The date of death;
(iii) The cause of death;
(iv) The place of death; and
(v) Policy number/s.

The other requirement for settlement of death claim depends upon the duration of the policy.

2. **Age Proof:** The age proof of death required to be authentic such as School Certificate. Submission of Proof of Age will normally be waived by the Office if the Sum Assured or paid-up value is upto Rs.15,000 and age is not admitted.

3. Certificate of Death: The proof of death required to be submitted is a certificate by Municipal death register or by a Public Record Office which maintains the records of births and deaths in the locality. Agent should assist the claimant in obtaining the Death Certificate. This requires the following forms:

- **(i) Claim Form 'A' (F. No.3738 (Revised)):** This is a statement of the claimant.
- **(ii) Claim Form 'A' (F. No.3784 (Revised)):** This is a statement from the doctor who attended the deceased Life Assured's last illness.
- **(iii) Claim Form 'B1' (F. No. 3816 (Revised)):** This is a certificate of treatment in hospital where the life assured died or was treated and it is required to be completed by the Hospital Authorities.
- **(iv) Claim form 'C' (F. No.32785 (Revised)):** This is a certificate of identity and burial or cremation to be completed by an independent person who has attended the funeral and seen the dead body.
- **(v) Claim Form 'E' (F.No.3787 (Revised)):** This is a certificate to be completed by the employer if the assured was an employed person.

4. Proof of Title: The claim is payable to the nominee or the assignee as the case may be. When the Life Assured has died without making an assignment or a nomination under the policy, the Corporation would require Legal evidence of Title (Proof of ownership) such as Succession Certificate or Letters of Administration or Probate of a Will where a will is made.

If the total estate including the policy moneys left by the deceased does not exceed Rs.15,000 in value, a Certificate from the Administrator General can be easily obtained and this will be accepted by the Corporation as sufficient Proof of Title. Moneys deposited in a Government Saving bank or in a recognized Provident Fund shall be excluded for determining the total estate with a view to obtaining Administrator General's Certificate. A specimen form of application for this type of Legal Representation can be obtained from the Divisional Office. If the application is returned duly completed by Claimant, the Divisional Office will obtain at his request the certificate from the Administrator General by paying the necessary fees. The fees paid, however, will have to be deposited by the claimant.

5. Early Claims: If the claim has arisen within 2 years from the risk date or revival, investigations are done by the office on receipt of claim form. After the investigation is completed and found satisfactory the claim is admitted and Form of Discharge is issued to the claimant for completion provided no fraud is detected and/or there was no concealment of material information from the Corporation. Obviously, settlement of claims which are being investigated is slightly delayed.

The net amount payable under a policy in settlement of its claim depends upon its status on the date of death.

6. Claim concession: Under a reduced paid-up policy, Corporation pays the claim for the Sum Assured instead of the paid-value provided the following tow conditions are satisfied:

(i) The Life Assured has died within six months from the due date of first unpaid premium, and
(ii) Premium under the policy have been paid for a minimum period of 3 full years.

7. Extended Claims Concession: In terms of concession, claim for the sum assured is paid under a reduced paid up policy provided the following two conditions are satisfied:
(i) The life assured has died within one year from the due date of first unpaid premium; and
(ii) Premiums under the policy have been paid for a minimum period of 5 years.

8. Relaxation in the Matter of Certain Early Claims: In terms of C.O. Circular of October 1987, it is now possible to consider a claim where more than two year's premiums have been paid and the death of the life assured takes place within 3/6/9 months of the first unpaid premium. Such claims are to be settled purely on ex-gratia basis for full Sum Assured or for 50% of the Sum Assured or for Paid-up Value as the case may be.

The following of Discharge (F. No. 3801) should be signed by the following:

1. Nominee if nomination was made under the Policy;
2. Assignee of the policy was conditionally or absolutely assigned;
3. Holders/s of legal representation obtained if the policy was not nominated or assigned; or
4. All Class I heirs if the Divisional Office has waived Proof of Title:
5. Trustee/s, if the policy was issued under M.W.P. Act, 1874.

10.2 L.I.C.'S STEPS TO HASTEN THE CLAIM SETTLEMENT:

1. **Age Proof Dispensed With:** In case where the claimants are unable to produce a proof of age of the deceased life assured, age proof is dispensed with for polices of small amounts provided the office is satisfied that prima facie there has been no understatement of age.

2. **Payment by Money Order:** Small claims are now being paid by money order at the corporation's cost without the necessity of the policy-holder calling on at the office. The offices of the corporation have been vested with wide power or matters connected with servicing of claim.

3. **Direct Contact of D.O's:** In cases where the Corporation does not hear from the claimants, it send's its development officials to contact the claimants and assists them in complying with the requirements. The Corporation makes all attempts to settle the claims expeditiously.

4. **Time Bound Investigation:** Where investigation has to be carried out, instructions have been issued to the offices to draw up a time bound programme for completing the outstanding investigations. In case any claim is pending for an unduly long time, senior officers at the Divisional office have been asked to review such cased and the officers have been asked to submit a report within three months. Continuous efforts are directed at al levels to see that all claims are settled as quickly as possible. This will naturally help many distressed families to receive the insured amounts as early as possible.

5. **Advance Discharge Voucher:** In the case of maturity claims the office sends a discharge voucher to a policy-holder generally one or tow months, on advance of the date of maturity with a request to return the voucher and policy and age proof if the if the proof of age has not been admitted. All these steps are surely going to improve the image of the corporation.

10.3 LOANS AGAINST POLICY

1. The corporation grants loans on the security of Life Insurance Policies to the persons entitled for the same, under the contract. Loans are granted upto 90% of the surrender value (inclusive of cash value of Bonus) in case of policies which are in force for full sum Assured and 85% of the surrender value (inclusive of cash value of Bonus) in case of policies which are paid-up, being in force for reduced sum assured.

2. Loans cannot be granted for amounts less than Rs.150 under any policy. But if the policy conditions under a policy issued by any unit provide for grant of loan for an amount less than Rs.150. Loans under such a policy may be granted for an amount upto the minimum amount specified in the policy conditions.

3. If loan is required for the specific purpose of payment of premiums under a policy the same may be granted for a lesser amount but not below Rs.100.

4. While granting an additional loan, the overdue interest on previous loans, if any, is deducted.

5. The title of the person/s asking for loan should be complete and clear in respect of the policy moneys and such persons/s should be competent to contract. Loans are not granted if an assignee is minor and therefore, not competent to enter into the contract or the assignee, or any of the assignees does not join in the loan transaction.

10.4 POLICIES UNDER WHICH LOANS CANNOT BE GRANTED

1. Immediate Annuity and Deferred Annuity Policies.
2. Children’s Deferred Assurance Policies during the deferment period.
3. Two-year Temporary Assurance Policies.
4. Fixed Term Marriage Endowment or Education Endowment Policies issued by any Unit where name of the Child is incorporated in the Policy as Beneficiary is a minor.
5. Janata Policies.

