Structure

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1.0 Introduction

Insurance means a process of transferring the risk from someone who cannot bear it, to someone who has the capacity to bear for such risk, in return for the consideration.

Definition: An insurance company (referred to usually as an insurer) promises to pay to the owner (insured) or beneficiary of the asset, a certain sum of money (sum assured), if a loss occurs, so that they may try to ensure continuance of the financial benefits. The insured pays a certain amount (consideration) to the insurance company for bearing the risk, which is known as premium.
Insurance can also be defined as a co-operative arrangement to spread the loss caused by a particular risk over a large number of people who are exposed to it, in exchange for a small sum of money.

Need and Significance of insurance

Advantages of insurance

Insurance renders a valuable service to commerce as well as society as a whole. Risk is incidental to life. Although the ways and means are always explored to eliminate or minimize the risks, their magnitude and extent go on multiplying with the gradual expansion of world of commerce.

Insurance covers many risks and uncertainties in the world of business and acts as a boon to business concerns.

Insurance has become an integral part of business and human life. The “fear of loss” and “uncertain future” has been minimized. Insurance helps in solving many problems of business and private life. The advantages of insurance are as follows:

i. Provides Security

It provides a cover against any sudden loss. In case of fire and marine insurance the loss suffered by the insured is fully compensated and he is restored to his earlier position. In case of life insurance, if the bread earning member of the family dies prematurely, the family is provided with money to continue with its livelihood. So, insurance gives security to both individuals and businessmen alike. These days insurance covers various social welfare schemes also viz., schemes for unemployment, sickness, accident health, old age etc. These schemes are advantages for poor people and help establishing social justice.

ii. Spreading of Risk

The basic principle of insurance is to spread risk among a large number of people. A large number of people get insurance policies and pay premium to the insurer. Whenever a loss occurs, it is compensated out of funds of the insurer. The loss is spread among a large number of policy holders. Insurance covers the loss of an individual but the social loss cannot be eliminated. If the property of a person is lost by fire, he will be compensated by the insurance company. Insurance cannot eliminate loss but it can reduce the risk to the individual.
iii. Source for Collecting funds

In lieu of insurance cover, the insured pays premium to the insurer. The premium is received regularly in installments. Large funds are collected by way of premium. These funds can be gainfully employed in industrial development of a country. Life Insurance policies are purchased by persons from all walks of life. It helps in collecting savings from a large number of persons. These funds are productively used for the industrial development of a country. So, insurance has become an important source of capital formation.

iv. Encourages Savings

Insurance not only provides risk coverage, but also provides an investment channel. Life insurance provides mode of investment. The insurance develops a habit of saving money by paying premium. The amount of policy is paid to the insured or his nominees. In case of a fixed time policy the insured gets a lump-sum amount after the maturity of the policy.

v. Encouragement of International Trade

International trade involves many risks in transporting goods from our country to another. In the absence of insurance the traders will always be worried about the safe arrival of these goods. The quantum of trade will be limited because of uncertainties and risks involved during transit. Insurance provides protection against all types of sea-risks. It has helped the development of international trade on a large scale.

1.2 Brief History of Insurance

History of Insurance in India.

In India, insurance began formally in the 18th century. The following are some of the early companies who started operating in India.

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>1818</td>
<td>1st life insurance company – Oriental Life Insurance Company was established in Kolkata</td>
</tr>
<tr>
<td>1829</td>
<td>Madras Equitable was established in Chennai Presidency.</td>
</tr>
<tr>
<td>1850</td>
<td>1st non-life insurance company- Triton insurance company Limited.</td>
</tr>
<tr>
<td>1870</td>
<td>Bombay mutual was started in Mumbai.</td>
</tr>
</tbody>
</table>
1874 Oriental Was started in Mumbai.
1896 Bharat Insurance Company Limited was started in Delhi
1897 Empire of India was started in Mumbai


**Life insurance Corporation of India (LIC)**

In 1956, the Life insurance business in India was nationalized and then life insurance corporation of India (LIC) was formed on 1st September 1956.

General Insurance Corporation (GIC) in 1973 general insurance business was nationalized in India and the General Insurance Corporation of India (GIC) and the four Subsidiaries; National Insurance Company Limited, The New India Assurance Company Limited. The Oriental Insurance Company limited and United India Insurance Company Limited were formed. As part of the nationalization process, the funds of all existing companies were merged with the four subsidiaries of the GIC.

**Further Changes**

Till 1999. LIC had the exclusive right over Life Insurance business in India. In 1999, the relevant laws were amended and the life insurance sector was opened for business to private players. In 2010, there are 23 life insurance companies transacting life insurance business in India.

**Liberalisation of the Indian Insurance Sector**

Insurance in India is governed by the Insurance Act, 1938 as amended form time to time. It lays down the rules and regulations for the Insurance industry. The Insurance Regulatory and Development authority (IRDA) Act was enacted in 1999, IRDA is the regulator for insurance business in India.

In the year 2000 the Insurance sector was liberalized and opened up for business to the private sector.

Foreign Direct Investment (FDI) was allowed in insurance up to 26% wherein the foreign players were allowed to enter into joint ventures with domestic players

Lot of domestic players joined hands with foreign partners who brought in valuable expertise and capital.
Opening up of the insurance sector has led to emergence of innovative insurance products and has also helped in deeper spread of insurance.