6. Grihalakshmi Policies.
7. Money Back Policies.
8. Cash and Cover policies during the premium paying period.
9. Anticipated Whole Life Policies during the premium paying period.
10. Polices on the lives of minors during their minority.
11. Policies where there is one assignee and the assignee is a minor.
12. If there are more than one assignee and all or any of them is/are minor/s during the minority of the youngest assignee.
13. Where there is no assignment or if there is one, it is conditional assignment and the assured or the conditional assignee has become insane or is main undischarged insolvent.
14. Policies effected under Section 6 of the Married Women's Property Act, 1874 unless Trustees have been appointed and they are empowered to raise a loan on the security of the policy for the benefit of the Beneficiaries and the Beneficiaries are major and competent to contract and not mentioned as a class. The Beneficiaries should be on one mind and give consent to the loan being granted to the Trustee/s. Where while completing the Proposal of the Proper authorized the trustees to raise loan for the benefit of the Beneficiaries, irrespective of whether the beneficiary/ies are minor, the loan can be granted to the Trustees. However, the consent of the major Beneficiaries may be obtained.
15. Policies which have been irrecoverably lost or destroyed, unless duplicated have been duly issued therefore, if any Deed of title, such as a Deed of Assignment forming a ling in the chain of title of the Policy is missing, a loan cannot be granted in the absence of the Deed, unless a satisfactory explanation is given for its loss by the Policy-holder and a suitable Indemnity Bond is furnished.
16. Where the title to Policy is not clear or an assignment executed thereof is defective but it has been registered in the Corporation's books 'for whatever it may be worth' or Deed of Assignment is unstamped or inadequately stamped, in the later case, if the Deed of Assignment is otherwise in order, a loan can be granted provided the policy-holder gives an undertaking in writing to get the assignment deed duly stamped, if and when required to do so.

17. Where a Prohibitory or Attachment Order has been served on the Corporation attaching the Policy or restraining the Corporation from allowing any dealing in respect thereof.

18. Where a Policy-holder is residing in a country other than the country in which the Corporation's Office paying the loan is situated, the payment can be made only subject to the Exchange.

10.5 CONDITIONS FOR GRANTING OF LOAN

1. Interest: Interest on loan is charged at the rate of 9% payable half-yearly corresponding to the date and month of commencement of the Policy. Even though the terms and conditions of loan provide for compounding of the interest half-yearly, the Corporation adopts the practice of charging only simple interest. However, where two half-yearly installments of interest on loan (excluding installments for the broken period) are in arrears and the same are not paid within the days of grace for the second installments, compound interest is charged. In the cases of policies which become claim either by maturity or by death, within six months of the date of loan, interest only upto the date of maturity or death as the case may be, will be charged. If the interest under a loan granted on security of the policy is not paid, Corporation retains the right to charge compound interest. Failure to pay interest in time may lead to the Corporation calling for repayment of the loan or applying the surrender value under the policy towards adjustment of the loan, interest, charges if any, and refunding the balance of surrender value to the party entitled to the policy moneys. As such, the agents should advise the Loanees to punctually pay interest on loan taken by them.

Loans are granted subject to the condition that interest has to be paid for a minimum period of 6 months, i.e., even if a party wants to repay the loan within months of his availing it, he has to pay the interest for six months.

2. Repayment: The terms and conditions of loan provide for repayment of the loan with interest, on the Corporation giving three month's notice to other loaner. Ordinarily, however, repayment of loan will not be required to be made either in full or part during the currency of the policy, so long as interest on loan is paid regularly every half year. The amount of loan with interest due upto the date when the claim arises will be deducted from the claim amount if a policy holder desires to repay the loan in installments, allowed to do so, provided

each installment paid towards repayment of the loan is multiple of Rs.10 and it is not less than Rs.50.

3. Notice: As per the terms and conditions of loan, the Corporation may give notice to the Loanee for repayment of the loan with interest within three months. If the Loanee fails to comply with this requirement, the Corporation may apply the Surrender Value allowable in respect of the policy towards adjustment of the loan, interest there on and the expenses in connection with the loan. Any balance of surrender value after such adjustment would be paid to the party.

4. Compound Interest: If the interest under a loan granted on security of the policy is not paid, Corporation retinas the right to charge compound interest. Failure to pay interest in time may lead to the Corporation's calling for repayment of the loan applying the surrender value under the policy towards adjustment of the loan, interest and charges, if any, refunding the balance of surrender value to the party entitled to the policy moneys.

5. Claim: On the policy becoming a claim, the Corporation appropriates its loans and interest out of claim amount and only the balance remains payable under the policy.

10.6 REQUIREMENTS TO BE OBTAINED FOR LOAN

1. An application for loan in the appropriate form-Form Nos.51926, 5204, 5206.
2. An absolute assignment in favour of the Corporation (Form No.5199 depending on whether the policy is in favour of the policy-holder or there exists a conditional assignment).
3. Receipt for the loan amount (Form No. 5200).
4. Policy document with Deeds of Assignment or Reassignment, if any.
5. The Letter of Agreement (Form Nos.3516, 16517, 3518, 3599 or 5214 depending upon the plan of the policy).
6. A letter of consent from all the beneficiaries as per para 3.
7. Whereas previous loan has been granted at lower rate of interest than 9% the Application Form and Receipt for the present loan should be obtained for the

consolidated amount of loan from which the previous loan and interest there on will be deducted and the balance amount will be paid to the party.

8. For first loans on policies issued prior to 1.6.1969 of for subsequent loans where previous loans were granted on the strength of a Loan Bond, the Stamp Fee for the endorsement regarding the terms and conditions of the loan to be placed on the policy, will be deducted from the loan amount.
9. The loan papers will have to be completed by all the parties that have either immediate or contingent interest in the policy. For example, if the policy bears a conditional assignment with reversion of interest to the Life Assured on his surviving the date of maturity or on prior death of the assignee, the relevant papers would be required to be signed by both the policy-holder and the assignee.
10. Agent should get all the above requirements after informing the party the amount of loan available under the policy. In case the Agent has any difficulty in calculating the loan, he should approach the Branch Office to ascertain the requirements and have them complied with the concerned person/s.

10.7 SELF- ASSESSMENT QUESTIONS

Short Answer Questions

1. Claim by maturity
2. Policy document
3. Claim by death

Essay Questions

1. What is claim by maturity? Explain the requirements for the settlement of maturity claim
2. Explain the steps taken by LIC to hasten the claim settlement.
3. Explain the method of taking loans against Life Insurance Policies
4. What are various policies under which loans cannot be granted?
5. Explain the conditions of granting of loans.
6. What are the requirements to be obtained for a loan from LIC?

10.8 REFERENCE BOOKS

1. P.K. Gupta, Fundamentals of Insurance, Himalaya Publishing House
2. Anand Ganguly, Insurance management, New Age International.
3. M.N.Srinivasan, Principles of insurance law, Universal Publishing Company
4. Dr.E. Dharmaraj, Elements of Insurance, Simres Publications, Chennai
5. Dr.P. Periaswamy, Principles and Practice of Insurance, Himalaya publishing House

Lesson – 11

Nomination and Assignment

Objectives

After completion of this lesson you should be able to understand :

- The importance of nomination in life insurance
- the assignment of policies
- the problems relating to lapse and revival of policies
- the surrender value and its calculation

Structure

11.1 Nomination

11.2 Assignment

11.3 Essential Conditions of Assignments

11.4 Types of Assignments

11.5 Lapse and Revivals of Policies

11.6 Surrender Value

11.7 Suicide and Life Insurance Policies

11.8 Self-Assessment Questions

11.9 Reference Books

11.1 NOMINATION

Every policy-holder would desire that in the event of his unfortunate death the payment of the policy money may not be held up for want of Succession Certificate or Letters of Administration, which would involve both cost and delay. He can get his objective of prompt settlement of claim done in the event of his death either by effecting nominations or assignment of life insurance policy. There are specific provisions made in the Insurance Act to enable the policy-holder to obtain prompt payment of claim in the event of his death under a life insurance policy on his life.

1. **Who can effect a Nomination:** The nomination is governed by Section 39 of the Insurance Act, 1938 which empowers the holder of a policy on his own life to effect nomination in favour of a person or persons to receive the policy moneys in the event of policy becoming a claim by death of the life assured during the currency of the policy. If a policy is issued on the life of another person, the proposer cannot make a nomination.

However, the life assured can make a nomination as and when the policy vests in the life assured or when absolutely assigned by the proposer in his favour, as the case may be.

2. **How to effect a Nomination:** While submitting the proposal on his own life the proposer may appoint nominee in the Proposal Form. If full details are given before issue of the policy, the nomination will be incorporated in the text of policy. If the proposal has already been sent to the Corporation the life assured can write a letter stating that he desires to appoint a Nominee under Section 39 of the Insurance Act, 1938.

   After issue of the policy, nomination can be made only by an endorsement on the back of the policy itself. Such a nomination is required to be notified to the Corporation and registered by it in its records. Section 39 specially provides that the nomination should either be incorporated in the text of the policy at the time of its issue or it should be made by an endorsement on the back of the policy, the nomination on a separate sheet of paper would be invalid. Where no blank space is available on the policy to make an endorsement of the nomination, the same may be done on a slip of paper pasted to the policy and signed across the four corners.

3. **Effect of Nomination:** The nomination merely gives the Nominee the right to receive the policy moneys in the event of death of the life assured. It does not pass on the property in the policy to the Nominee and the Nominee has no right to deal with the policy. The policy continues to be a part of the estate of the life assured and he can deal with it in any manner without the consent of the Nominee. He can even revoke the existing nomination without the consent of the Nominee.

4. **Death of Nominee:** In the event of the death of the Nominee, the nomination becomes ineffective. The nominee’s successors or heirs do not have any right to the policy moneys. If the Nominee dies before the life assured, the assured has the right to make a fresh nomination in favour of another person. If the Nominee dies after the death of the life assured but before receiving the policy moneys, the nomination would be ineffective and the policy moneys will become payable to the legal heirs of the life assured. Thus, if the Nominee dies before receiving the payment of the policy moneys, Nominee’s estate would not have any right to the policy moneys and the right would then vest in the estate of the life assured. If on the date of maturity, the life assured is alive the Nominee will have no right to receive the policy moneys.

5. **When the Nominee is a Minor:** An appointee a major person may be appointed to receive the policy moneys in the event of death of the life assured during the minority of the Nominee. His appointment is valid by the Indian Insurance Amendment Act, 1950, only under such policies which provide for payment of policy moneys at any place in India including Jammu and Kashmir. The Appointee must affix his signature to the endorsement in a token of his having consented to act as and Appointee and his signature must be witnessed by a responsible person. The life assured has a right to revoke the Appointment of the Appointee and to appoint a fresh Appointee.

6. **Notice of Nomination:** If Nomination is made by an endorsement on the policy, it will have no effect unless it is communicated to the Corporation and registered in their books. When such a nomination is made for the first time, the Corporation will register it even if no notice is served. However, a notice of nomination by the life assured or his duly authorized agent is required to be served on the Corporation for all nominations subsequent to the first, revocation of nomination or change of nomination in terms of Section 39 of the Insurance Act, 1938.

7. **Change of Nomination:** A nomination can be cancelled or changed either by an endorsement or by a Will. If cancellation or change of nomination is made in a Will, notice of such nomination or change would be required from the executors of the Will after the death of the life assured. As the Will takes place only from the date of death of the life assured any cancellation or change of nomination can take place only from that date. There must be provision in the Will for a nomination to be cancelled.

8. **Assignment:** An assignment automatically cancels a nomination. However, an assignment made in favour of the Corporation in consideration of a loan granted within the surrender value of the policy or reassignment on payment of loan does not cancel the nominee.

9. **Joint Life Policy:** Under this policy the policy moneys are payable to the survivor on the first death. However a nomination can be effected jointly for the purpose of nominating a person to receive the policy moneys in case both the lives assured die simultaneously in common calamity where it would be difficult to prove which one of them predeceased the other. Hence, the nomination cannot be incorporated in the policy at the time of its issue.

However, the Corporation allows this nomination by an endorsement on the policy itself by making suitable changes in the nomination.

11.2 ASSIGNMENT

Before we deal with the salient features of assignment as enumerated it would be necessary to define the assignment of life insurance policy. An assignment of a policy may be defined as an instrument whereby the beneficial interest, title and right under a policy is transferred either absolutely or conditionally be one person to another person.

Salient features under Section 38 of the Insurance Act, 19378.

1. An assignment can be made by an endorsement on the policy or by a separate Deed.
2. A notice of Assignment in writing is necessary to be submitted to the Corporation along with either the Policy document duly endorsed or Deed of Assignment, or a certified copy thereof.
3. The Corporation has to record the fact of the transfer or the assignment and has to give a written acknowledgement of receipt of such notice.
4. As a result of assignment all the rights and liabilities under a policy will be transferred to the assignee subject to any condition set in the assignment.
5. It is possible to make an assignment which is conditional. It is also possible to make assignment in favour of survivor or survivors of a number of persons.
6. Section 38 makes it very clear that the conditional assignment made after the Act came into existence cannot be considered absolute notwithstanding the Personal Law of Mohammedans. That is, the conditional assignment made after the Act came into force by a Mohammedan, inspite of his Personal Law, is valid and cannot be treated as Absolute Assignment.

11.3 ESSENTIAL CONDITIONS OF ASSIGNMENTS

1. The person assigning the policy must have absolute right or interest vesting in him in respect of the policy either in terms of the policy contract or by virtue of the previous assignment in his favour.
2. The assignor must be major and otherwise competent to contract.

3. He must not be subject to any legal disqualifications.

4. Assignment must be supported by consideration which may be:

   (i) Valuable Consideration money or money's worth.

   (ii) Good or moral or meritorious consideration, i.e., natural love and affection which a person may have towards his wife, children etc.