Liberalization brought in the much needed competition and better customer service.

Perils and risks

Life is very uncertain. Any person can meet with death due to some unfortunate or unexpected event at any point of time. Assets are also likely to be destroyed or made non-functional due to accidental occurrence before the expected life time hence, assets need to be insured.

Peril is the cause of loss, anything that causes the loss is a peril.

Fig. 1.1 Different Types of Peril

Eg: fire flood Earthquake, lighting, landslide etc.

An event or incident that may cause a loss is called a peril.

Insurance does not protect the asset. It does not prevent its loss due to the peril, and the peril cannot be avoided through insurance. Insurance only tries to reduce the impact of the financial loss on the owner/beneficiary of the asset.
Eg: A person takes fire insurance for his office so that he can protect himself against any loss due to fire in his office. In this case, fire is the peril. But taking fire insurance cannot prevent the occurrence of the peril (fire in the office) the impact of peril (fire) can be reduced by installing smoke detectors and fire extinguishers in the office premises. In the event of fire (peril) in the office insurance can only compensate the owner against the losses suffered due to fire. Insurance tries to put the person in the same position that he was before the fire occurred in the office.

Insurance can compensate only economic or financial loss. It cannot compensate for non-economic losses which cannot be measured in monetary term, as in the case of death of a person.

Examples of non-economic losses can be love and affection to the family, sentimental attachments, innovative and creative abilities etc. These are not quantifiable in monetary terms.

Risks: Perils differ according to frequency and intensity. If such perils can cause damage to an asset, we say that the asset is exposed to that risk.

Definition:

Risk in uncertainty of outcome. If there is a chance that the outcome will be different from expectations, there is a risk.

Example

People staying in buildings in the hills are not exposed to the risk of tribal waves. They are exposed to the risk of landslides. Similarly, people staying near the seashore may not be that much exposed to the risk landslide. But they are certainly more exposed to the risk of tidal waves.

Perils are the events like landslides or tidal waves, which can lead to losses or damages. Risks are likelihood of loss or damage resulting from the occurrences of perils. The risks to the owner of a building, due to the occurrence of a peril like fire, can be a few lakhs or a few crores of rupees, depending on the extent of the damage. It is also possible that there may be no damage at all; Insurance is not taken to prevent the peril or to pay compensation if the peril happens. Insurance is taken against the likely damage or the loss that the peril may cause.

1.3 Classification of Risks

Risks can be classified into five broad categories
1. Catastrophic and Important risks

Risks can be classified on the basis of extent of damage likely to be caused.

Critical or Catastrophic risks are risks where a single event or major magnitude leads to a significantly higher than usual number and/or amount of claims on an insurer. Catastrophic risks are big enough to cause bankruptcy of the owner or even the insurer.

2. Financial and non-financial risks

Risks can also be classified as financial and non-financial. Financial risks are those risks that lead to losses that can be quantified or measured in monetary terms.

Example: Financial risks are related to changes in the value of assets like shares or property.

Non financial Risks: are those that can’t be measured or qualified in monetary terms.

Example of non-financial risk can be health; but it can lead to financial losses through treatment and temporary loss of income due to incapacity to work. Bad business decisions may cause inability to pay debts. Non-financial
risks are not insurable as such, but are sometimes paid through insurance. Through ill-health is non-financial, loss of earnings due to ill-health or treatment costs can be quantified and insured. Similarly, Courts impose damages for mental agony or loss of reputation due to reasons like professional misconduct, misuse of power and harassment. Mental agony and loss of reputation are not financial losses. When the court imposes a penalty, a person becomes duty-bound to pay the amount. The financial liability is insurable under insurance policies. Non-financial risks where the financial impact cannot be estimated cannot be insured.

3. Dynamic and static risks

**Dynamic risks** are those resulting from changes in the economy. Changes in the price level, consumer tastes, fashions, income and output, technology, political upheavals or Government suddenly losing vote of confidence may cause financial loss to the members of the economy. Dynamic risks normally benefit society over the long run. Since dynamic risks may affect a large number of individuals, they are generally considered less predictable than static risks.

**Static risks** involve those losses that occur even if there were no changes in the economy. If consumer tastes, output and income, and the level of technology do not change, some individuals would still suffer financial loss. These losses arise from causes other than the changes in economy, such as perils of nature and dishonesty of other individuals.

Example of static risk can be small fire or theft in one particular house. Static risk are more predictable and more likely to occur as compared to dynamic risks. Static risk can be managed through insurance as their frequency and possibility can be studied as forecast.

**Hazard**

Hazard is a condition that increases the chances of loss. It is something that accelerates the perils.

Example: If there is a fire in an explosives manufacturing unit, the explosives will result in a rapid spread of fire destroying everything in a very short time.

**Types of Hazards:**

Hazards can be classified into two categories as physical hazards and moral hazards.

**Physical Hazard**: This refers to the characteristics and qualities of the subject matter which is proposed to be insured.

Eg: Petrol is more hazardous than edible oil for a fire peril.
A physical hazard consists of those physical attributes or physical conditions that affect the risk.