5. Assignment must not be opposed t o any law for the time being in force for example no assignment can be made in contravention of exchange control Regulation. Assignment of a policy by a resident of India to a non-resident in different countries cannot be made without the prior approval of the Reserve Bank of India. However, a policy can be assigned by a non-resident of India to a resident of India without Reserve Bank of India's approval.

6. Assignment must be in writing and it must be very clear in the operative part of the endorsement that interest in the policy has been transferred and has become vested in the assignee.

7. Assignor must affix his signature to the assignment.

8. The assignor's signature must be attested by at least one witness.

11.4 TYPES OF ASSIGNEMENTS

To suit the need of the policy-holder, Section 38 of the Insurance Act provides two kinds of assignments:

(i) **The Conditional Assignment:** It would be useful where the policy-holder desires the benefit of the policy to go to a near relative in the event of his earlier death. It is usually affected for consideration of natural love and affection. It generally provides for the right to revert the policy-holder in the event of the assignee predeceasing the policy-holder or the policy-holder surviving to the date of maturity.

(ii) **The Absolute Assignment:** It is rules concerning assignment generally made for valuable consideration. It has the effect of passing the title in the policy absolutely to the assignee and the policy-holder in no way retains any interest in the policy. It must clearly mention the consideration involved. The absolute assignee can deal with the

policy in any matter he likes and may assign or transfer his interest to another person.

(i) The LIC's agents are prohibited from being assignees under the policies on the lives of persons other than own-selves or their very near relatives.

(ii) An assignment involving a part of the policy moneys is considered to be void in law.

(iii) Mere deposit of policy without any assignment in writing does not create any charge. So the policy cannot be mortgaged by just depositing it with another person.

Rules of Assignment:

1. **Notice of Assignment:** A written notice of assignment as required by the Insurance Act has to be submitted to the Divisional Office along with the Assignment in original or copy there or certified to be correct by both the assignor and assignee for registration of the Assignments in the Books of the Corporation. The assignment will not be operative as against the Corporation until such Notice of Assignment is received.

2. **Prohibitions:** If more than one Notice is received, priority will be determined according to the date on which the relative notices are delivered to the Corporation. A situation may arise where two assignments might have been executed, one on a separate paper and the other on the policy document. Notice in respect of earliest assignment on a separate paper is not sent to the Corporation. While a due notice is sent to the Corporation in respect of the latter assignment the second assignee will have priority over the first. The Notice of Assignment must be served by the assignor failing him by the assignee.
3. **Minor Assignee:** If the assignment is in favour of a minor, in the event of claim, policy moneys cannot be paid to him as he cannot give a valid discharge. Therefore, it is desirable that where the assignee is a minor, testamentary guardian should be appointed in respect of all the properties of such minor including the policy moneys. A testamentary guardian can only be appointed by the natural guardian of minor by a separate instrument or on the back of Policy. The following points should be noted in this connection:

    (i) The appointment relate to the entire property of the minor and not the minor's property.

(ii) The guardian can be appointed only by the father of the minor so that if the proposer is not the farther of the minor, the appointment will have to be made by the father of the minor.

(iii) The appointer of the guardian must affix his signature to the appointment in the presence of at least two witness who must also sign in the presence of each other.

(iv) No stamp fee is required on the document of appointment of guardian.

(v) The document must clearly identify the minor and the guardian.

(vi) The agent must also note that during the minority of assignee the policy cannot be dealt with the consent of the testamentary guardian unless the Guardianship Certificate under the Guardian and Wards Act issued by a Court of competent jurisdiction is furnished to the Corporation empowering the holder to deal with the property of the minor.

4. **Stamping the Assignment:** Where the assignment is made on the policy itself, it is exempted from Stamp Duty. However, where an assignment is made by a separate Deed, it attracts the Stamp Duty.
5. **Death of Assignee:** In the case of conditional assignment, if death of the conditional assignee is established the benefit under the policy reverts to the life assured. If the assignment of a policy made in accordance with the section 38 of the Insurance Act automatically cancel the nomination under a policy subject to the provision where a loan is granted by the Corporation of the security of the policy, the assignment in favour of the Corporation dose not cancel the Nomination by affect the right of the Nominee only to the extent of the Corporation's interest in the policy.

Reassignment :

An assignee may during the currency of the policy reassign the interest in the policy to the previous assigner, such reassignment will have the effect of cancelling the assignment and the interest title of the policy revert to the previous assigner.

11.5 LAPSE AND REVIVAL OF POLICIES

Where the premium is not paid on the due date or within the days of grace, the policy lapses but it can be revived at any time during the remaining period of the policy, subject to medical evidence and arrears of premium along with interest thereon at the applicable rate. If

the policy has lapsed within 3 years of the date of commencement, it is not entitled to any claims concession, except days of grace, usually 30 days. As per IRDA guidelines details, all those policies which have lapsed is required to be submitted within stipulated time to IRDA.

Revivals :

If the premium under a policy is not paid within the days of grace, the policy lapses. Revival is a fresh contract wherein the insurer can impose fresh terms and conditions In case of LIC, a lapsed policy can be revived within 5 years from the date of first unpaid premium. A policy can be revived under the following types of revival.

1. **Ordinary Revival :** If a revival of the policy is effected within 6 months from the due of first unpaid premium, no personal statement regarding health is required and the policy is revived on collection of delayed premium plus interest. The rate of interest to be charged for such delayed premium will depend on the date of commencement of the policy.

2. **Revival on Non-medical basis :** For revival of the policy on non-medical basis, the amount to be revived should not exceed the prescribed limit for non-medical assurance taken by the life assured.

3. **Revival on Medical basis :** If a policy cannot be revived under ordinary revival or revival on non-medical basis, it can be revived with medical requirements. The medical requirements will depend upon the amount to be revived.,

4. **The other schemes for Revival are :**

   (a) Special Revival Scheme
   (b) Revival by installment
   (c) Loan cum revival
   (d) Survival benefit cum revival

   (a) Special Revival Scheme : If the policy was in force for at least 6 months and has not acquired surrender value, the policy may be revived where the original date of the policy is shifted by the period for which the policy was in force. A fresh policy was will have to be issued for the age as on that date. The arrears of premium will be a nominal amount. The cost of the preparation of the policy will have to be borne by the policyholder.

(b) Revival by Installment : The policyholder, in that case, can pay arrears of premium by suitable installments, which should be paid along with regular premiums. The unpaid installments of premiums are treated as a debt/charge against the policy.

(c) Loan-cum-Revival : If the lapsation period is long, the arrears of premiums could be a very substantial amount, the insurer offers a loan-cum-revival scheme, provided the policy has acquired surrender value, notionally on the date of revival.