Moral Hazard: This refers to the character of the person who is approaching the insurance company for insurance. If his/her intentions are malafide (cheating the insurers or making profits out of insurance), then the moral hazard is high. Moral hazards are losses that result from dishonesty. Dishonest persons are likely to attempt fraud and make money. Taking advantage of the available facilities of insurance. Insurance companies suffer losses because fraudulent or inflated claims. Moral hazard can also increase because of carelessness on the part of individuals. This is referred to as morale hazard.

1.5 Classification of Insurance and its Working

The insurance industry works on the concept of pooling. People who are exposed to similar risks are brought together. The members in the group agree that, if any one of them suffers a loss, the group members will share the loss and compensate the person who suffered the loss. The compensation is expected to put the person in the same place, financially as he was before suffering the loss.
Insurance business is broadly classified into life insurance and general insurance.

1. Life Insurance

Life insurance deals with covering the lives of human beings. In life insurance, the asset in question is the ‘economic value’ of a person. A person’s earning capacity depends on his skills, knowledge, ability and other factors. The family, employer and in directly the users of products created by this asset (human beings) enjoy value and benefits.

2. General Insurance

Non-life insurance or general insurance deals with covering non-human objects like animals, agricultural crops, goods, factories, cars etc. In some countries non-life insurance is also known as Property and Casualty Insurance.

Non-life insurance also covers losses through individual behaviours like fraud, burglary, non-fulfillment of promises (in the case of repayment of mortgage loans) and negligence of professionals in their service. General Insurance policies and mostly for one year and are renewable.

Fire Insurance deals with all fire related risks and will include damage due to riots, malicious acts, typhoons, cyclones, earthquakes and consequential expenditures related to these events.

Marine Insurance deals with goods being transported by sea, air, rail or road as well as all marine related risks.

A part from fire insurance and marine insurance all other businesses are included in the miscellaneous class. These include motor insurance, engineering, liability, burglary, fidelity, health, person accident etc.

Accidents and illness to human beings are covered in health (non-life) insurance in India. Accidents and some critical illnesses are covered in life insurance only as additional cover (riders) along with the main life insurance policy. In India, insurance on life of a person for death by accident only is treated as non-life insurance.

1.6 Importance of Insurance Industry

The economy is directly linked to the non-life insurance business. By having insurance:

· Trade and industry get some steadiness and stability.
Business owners can concentrate on their business without worrying about the vagaries of nature like floods, earthquakes, cyclones etc.

Business owners know that in the event of natural calamities the insurance companies will come to their rescue to compensate the losses faced due to these perils.

In the absence of insurance companies, the business owners will be exposed to the risk of losses due to these vagaries and will have to bear heavy losses in the event of any natural calamity.

Insurance arrangements increase the capacity of those affected, to cope with these losses and incidental problems.

The business of general insurance is closely linked to international trade and industry. Insurance along with banking provides infrastructure for trade and industry to perform. Like banks, non-life insurance companies have associates in most of the countries that provides services related to inspection, salvages, documentation etc. insurance introduces security, increases business efficiency and creates equitable distributions of losses, insurance enhances creditworthiness, capitalizes earning power, makes possible and thus enables investment also reduces destitute, facilitates better health care and trade.

**Short Answer Type Questions**

1. What is Insurance?
2. What are Perils?
3. Define Risk.
4. What is meant by Hazards?
5. What is Insurance industry?

**Long Answer Type Questions**

1. Explain the advantages of insurance.
2. Briefly explain about history of Insurance.
3. Explain the classification of risks.
4. Write about various classes of Insurance.
5. Explain the importance of Insurance Industry.
2.0 Introduction

Insurance is a contract in writing under which one party agrees in return for a consideration to indemnify the other party against the laws of damage suffered on account of an uncertain feature event, or contingency or to pay a specified sum on the happening of a specified event.
2.1 Managing Risks

There are four ways to manage risks.

When risk is retained, it is implied that the cost of the damage will be met out of internal resources. Organizations can meet these costs in two ways:

- From the current revenue, as and when losses occur
- Create a special fund specifically to meet these costs in future

The advantage of creating a special fund is that the costs are spread out between the good and the bad years as the size of the damage in any one year cannot be predicted.

In practice, risks are managed using a mix of all the alternatives. None of the alternatives are mutually exclusive. For example, attempts to reduce and prevent risks will continue to occur after transfer has been arranged. This is because invariably the loss will be more than the insurer will compensate for. Retention and transfer may appear mutually exclusive but they are not. Through systems of excess, retentions are possible from what has been transferred to insurers. The relevant considerations are costs and feasibility. Costs include not only the amount of rupees required to be spent to implement the alternative, but the potential loss of revenue and costs associated with negative publicity for
the products. Prevention of risks may be perceived to cost too much, however, when compared to the overall benefits the costs of prevention is never ‘too much’. The objectives will influence the decision on how much is ‘too much’.

2.2 Retention

In case of the life of an individual, there is an option to transfer the risk to an insurer by way of a life insurance policy or the risk can be retained by not taking life insurance. In the event of untimely death of the individual, if the risk has not been transferred to an insurer, the surviving dependents bear the brunt of coping with the loss of income.

2.3 Life Insurance

Life insurance deals with covering the lives of human beings. In life insurance the asset in question is the ‘economic value’ of the person. A person’s earning capacity depends on his skills, knowledge, ability and other factors. The family, employer and indirectly the users of products created by these asset human beings enjoy value and benefits.

2.4 Managing Insurance

Understand the way to manage risk.

Risk is unavoidable in life; we all take risks everyday whether it is driving a car or managing a business. The ways in which we manage risk depends upon the type of risk and the potential impact it can have on our life. Risks can affect our assets (such as our car or home) or us. As human beings (through accidents which lead to permanent disability or death). The risk has to be identified along with its features and specialties. Assessing the risk and finding out the chances of losses are also important.

Example: Situation 1: Imagine that you are buying a house. Think of some of the risks associated with this. These can include:

- The risks to damage to your house from fire or flood.
- The risks of being unable to make loan payments if you are injured and unable to work, or die unexpectedly

Example: Situation 2: Imagine that you own a business. Think of some of the risk related to this. These can include:

- The risks of damage to the premises where you run your business
- The risk of theft of stock
There are ways to manage the risks described above. Before the risks can be managed they must be identified and analyzed. Once this has been completed, it is possible to manage the risks. There are four ways in which risks can be managed. These are:

- Avoidance or prevention of risk
- Reduction of risk
- Retention of risk
- Transfer of risk to an insurance company

**2.5 Funds of an Insurer**

Managing funds

An insurer is effectively a trustee as it is managing a common fund on behalf of its policyholders and as such must ensure that it protects the interest of these policyholders. To this extent, an insurer must:

- Not accept risk which is not of the same kind as faced by the people already in the group
- Not pay claims for losses which are not accidental
- Identify and refuse claims for losses which are exaggerated

Underwriting is the process used to determine entry into the group. Underwriting includes assessing the risk to determine the exposure of the group, determining the premium to be charged based on the risk.

Example: Suppose an insurance company received Rs. 50,000 as premium revenue and Rs. 20,000 as investment income each year. This would give the company a total revenue of Rs. 70,000. Its expenses are Rs. 15,000 for salaries and business related expenses and Rs. 40,000 to be kept in premium reserve for payment of claims. The company would be left with Rs. 15,000, which could be distributed as profit to be shared amongst shareholders, or as bonus paid to policyholders.

**2.6 Reinsurance**

The transfer of risk from one insurance company to another is called reinsurance. Catastrophic events such as earthquakes or oil tankers spilling oil into the sea can generate claims that could place a considerable financial burden on the insurer.
2.7 Role of insurance in Economic development

Non-life insurance business grows parallel to economic growth. Economic growth depends on business and business depends on insurance. Without insurance the ability of a business to continue after a peril is reduced. For small business, having no insurance could stop them from operating. If there is no way for a business to recover from a loss, it cannot operate. This impacts the economic growth of the country.

Example: Imagine you own a textile company. Think of some of the risks that could significantly reduce the company’s ability to continue manufacturing.

- Fire destroys the premises where the business is run.
- Machinery used to manufacture the textiles is stolen.
- Stock of finished goods is stolen.

Insurance plays an important role in economic development as the industry depends on insurers to manage their manufacturing and commercial risks. As in the above example, if insurance was not available to businesses and a fire destroyed their premises it would be likely that the business could no longer continue. Although insurance cannot remove the risk of fire or theft, the impact of these events is reduced as the compensation paid by the insurance company will allow the business to continue.

2.8 Insurance and Social Security

Example: Imagine what would happen if the income earning member of a family unexpectedly dies and they did not have life insurance. The family would be affected in some of the following ways:

- Inability to pay an outstanding debt as the sole income earner has died.
- Inability to pay for basic essential items such as food, clothing and housing.
- Inability to pay for children’s education.

The family would become a burden to the society as they would rely on the Government for income. Life insurance and general Insurance Social Security schemes, prevents families from becoming a burden on the society. If the earner in a family was to die the family may have no income in order to survive.
Short Answer Type Questions

1. What is Retention?
2. What is meant by life Insurance?
3. What is managing Insurance
4. Define Re-insurance.

Long Answer Type Questions

1. Explain about managing risks.
2. Write about the funds of an Insurer.
3. Explain the role of Insurance in economic development.
4. Describe about insurance and social security.
Insurance is a contract in which a sum of money as a premium is paid in consideration of the insurer’s incurring the risk of paying a large sum upon a given contingency.

It follows that every contract of insurance must have the following elements. (a) There must be a contract between parties who are called ‘Insurer’ and ‘Insured’. (b) The contract must be that the insurer undertakes to protect the insured from any loss of damage to be insured on the happening of the event. (c)
In consideration for the above, the assured undertakes to make the insurer a periodical payment of a sum of money called premium. (d) The contract must be in writing and the document is called the insurance policy.

**The Insurance Contract:** Insurance is a contract between two parties:

a. The insurance company; and  
b. The policyholder.

Diagram: Insurance, A Contract between two parties

According to the Insurance contract:

- The insurance company agrees to pay the policyholder a certain sum of money (sum insured);
- If the event (death or peril e.g. fire, earthquake etc.) specified in the insurance contract happens;
- Provided the policy holder has been paying the premium(s) as specified in the insurance contract.