Difference between Assignment and Nomination

S.No.	Basis of difference	Assignment	Nomination
1.	**Transferability**	Assignment of a policy involves the transfer of all rights of the policy holder to the assignee,	Nomination does not involve the transfer of the policy-holder's rights.
2.	**Right of Action**	The assignee is entitled to all the benefits of the policy and can sue in its own name	The nominee cannot sue by his own name but he gets the money only by the trustee on behalf of the beneficiaries of the policy.
3.	**Cancellation**	A nomination can be changed at any time	An assignment cannot be changed although there may be a reassignment under certain cases.
4.	**Alteration**	While a nomination can be altered during the policy period	An assignment cannot generally be changed.
5.	**Object**	While assignment is made with the purpose of giving benefit to the intended beneficiary,	The nomination is made to provide the insurer with a convenient method of discharging his obligations.
6.	**Consideration**	While assignment is made with or without consideration	Nomination is made without consideration.

S.No.	Basis of difference	Assignment	Nomination
7.	**Procedure**	While assignment can be made on the policy by endorsement or by a separate deed,	Nomination is generally made by endorsement on the policy with a notice to the insurer.
.	**Automatic Cancellation**	While nomination is automatically cancelled if the policy-holder survives the policy.	An assignment does not depend upon the life of the policy-holder. For example, where the policy is mortgaged, assignment gets cancelled on the payment of the money to the creditor.

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11.6 SURRENDER VALUE

The term surrender value refers to the amount of money which the insurer agrees to pay, in case the assured decides to surrender his policy before its maturity. It is said that the policy holder wishes to surrender his policy to the insurer and gives up his claim on it. Surrender of policy indicates termination of the contract of insurance. The amount of surrender value is calculated on the basis of actual premium paid and number of years the policy has been alive. Surrender value increases with each payment of premium.

According to Life Insurance Corporation of India a policy acquires surrender value only after payment of two or three years premium. Thus, the policy is required to have run for three years before it acquires surrender value. In this regard some insurance companies guarantee a minimum surrender value of 40 per cent of the total premium paid.

Paid up value :

If a policy holder discontinues the payment of premium after atleast two years premiums have been paid and subsequent premium is not paid, the policy does not become void but continues as a paid up policy. According to Insurance Act it is defined as the policy paid up for an amount bearing the same proportion to the amount of original sum assured which the

number of premiums paid bears to the total number of premiums payable under the policy as a whole, the policy with the reduced amount is called Paid up Policy.

In the case of With profit or participating policy it is assured that bonus or profits will be added to the paid up value but future gains or profits are not entitled to such policy.

Days of grace :

Insurance company allows certain days after the stipulated period of insurance during which the insured can pay the premium to renew or continue the policy. Life insurance corporation allows fifteen days of grace from the due date of pay monthly premiums and third days of grace for the payment of quarterly, half yearly and yearly premiums.

A life insurance policy creates a continuing risk and it merely lapses if the premium is not paid. Death of the insured during the days of grace makes the insurance company liable to pay the money due under the policy.

Revival (or) Discontinued (or) Lapsed Policies :

When the premium is not paid within the days of grace, the policy lapses. It may be revived during the life time of the life assured. It can be revived within a period of five years from the due date of the first unpaid premium and before the date of maturity.

11.7 SUICIDE AND LIFE INSURANCE POLICIES

Suicide means a willful and intentional act on the part of the self destroyer. It includes every act of self destruction. Policies of life insurance contain conditions by which the liability of the insurer is modified and limited in case of suicide by the assured. Where there is such a clause in a policy, the insurer can avoid payment on the policy on death by suicide.

The position in England and in India is different on this issue. In England suicide in a sane state of mind. On the other hand if the assured was insane at the time of committing suicide, the sum due can be recovered by his legal representatives.

Under the Indian law, suicide in itself is not an offence, and as such a policy cannot be avoided on the ground of suicide, unless the policy otherwise provides. Suicide will, however, not affect the rights of assignee, if the policy holder had assigned policy for valuable consideration.

The burden of proving suicide is upon the insurers and where the cause of death is not known, the presumption is against suicide and the policy cannot be avoided.

Payment of claims :

A person claiming money on the maturity of the policy must satisfy the insurer that he is entitled to receive the money either.

(a) as the owner of the policy, or

(b) because the actual claim is vested in him as legal representative or as nominee or as assignee.

On the maturity of the life policy the insurer requires a satisfactory and reasonable proof of age and death of the assured. Death may be proved by direct or indirect evidence. In the absence of any conditions to the contrary, suicide does not avoid the policy in India.

11.8 SELF ASSESSMENT QUESTIONS

Short Answer Questions

1. Nomination of Life Policies
2. Assignment
3. Conditional Assignment
4. Absolute Assignment
5. Minor as Assignee
6. Surrender value
7. Days of grace

Essay Type Questions

1. What is Nomination? Explain the essentials of nomination in Insurance Contract
2. What is Assignment? Explain the essential conditions of assignments
3. What are various types of assignment?
4. Explain the rules relating to lapse and revivals of policies.
5. Distinguish between Assignment and Nomination
6. Explain the rules relating to suicide in the finalization of claims

11.9 REFERENCE BOOKS

1. P.K. Gupta, Fundamentals of Insurance, Himalaya Publishing House
2. Anand Ganguly, Insurance management, New Age International.
3. M.N.Srinivasan, Principles of insurance law, Universal Publishing Company
4. Dr.E. Dharmaraj, Elements of Insurance, Simres Publications, Chennai
5. Dr.P. Periaswamy, Principles and Practice of Insurance, Himalaya publishing House

Chapter – 12

IRDA and Other Regulatory Agencies

Objectives

After completion of this lesson you should be able to understand :

- Mission, duties and powers of IRDA
- Functions of IRDA
- Know the redressal mechanism in insurance business

Structure

12.1 Insurance Regulatory and Development Authority

12.2 Functions of IRDA

12.3 IRDA permits Life Insurers to Outsource Investment

12.4 Accounting and Actuarial Standards

12.5 IRDA Technical committee

12.6 Redressal of Public Grievances Rules, 1998

12.7 Tariff Advisory Committee

12.8 Self-Assessment Questions

12.9 Reference Books

12.1. INSURANCE REGULATORY AND DEVELOPMENT AUTHORITY

Insurance Act, 1938 and Insurance Rule, 1939 primarily govern the conduct of insurance business in India. As per the Preamble of the Act, Insurance Act, 1938 is an act to consolidate and amend the law relating to the business of insurance. Most of the provisions of the Act are applicable to all classes of insurance business.

The Insurance Act, 1938 provides that the Government should appoint a Controller of insurance to ensure that insurance companies registered under the Act, comply with the various provisions of the Act. His duties include approval of the terms and conditions of various plans being offered by the companies, including the adequacy on the basis of premium. Scrutiny of the various returns on investments, annual accounts, periodicals, actuarial valuations etc required to be submitted by the companies. The controller also has powers to order special investigation and also to take over the management of the companies.

After the nationalization of the insurance industry the responsibilities of supervision had reduced considerably. But with the proposal to open up the industry, following the policy of

liberalization and globalization, and the likelihood of private companies being permitted to transact insurance business in India, it became necessary to establish an authority to regulate insurance corporations.