### 3.1 Utmost Good Faith

To understand the principle of utmost good faith, consider the following situation:

**Example:** David made a proposal for a health insurance for a health insurance policy. At the time of applying for the policy, David was suffering from diabetes. But David did not disclose this fact to the insurance company. David was in his thirties, so the health insurance company issued the policy without asking David to undergo a medical test. Later in the year, David had to be hospitalized and a claim was raised on the health insurance company. To David’s surprise, the insurance company rejected the claim. In its investigation, the insurance company found out that David was already suffering from diabetes at the time of applying for the policy and this fact was deliberately
hidden by David. Hence the insurance contract was declared null and void and the claim was rejected.

### 3.2 Insurable Interest

To understand the concept of insurable interest, consider the following situation:

**Example:** Ramesh is a 35 year old person working with a private company. Ramesh’s family includes his wife, a five year old son and dependent parents. They have their own house. Imaging the following situation, if any of the events happen (Ramesh falls sick, Ramesh’s house catches fire, Ramesh father suffers from critical illness), it will affect Ramesh’s financial position adversely. If none of the events happen and everything continues normally, then Ramesh stands to gain and enjoy the continued benefits from this property, his family’s good health and his own.

**Definitions:** A person is said to have an ‘insurable interest’ when they stand to gain or benefit from the continued existence (safety) and well-being of the person or property insured, and would suffer a financial loss if there is damage to the person or property.

Insurable interest is then legal right of a person to insure the subject matter with which they have a legal relationship recognized by law.

From the above definition we can say that Ramesh has an ‘insurable interest’ in his own well-being. His life, his property and his father’s health in a way that the continued well-being (safety) of all four would benefit Ramesh, and if something goes wrong with any of them, it would affect Ramesh financially and he would suffer loss.

**Importance of the principle of Insurable interest**

The principle of insurable interest is very important as it forms the legal basis for deciding whether insurance can be taken or not. The proposer has to prove that they have insurable interest in the subject matter for which they want to take insurance.

### 3.3 Indemnity

The insurance company compensates the insured only to the extent of the loss so that the insured does not profit from insurance. The insured should neither be better off nor worse off after the claim settlement.

**Definition:** Insurance is meant to indemnify (i.e. compensate for losses). Broadly, according to the principle of indemnity, insurance should place the insured in the same financial position after the loss, as they enjoy before it; not
better, the principle of indemnity ensures that insurance cannot be used to make profit.

Most general Insurance contracts work on the principle of indemnity, but life insurance is an exception to this rule. The principle of indemnity does not apply to life insurance. Life insurance contracts are value contracts. There is no need to assess the extent of the loss. In life insurance policies, in the case of death, the full sum assured is paid.

Example

Karan has taken a life insurance policy of Rs.10,00,000 for a period of 20 years. Karan pays premium on a quarterly basis. He dies in the seventh year of the policy and his nominee files a claim. The insurance company will pay the full policy benefit amount of Rs. 10,00,000.

In the case of life insurance, if a person has taken two policies from two different companies and if there is a claim on death of the person, the concept of sharing of claims does not apply.

Example

Amit takes a life insurance policy worth Rs.5,00,000 from insurance company ABC and another life insurance policy worth Rs.10,00,000 from insurance company.

3.4 The Insurance Contract

Insurance is a contract between two parties:

A. The insurance company; and
B. The policyholder.

According to the insurance contract:

- The insurance company agrees to pay the policyholder a certain sum of money (sum insured);
- If the event (death or peril e.g. fire, earthquake etc.) specified in the insurance contract happens;
- Provided the policy holder has been paying the premium(s) as specified in the insurance contract.
3.5 Subrogation and Contribution

Principle of Subrogation

Once the insurance company compensates the insured for the financial loss, the rights of the insured person get transferred to the insurance company. The process of transfer of rights from the insured person to the insurance company is known as subrogation.

Subrogation ensures two things:

1. Having paid the claim, the insurance company gets the rights to make good the damages from the party who caused the loss.

2. Having been indemnified by the insurer, the insured does not retain the right to get compensated by the party who caused the loss and thus make profit from insurance.

Definition: The substitution of one person in the place of another with reference to a lawful claim, demand, or right, so that he or she who substituted succeeds to the rights of the other in relation to the debts or claim. And its rights, remedies, or securities. Another simple definition is: subrogation is the process an insurance company uses to recover claim amounts paid to a policyholder from a negligent third party.

Subrogation can also be defined as surrender of rights by an insured against the third party to an insurance company that has paid a claim.

Normally, the right of subrogation arises after the insurance company has accepted the insured person’s claim and paid the claim. But there is usually a time gap of a few days, a month or even more between the date the claim is raised by the insured person and the date the claim is settled by the insurance company.

3.6 Proximate Cause

This is not exactly a principle but a concept of General Insurance, where only fortuitous, pre agreed events are covered.

Definition: Proximate cause is defined as the active and efficient cause that sets in motion a chain of events which brings about a result, without the intervention of any force started and working actively from a new independent source.

The dominant, effective or operative cause of an event is known as the proximate cause. If there is a claim of events leading to this cause. It should be
examined, whether the first cause was an insured peril and whether the ultimate cause has resulted from an uninterrupted chain of events, without an independently intervening cause interfacing in between.

**Short Answer Type Questions**

1. What is insurance contract?
2. What is utmost good faith?
3. What is Insurable Interest?
4. Define Indemnity.
5. What is insurance contract?
6. What is subrogation?