The Insurance Regulatory and Development Authority (IRDA) Act 1999 was passed by parliament in December, 1999 by which the Insurance Act 1938, the Life Insurance Corporation Act 1956 and the General Insurance Business (Nationalization) Act 1972 were amended to remove the exclusive privilege of nationalized insurance companies to transact life and general insurance business and allow for the entry of private sector players in the insurance sector. The Insurance Act 1938 allows for only Indian insurance companies registered under the companies Act 1956 to transact insurance business in India after registration with the IRDA.

Constitution of the IRDA :

The IRDA shall consist of not more than nine members, not more than five members of whom, including the chairperson to be full time. The whole time members shall hold office for 5 years or until the age of 62 (65 in the case of chairperson) whichever is earlier, part time members will hold office not more than 5 years. The above said members to be appointed by the Central Government from among persons of ability and standing who have knowledge or experience in life insurance, general insurance, acturial science, finance, economics, law, accountancy, administration or any other discipline which would in the opinion of the Central Government, be useful to the Authority.

The IRDA Act, 1999 provides huge opportunities to private sector to do insurance business. The Act provides for the establishment of statutory insurance regulatory and development authority to regulate, promote and ensure orderly growth of the insurance industry. It protects the interests of the policy holders and ensures benefits from the insurance industry. There were 43 insurance companies operating in India at the end of 2014, of this 21 were life insurers and around 22 non life insurance companies, and one reinsurance company. Among the non life companies, Agricultural insurance company handles crop insurance and Export Credit Guarantee Corporation is transacting export credit insurance.

Mission of IRDA:

The mission of IRDA include the following.

1. To protect the interest of and secure fair treatment to policy holders.

2. To bring out speedy, and orderly growth of the insurance industry (including annuity and super annuity payments) for the benefits of the common man and to provide long term funds for accelerating growth of the economy.

3. To promote monitor and enforce high standard of integrity, financial soundness, fair dealing and competence of those if regulates.

4. To ensure speedy settlement of genuine claims, to prevent insurance frauds and other malpractice and put in place effective grievance redressal machinery.

5. To promote fairness, transparency and orderly conduct in financial markets dealing with insurance and build a reliable management information system to enforce high standards of financial soundness among market players.

6. To take action where such standards are inadequate or ineffectively enforced.

7. To bring about options, amount of self regulation in day to day working of the industry in consistent with the requirements of prudential regulations.

Duties and Powers of the IRDA:

The following are the powers of IRDA.

1. To regulates, and promote insurance business and reinsurance business.

2. Powers to registration, renew, modify, withdraw, suspend or cancel the registration of insurance companies.

3. Conducting inquiries, investigations, audit of insurers, intermediation, insurance intermediaries and other organization connected with insurance business.

4. Control and regulation or rates, advantage, terms and conditions offered by insurers in respect of general insurance business.

5. The powers to control price of the product, premium rates which are fixed by the Tariff Advisory Committee constituted under section 64U of the Insurance Act 1938.

6. Investment policy of the insurance companies is governed by the guidelines of the IRDA.

7. The IRDA may direct the insurer to invest certain proportion of their funds in specified securities.

8. The IRDA has power to investigate and inspect the affairs of insurance companies.

9. The insurers are required to prepare balance sheet, profit and loss account and a separate account of receipts and payments and a revenue account in respect of each type of insurance business and made mandatory for the appointment of Actuary.

12.2 FUNCTIONS OF THE IRDA:

The following are the important functions performed by the IRDA.

1. Protect the interests of policy holders in matters like assigning of policy, nomination by policy holders in matters like assigning of policy, nomination by policy holders, insurable interest, settlement of claims, and surrender value of policy etc.
2. Specify the code of conduct for surveyors and loss assessors.
3. Promoting efficiency in the conduct of insurance business.
4. Promoting and regulating professional organizations connected with the insurance and reinsurance business.
5. Specifying the norms in which the books of account shall be maintained and statement of accounts shall be rendered by insurers and other insurance intermediaries.
6. Regulating the investment of funds by insurance companies.
7. Regulating the margin of solvency.
8. Adjudication of disputes between insurance and insurance intermediaries.
9. Supervising the functioning of the Tariff Advisory committee.
10. Specifying the percentage of premium income of the insurer.
11. Specifying the percentage of life insurance business and general insurance business to be undertaken by the insurers in rural sector.

12.3 IRDA PERMITS LIFE INSURERS TO OUTSOURCE INVESTMENT

Insurance Regulatory and Development Authority (IRDA) has allowed the private life insurers to outsource some of the investment functions including custodial services and calculation of Net Asset Value (NAV) of unit-linked products (ULIP). The custodial service provider should maintain confidentiality and protect data from international or inadvertent disclosure to unauthorized persons. The outsourcing function of calculation of NAV would be advantageous in view of higher investments required in acquiring hardware and software for small-sized funds. Life Insurers to outsource the custodial services, the outsourcing arrangement in no way takes away the obligations, accountability and responsibilities to the insurer to its policy holders.

The custodial service provider should have expertise in NAV computation, an adequate system to address operational risks from technology, errors and frauds, a comprehensive and effective system for disaster recovery and periodic testing of back-up facilities. The outsourcing agreement should have an exit clause providing for smooth transfer of records and functions to the insurer or its contractor in the event of termination of contract without onerous penalties.

Role of IRDA in Appointment of Agents :

The conditions of appointment of agents are regulated by LIC of India (Agents) Regulations, 1972. The procedure for appointment and renewal of licences of agents as stipulated in IRDA Insurance Agents Regulations, 2000 will have to be strictly adhered to from the date of notification. Accordingly,

1. A person (natural persons, Registered Society, Panchayat, Co-operative Society or Film or Company registered under companies Act, 1956) can be appointed as Insurance agent, in any place within India for soliciting or procuring insurance business, by the insurer or a designated person provided he holds a valid certificate of license issued by IrDA at the time of appointment.
2. The certificate of license will be issued by IrDA as per the procedure prescribed in the Insurance agents Regulations, 2000. The designed persons (appointed by the insurer having authority to appoint agents, and notified to the authority) will receive and forward the application for issue or renewal of license, with requisite fees prescribed by IRDA, to IRDA in the manner prescribed in the Insurance Agents Regulations, 2000.

Solvency Margin of Insurers:

Every insurer is required to maintain a required solvency margin as per section 64 VA of the Insurance Act. The IRDA (assets, liabilities and solvency margin of insurers) regulations, 2000 describes the method of computation of the required solvency margin. Every insurer shall maintain an excess of the value of assets over the amount of his liabilities of not less than an amount prescribed by the IRDA which is referred to as a required solvency margin. The required solvency margin higher of an amount of Rs.50 crore in the case of life insurer, Rs.100 crore in the case of reinsurer or a sum which is based on a formula given in the regulation.

Reinsurance Advisory Committee:

As per section 101 A of the Insurance Act, every insurer shall reinsure with the Indian reinsurer such percentage of the sum insured on each general insurance policy may be specified by the authority which are also known as obligatory cessions or statutory cession with the previous approval of the central government after consultations with the Reinsurance advisory committee. For this purpose the authority may by notification specify the percentage of the sum insured on each policy to be reinsured with the Indian reinsurer and different percentages may be specified for different clauses on insurance that no percentage so specified shall exceed 3% of the sum insured on such policy and also specify the proportion in which the said percentage shall be allocated among the Indian reinsurer.