**Long Answer Type Questions**

1. Explain the principles of Insurance.
2. Write briefly about personal and non-personal contracts.
4.0 Introduction

In this unit, the student will be learning about different products offered by life insurance companies. Life insurance companies offer products which cover the risk of dying early or living too long. You will learn about products offered by life insurance companies which pay only on the death of the insured during the policy tenure. (Term plans) and products which pay only if the insured does not die during the policy tenure (pure endowment plans). Life insurance companies also offer a lot of other plans under various names which are a combination of the above two basic plans.

4.1 Life Insurance

Non-linked policies:

Insurance business in India is classified into life insurance and non-life insurance.
Life insurance covers perils related to the life of human beings, these are mainly risks related to dying early or living too long. Life insurance companies offer products such as term policies, Endowment policies, Money back policies etc, to cover the risk of dying early. Life insurance companies offer products such as annuities, Pension plans etc, to cover the risk of living too long. Human beings are also exposed to other risks such as unemployment, illness and disabilities that are covered by non-life insurance companies. Apart from offering these basic products, Insurance companies keep coming up with new and innovative products regularly to meet the evolving needs of the society and to take care of competition.

**Products offered by life insurance companies** : Life insurance products are usually referred to as ‘plans’ of insurance. These plans have either or both of the two basic elements:

1. **Death benefit**: this is also known as ‘death cover’. It is payable on the death of the insured person during the tenure of the policy.

2. **Survival benefit**: this is also known as ‘maturity benefit’. It is payable on the maturity of the policy of the policy if the insured person survives the entire tenure of the policy.

**Example:**

**Term Assurance Plan** : Wasim takes term insurance plan for sum assured (death cover) of Rs. 50 lakhs for 25 years at an annual premium of Rs. 10,000. The policy specifies that if Wasim dies anytime during the 2 year tenure of the policy, the insurance company will pay the nominee/beneficiary the sum assured (death cover) of Rs. 50 lakhs.

**Pure Endowment plan** : Ashok takes a pure endowment plan for a sum assured (survival benefit) of Rs. 50 Lakhs for 25 years. The policy specifies that the survival benefit amount of Rs.50 lakhs will be paid at the end of 25 years if Ashok survives the entire tenure of the policy.

**Linked Policies** : Definition: A Unit Linked insurance plan (ULIP) is an insurance plan which is a combination of insurance protection and investment.
A ULIP can be an ideal investment vehicle for people who are looking for the triple benefits of:

1. Insurance Protection;
2. Insurance; and
3. Insurance tax benefits.

Growing popularity of ULIPs

ULIPs gained a lot of popularity among investors during the bull run of Indian stock markets from 2003 and 2007. During this time period, the BSE Sensex skyrocketed from 3000 points to 20,000 points. With the BSE index multiplying six times over this five year period, the interest of investors in the capital markets was very high. So keeping in mind the requirements of the investors, Insurance companies came up with various ULIP products and their variants. The companies which were already having ULIPs in their products portfolio stepped up the marketing of these products in the last few years.

The premium paid by the insured in a ULIP is divided into 3 parts:

1. **Expenses**: a portion of the premium goes towards meeting the expenses of issuing a policy like agent’s commission, policy set up costs, administrative costs and statutory levies. This amount is also known as ‘Policy Allocation Charge (PAC)’.

2. **Mortality**: a portion of the premium goes towards covering the risk or providing life cover to the life insured.

3. **Investment**: after deducting the above two amounts, the remaining premium goes towards investment on behalf of the life insured. The individual is given a choice of funds to select from and decide where they want their premium to be invested.

Annuities

Annuities cover the risk of living too long. These are periodic payments made to an individual in consideration of a lump sum paid to the insurer before the commencement of annuity payments. Annuities work in the reverse way as compared to insurance. In insurance the life insured pays premium installments to insurer to get back a lump sum at the end of a term or on happening of the insured event, while in an annuity contract, the person pays a lump sum amount to the insurance company who invest this amount on behalf of the policyholder and then makes regular payments to the policyholder from the returns earned on the amount invested.
Features of Annuities

a. Intermediate annuity: In this type of contract, the annuitant makes a lump sum payment to the insurance company and the insurance company starts paying annuities periodic payments soon after the policy commences.

b. Deferred annuity: here, the annuity payment starts after a specified period, this time period is known as the deferment period. In deferred annuities there are two scenarios. In the first scenario the annuitant makes a lump-sum payment and the insurance company starts paying annuities after a specified period. In the second scenario, the annuitant keeps making periodic payments to the insurance company for a specified period and the annuity payments start after the deferment period.

c. Frequency of annuities: The plans offered by insurance companies give the annuitant the option to receive the annuity payments monthly, quarterly, half-yearly or annually.

d. Policy tenure: the annuities may continue:

i. As long as the annuitant lives: or

ii. For a minimum specified period and thereafter till the annuitant lives: or

iii. Till the last person among the joint annuitants dies.

Group policies

Group policies offer benefits to large number of persons through one policy. This single policy covering multiple people is known as the Master Policy. It is issued in favour of the person representing the group of beneficiaries. Group policies can be issued to:

a. Employers representing companies/organizations

b. Professional associations representing a group such as an association of lawyers.

c. Trade unions

d. Banks for their loan accountholders

e. Any other professional organization representing a group of people brought together for a common objective.