Regulatory Investment of Funds:

Insurance companies approached the IRDA to invest their funds in the new financial instruments. The IRDA has set up a working group to review the existing statutory prescriptions on investments for insurance companies, constraints faced by them and to suggest measures. The IRDA has issued new regulations on investment of funds by insurance companies (vide IRDA (investment) fourth amendments regulations, 2008) after obtaining the approval of the advisory council.

For Life Insurers:

(a) Government securities not less than 25% of the fund.

(b) Government securities other approved security not less than 50% of the fund.

(c) Investment as specified in section 27A of the Insurance Act – approved investment and other investments not exceeding 35% of the fund.

(d) Investment in housing and infrastructure by way of subscription or purchase of bonds, debentures, asset based securities and investment in infrastructure not less than 15% of the fund.

12.4 ACCOUNTING AND ACTUARIAL STANDARDS

Accounting Standards: The IRDA has issued modified regulations for the preparation of financial statements and auditors reports of insurance companies in 2002.

1. The accounting standards issued by the Institute of chartered accountant of India (ICAI).

2. Cash flow statement under the direct method.

3. The financial statement shall be accompanies by the management report, duly certified by the management.

4. The corporate governance report as per section 217 (2AA) of the Companies Act, 1956.

5. The audit report is submitted by the format which is jointly audited by two auditors.

Section 12 of the Insurance Act, 1938 prescribes that all the insurance companies must be audited annually be the qualified auditors. Regulation 3(4) of the IRDA preparation of financial statements and auditor's report of insurance companies) regulations, 2002 prescribe the qualifications, experience of auditors, continuance and removal of auditors, their rotation, period of appointment etc through guidelines and directions and circulars.

Revised Guidelines: The revised guidelines are given below.

1. The IRDA maintains a panel of auditors.

2. Insurance companies are responsible for selection of audit firms to satisfy the eligibility criterion.

3. Insurers should verify the criteria before the appointment of auditors.

4. Insurance companies should intimate to the IRDA within one week about the details of the auditors.

5. The IRDA has set up a committee on the regulations of the preparation of financial statements of life and non life insurers.

6. The committee is responsible to examine.

7. Norms for recognition of income, provisioning and asset classifications for insurance companies.

8. Requirements of quarterly/half yearly reports by the insurers.

9. Reports are to be submitted by the insurers by the format only.

10. Investment in derivatives including the accounting aspects.

11. Accounting and disclosure issues relating to alternate risk transfer agreements being entered into by the non life insurers.

12. Tax implications.

13. Disclosure requirements for unit linked products in he financial statements of life insurers to ensure transparency in reporting.

14. Laying down procedures, guidelines of claims and accounting in respect of the life insurers.

15. Examine the feasibility of permitting the insurance companies to invest in real estate.

Appointed Actuary System:

The IRDA regulations, specified the privileges and obligations, qualifications of appointed actuary. They are given below.

1. No insurer can transact life insurance business in India without appointing an actuary.

2. Appointed actuary is a full time employee for the life insurers.

3. Appointed actuary may be a consultant or an employee for non life insurers.

4. The IRDA defined the qualifications of an actuary.

5. The Appointed actuary has the right to attend all board meetings, participate in discussions, rendering actuarial service to the management on product design and pricing.

The Actuaries Act, 2006:

The Government of India has notified the Actuaries Act in 2006. The actuarial profession has become very popular among professionals. The institute of Actuaries of India was constituted by the Government of India with the following objectives.

1. To promote, uphold and develop the standards of professional education, training, knowledge, practice and conduct amongst Actuaries.

2. To promote the actuarial profession.

3. To regulate the practice by the members of the profession of actuary.

4. To promote in the public interest, knowledge and research in all matters relevant to actuarial science.

Actuarial Standards:

The Actuarial Society of India (ASI) may issue guidelines (actuarial standards) to its members to protect the public. The ASI issued the first guidance note on appointed actuaries and life insurance. This guidance note on appointed actuaries and life insurance. This guidance note is a mandatory professional standard and covers the major responsibilities of the appointed actuary to maintaining solvency of the insurer.

The ASI issued guidance notes for the appointed actuaries of general insurers. It covers many aspects like the responsibilities and duties of the appointed actuaries, premium

rates, policy conditions of new products and already existing products, capital requirements, actuarial investigations, premium and claims reserves and guidance to actuaries who are directors on the board or consultants of general insurance companies.

International Associations of Insurance Supervisors (IAIS):

The International Associations of Insurance Supervisors (IAIS) was established in 1994 to promote cooperation among the insurance supervisors and financial sector institutions. The IAIS provides an effective forum for practitioners and policy makers to share knowledge, expertise, and experience.

The executive committee, budget committee, technical committee implementation committee have to look after the affairs of the day to day activities. Its headquarters is located at Basel, Switzerland. It helps to maintain fair and efficient insurance markets for the benefit of protecting the policy holders. It develops principles, standards, and guidance for effective insurance supervision.

It collaborates with international financial institutions and international associations of supervisors or regulators in shaping financial systems. It provides input to the International Accounting Standard Board (IASB) for its work on International Financial reporting Standards (IFRS).

12.5 IRDA TECHNICAL COMMITTEE

The Government of India has constituted a high level coordination committee of financial and capital markets to regulating coordination and resolving inter regulatory policy matters and policy issues. The guidelines include the following.

1. It addressed the policy issues of coordination among regulators regarding regular reviews of the capital markets.

2. It has three technical sub committees.

3. It provides an inter agency forum to review, exposure of the insurance sector.

4. To sharing information about the misconduct of the insurance companies.

5. To develop benchmark parameters of emerging irregularities in the insurance sector.

6. To coordinate with other regulators based on the early warning system.

7. The technical committee deals with the flow of funds to the capital markets.

8. Exposure to capital markets.

9. Operationalise the information system for supervision of financial conglomerates.

10. Operationalise the revised integrated system of alert.

Anti Money Laundering:

Insurance sector is exposed to various products that are being provided like risk transfer, savings and investment products. This industry generates a premium of US$ 2.94 Trillion and unfortunately highly vulnerable to money laundering and terrorist financer. Life insurance and non life insurance can be used by money launderers and terrorist financiers in different ways. The life insurance appears to be the most attractive to money launderers. This may be possible in the form of a proposal to enter into a single premium life insurance contract and in the form of fraudulent claim or insurance of assets produced out of illegal money in non life insurance etc.

A statutory duty imposed on all the insurance companies who know or suspect any property directly or indirectly represents the proceeds of drug trafficking to make a disclosure to the Director, FIU-IND. This obligation to establish anti money laundering programmes which applies to all the insurance companies in India. The insurance companies offer standalone medical/ health insurance, reinsurance and retrocession contracts, group insurance business, term life insurance contracts are found less vulnerable to money launderers.