4.3 Non life Insurance
Non-life insurance companies provide products that protect the policyholder against financial losses due to various perils such as fire, earthquakes, floods, storms, accidents etc. As per the insurance Act 1938, non-life products are bifurcated into three major categories – fire, marine and miscellaneous. All the insurances which do not fit into fire or marine category fall into the miscellaneous category.

In earlier times, fire and marine were the major types of insurances. Today, the biggest group is ‘motor’ followed by ‘health’ insurance.

However, in modern day terminology, terms like ‘property’ insurance and ‘casualty’ insurance are also used. ‘Property’ insurance includes insurance of buildings and their contents, money and securities, accounts-receivable records, inventory furniture, machinery, supplies and even intangible assets such as trademarks; which were conventionally covered under fire, engineering insurance and loss of profits insurance. ‘Marine’ or ‘Transit’ insurance denotes all cargo shipments by air, sea or land. Ships are also part of Marine. ‘Casualty’ or ‘Accident’ insurances denote mainly automobile or motor accidents. However, sometimes it is used to refer to other accidents too. ‘Liability’ insurances take care of the liability of the insured to anyone arising out of law suits or similar situations. Liabilities can be to the public or arising out of contractual obligations.

**Loss of Profits**

Fire insurance policies may have a provision to provide for ‘loss of profits’. Under this provision, the insurer provides compensation for loss of business and consequential loss of profits due to fire. Till normalcy is restored. The period for which this compensation is to be provided is chosen at the commencement of the policy. This period usually varies between three months to three years. Unless and until a claim becomes admissible under a material damage fire policy, the corresponding loss of profit policy will not pay. ‘Loss of Profit’ as a result of market fluctuations is not insurable.

**Marine Insurance**: Marine Insurance comprises marine cargo and marine hull insurance.

```
Marine Insurance
  ├── Marine Cargo Insurance
  │    ├── Marine Hull Insurance
```
Marine cargo insurance

Cargo insurance provides cover for goods in transit by sea, air, rail, and road or by the post. Export/import shipments are covered against the risk of fire or explosion, stranding of vessel, theft, pilferage, loss of package during loading and unloading etc. war, strikes, Riots and civil commotions can be added at extra premium. Inland transit policies by rail/road cover the risk of fire, breakage of bridges, derailment, etc. These policies cover the risk during the duration of transit only.

Export/import shipments are covered under the terms of covered under the terms of institute Cargo Clauses of Institutes of London Underwriters, according to international practice. Local clauses are used for inland transit policies.

Marine Hull Insurance

Hull insurance covers loss or damage to ocean going ships and other vessels such as fishing vessels, sailing vessels etc. Risks covered include maritime perils, fire, explosion, piracy, accidents in loading and discharging of cargo. War and strikes are covered under the Government of India War and Risks Scheme, which is a voluntary scheme for the ship owners.

Hull policies are generally issued for a period of twelve months. However, they can also be insured on voyage basis where a single voyage is sought to be covered. Cover provided is under the terms of the Institute Time Clauses (Hull) or Institute Voyage Clauses (Hulls) formulated by the Institute of London underwriters, which are used internationally.

Motor Insurance

Motor Insurance is the biggest portfolio in the miscellaneous class of Insurance.

Definition: Motor Insurance deals with insurance of motorized vehicles on road, whether used for private comfort or public service, whether carrying passengers or goods. As per Motor Vehicles Act, every vehicle playing on Indian roads should be insured for liability to Third Parties including property damage.

Motor insurance may cover;

a. Damage to vehicles
b. Injury or death of persons, and
c. Damage to property belonging to third parties.
Premium will depend on specifications of vehicle as well as on usage. Restrictions may relate to:

a. Areas in which the vehicle may be used  
b. The nature of usage (private or public usage)  
c. Adherence to laws (relating to driver needing a licensed, permitted load) etc.

(Premium does not depend on this factor)

**Personal Accident Insurance**

Definition: Personal Accident policies cover death or disablement arising out of accidents of any kind (caused by external, violent and visible means).

In this case of personal accident policies, there is no need for assessment of risk, except on the factor of occupation. The conditions are standard. The policy can also cover consequential costs medical care and loss of income due to disability leading to absence from workplace.

**Fidelity Guarantee:** Fidelity guarantee covers risks related to dishonesty, fraud and embezzlement by employees etc. and protects employers from loss of cash and securities.

**Health Insurance:** In the Indian market, health insurance premium has been steadily increasing over the years (and now it is next to motor premium), comprising 22% of the gross direct Premium income of General Insurers. Over the last few years our economy has done well leading to good GDP growth.

This has led to the rise in disposable income and better quality living standards. The increase in life expectancy exposes a person to health problems and diseases with increase in age. For an average person, in their retirement years, they do not have income to meet healthcare costs. Moreover, healthcare costs have soared in the last few years. This leads to a double blow to the person who falls prey to critical illnesses or other diseases which require hospitalization and result in huge medical bills. This underlines the importance of health insurance which is gaining popularity among the masses.