All insurers must file a copy of the anti money laundering policy with the IRDA. The insurers must appoint a principal compliance officer who is entrusted with the responsibility of implementing it. According to the guidelines, insurance companies should make some efforts to determine and document the true identity to all customers. The norms require the customer's sources of funds, his estimated net worth, his need for insurance cover etc should

be documented. Further insurers should not enter into any insurance contract with a customer whose identity matches with persons have link with criminals or with banned entities, terrorists or terrorist organizations.

The insurance companies are advised to classify their customers into high risk and low risk customers. Suspicious transactions reports, cash transaction reports are to be submitted to the FIU-IND.

The insurers/agents/corporate agents are required to maintain the records of the type of transactions a period of 10 years as mentioned under rule 3 and rule 10 of the PMLA rules, 2005. The anti money laundering norms pertain to know your customer should be applied by all insurance companies in respect of all policies.

Financial Intelligence Unit India:

The financial intelligence unit India (FIU-IND) is an independent body which is reporting directly to the economic intelligence council. It was set up by the Government of India in 2004 as the national agency for receiving, processing, analyzing and disseminating information relating to suspected financial transactions. The FIU-IND is also responsible for coordinating and strengthening efforts of national and international intelligence, pursuing the global efforts against crimes relating to money laundering.

12.6 REDRESSAL OF PUBLIC GRIEVANCES RULES, 1998

The redressal of public grievances rules shall apply to all insurance companies operating general insurance business and life insurance business in India. The objects of the rules are to resolve complaints relating to settlement of claims on the part of insurance companies in an efficient and impartial manner. By exercising the powers conferred in subsection (1) of section 114 of the Insurance Act, 1938, the Central Government framed the rules. By these rules, any person who has a grievance against any insurer makes a complaint in writing to the Insurance Ombudsman. The offices of the Ombudsman shall be located at such place specified by the Insurance council.

The advisory committee consists of five eminent persons shall be notified by the Government to assist the IRDA to review the performance of the Ombudsman. The IRDA may

recommend to the Government appropriate proposals for effecting improvements in the functioning of Ombudsman and suggestions for improvement of the insurance sector.

Governing Body of Insurance Council :

The Governing body of the insurance council consists of one representative from each of the insurance companies. The representatives of an insurance company shall be the Chairman or the Managing director or any one of the directors of such company. The governing body will formulate its own procedures for conducting business. The Chairman of Life Insurance Corporation of India shall act as the Chairman of the Governing body.

Insurance Ombudsman :

Insurance Ombudsman was created in 1998 for arbitration between customers and insurance companies. In India, 12 insurance Ombudsmen have been empowered to settle disputers arising out of repudiation of claims by an insurer, premiums paid or payable legal aspects of the policies, and delay in settlement of claims etc.

The governing body shall appoint one or more persons as Ombudsman of the purpose of the rules. The ombudsman shall have exposed to insurance industry, civil services, administrative services and judicial services etc. He shall be appointed for a term of three years and shall be eligible for reappointment and he should not exceed 65 years of age.

Powers of Insurance Ombudsman :

The ombudsman may receive complaints under rule 13 any partial or total repudiation of claims by any insurer, dispute in regard to premium paid or payable in terms of the policy, any dispute on the legal construction of policies relate to claims, delay in settlement of claims, non issue of any insurance document to customers after receipt of premium etc.

The Ombudsman shall act as counselor and mediator in matters which are within his terms of reference and if requested to do so in writing by mutual agreement by the insured persons and insurance company. The decision of the ombudsman is final. The ombudsman may ask the parties for necessary papers in support of their claims and where he considers necessary he may collect factual information available with the insurance company. He shall

dispose of a complaint fairly and equitably. He should adopt a procedure other than mentioned in sub rules 1 and 2 of the rule 13 for dealing with a claim. The recommendations of the Ombudsman shall be sent to the complainant of the concerned insurance company.

The ombudsman shall send a copy of the recommendation along with the acceptance letter received from the complaint. The insurer shall thereupon comply with the terms fo the recommendations within 15 days of its compliance. On the basis of facts and circumstances of a claim, the ombudsman shall pass an award. The award shall state the amount awarded to the complainant. The ombudsmen shall pass award with in a period of three months from the date of receipt of the compliant. The ombudsman has power to make ex-gratia payment.

12.7 TARIFF ADVISORY COMMITTEE :

Tariff Advisory committee (TAC) is an advisory body set up under the Insurance Act, 1938 Section 64 of the Act, defines it as a body which controls and regulates rates, terms and advantages of general insurance business. The committee will concentrate the areas of insurance such as fire insurance, marine hull insurance, marine cargo insurance, motor insurance, industrial risks insurance etc.

Objectives of TAC

The following are the objectives of Tariff Advisory Committee.

1. Tariffs should be simplified to understand easily and customer friendly.
2. Tariff should be made sensitive to the market requirements.
3. It eliminates delays in decision making.
4. Prescribe codes of practices to specific industries for achieving a minimum safety level.
5. Develop software packages to specific industries for insurance rating.
6. To conduct technical audit and recommend companies improving the underwriting standards.
7. Impart training to the technical staff of insurance companies.

Functions of TAC : The important functions of the Tariff Advisory Committee are described as follows.

1. **Market stability and correct pricing :** Insurance policies have to be priced correctly to ensure claims of the insured when need arises. It ensures stability in the insurance market, and strengthens public confidence.
2. **Standardization :** The insurance offer is to be standardized to avoid confusion. The insured's interest should be protected by standardization of products.
3. **Ensuring Equity amongst the Insured :** There should not be any unfair discrimination between risks.
4. **Ensuring Equity amongst the Insurer :** Competition is equitable and based on uniform rates, terms and conditions, which emphasize better services for the insured.
5. **Collection of information :** Section 64 UC of the Insurance Act, 1938 gives powers to the TAC to collect statistics from insurance companies and verify the accuracy of information submitted.

12.8 SELF ASSESSMENT QUESTIONS

Short Answer Questions

1. IRDA
2. Reinsurance Advisory Committee
3. Actuary System
4. Actuarial Standards
5. Insurance Ombudsmen
6. Governing Body of Insurance Council
7. Tariff Advisory Committee

Essay Questions

1. Explain the origin and importance of Insurance Regulatory and Development Authority
2. Explain the Mission, duties and powers of IRDA
3. What are various functions of IRDA
4. Explain the regulations of IRDA relating to Investment policies of Insurance companies
5. Explain the guidelines of IRDA relating to accounting and actuarial standards.
6. State the redressal mechanism available in Insurance business
7. What is tariff advisory committees?
8. Explain the function of TAC?

12.9 REFERENCE BOOKS :

1. P.K. Gupta, Fundamentals of Insurance, Himalaya Publishing House
2. Anand Ganguly, Insurance management, New Age International.
3. M.N.Srinivasan, Principles of insurance law, Universal Publishing Company
4. Dr.E. Dharmaraj, Elements of Insurance, Simres Publications, Chennai
5. Dr.P. Periaswamy, Principles and Practice of Insurance, Himalaya publishing House