**Overseas Medical Insurance:** the policy covers medical expenses incurred while travelling abroad. Hospital bills are paid by the insurer’s representative directly. The policy also covers loss of baggage or passport during overseas travel. This policy is meant for Indian residents travelling abroad for specified purposes like business, studies, holiday or employment.
Liability Insurance

Liability insurance provides indemnity (protection against financial loss payable under law) for injuries to third parties or their property. The policy covers indemnity for professionals providing services such as doctors, lawyers, accountants, engineers, etc. These professionals run the risk of being charged with negligence and subsequent liability for damages. Liability Insurance can be broadly categorized into Public Liability, (Industrial and Non-Industrial), Product Liability, professional Indemnity, and Errors & Omissions Policy. While the first three cover death/disablement due to the insured’s negligence. Errors & omissions policies cover financial loss due to negligent actions of professionals like Chartered Accountants, Surgeons, engineers etc.

Example:

- As accountant can be sued by the client if they face a loss because of wrong advice.
- An engineering company can be sued if a bridge built by it collapses, claiming some lives.
- A doctor can be sued if a patient dies because of the doctor’s negligence.
- An industry may be held liable for causing death or injury due to its operations. Example, the Union Carbide Tragedy.

The amounts claimed in damages can be fairly large and beyond the capacity of an individual to bear. These risks are insurable by way of professional liability insurance products. Liability insurance policies also cover product and public liability for industrial and non-industrial risks. The cover excludes liabilities arising out of willful non-compliance with statutory provisions and also fines and other punitive levies.

Engineering Insurance: This includes several kinds of risk covers like risk cover for contractors in civil engineering projects. Erection of electrical plants, breakdown of machinery and its consequential loss of profits etc. Delay in Start Up of projects is also covered in this sub branch of miscellaneous insurance.

Boiler and Pressure Plant: These policies cover damage (other than by fire) caused by explosions (boilers or pressure plants) to the plant, to surrounding property of the insured and to third parties. (This is part of Engineering Insurance)
Aviation Insurance: it covers damage to aircraft and liabilities to freight, passengers and third parties. Aviation insurance contracts are finalized after considerable negotiations on premium rates and are reinsured.

Other miscellaneous Insurance: these include burglary, loss of baggage during travel, householders effects, shopkeeper’s business, banker’s indemnity. Horses, bees, cattle, poultry, plantations etc. Event insurances and other specialized insurances like identity theft cover (loss of credit card, pan card etc. and losses thereof are being given today.

Innovative Plans

The insurance industry is constantly evolving and coming out with new products to cater to the ever changing needs of the society.

- Some health insurance companies have some out with lifelong renewal health insurance plans.

- Some health insurance companies also offer the option of additional sum assured only for critical illnesses over and above the normal sum assured just like a rider in a life insurance policy.

- Some companies also offer insurance for misuse of credit card after theft up to a certain number of days after the theft is reported.

- Some health insurance companies also offer a fixed daily cash amount when the insured person is hospitalized. The daily amount is fixed irrespective of the cost of treatment. The amount per day may be different for normal hospitalization, ICU admission and critical illness treatment.

- In 2005, the IRDA allowed micro-insurance to be offered by both life and non-life insurance companies with mutual collaboration.

- Some Insurance companies are also offering health insurance plans in the form of ULIP's wherein the insured can contribute premiums towards investment in funds during the initial years of the plan and accumulate a corpus which can come in handy during old age.

- Many insurance companies have come out with guaranteed unit linked life insurance plans. In such ULIP’s the highest NAV is guaranteed by the insurance company.

- Many life insurance companies are also offering term plans and ULIP’s online, through the internet. Thereby eliminating the agents. The commission thus saved by selling plans directly to the end customer is passed on them in the form of lower premiums.
Short Answer Type Questions

1. What is Life Insurance?
2. Define linked policies.
3. What is meant by annuities?
4. Define marine Insurance.
5. What is Hut Insurance?
6. What is meant by motor Insurance?
7. Define accident.
8. What is health Insurance?
9. What is medical insurance?
10. What is miscellaneous Insurance?

Long Answer Type Questions

1. Explain about Linked and non-linked policies.
2. Write briefly about Group Policies.
3. Explain the personal accident and Fidelity Guarantee.
4. Write about innovative plans.
5. Explain briefly about Boilers and pressure plant, Aviation Insurance.
6. Write briefly about non-life Insurance.
5.0 Introduction

Insurance Terminology aims to help you understand the common terms used in insurance. Some terms are common to both life and non-life insurance whereas some terms are specific to life and non-life Insurance. It is important to be able to understand these terms and the way they are used as well as explain these terms in simple language.

Example:

Rajesh decides that he needs to buy insurance. He doesn’t know enough about insurance and the process involved in buying insurance. So he goes to see Mohan, Who is his close friend and also an insurance advisor, to help him understand the importance of insurance as well as the process of buying insurance. Rajesh has worked hard to build up the assets that he has, and so wants to make sure his car, home etc, are covered for risks. He also wants to take life insurance as he is married with children and wants to be sure that should anything happen to him, his family would be taken care of financially.
Insurance is a contractual process where a person protects their physical assets (such as a car or home) as well as life from certain events of perils by transferring the risk to an insurer. An insurer is a company who provides protection by entering into a contract with the person seeking protection for their assets. The person who applies for insurance protection is called the insured.

The insurance process starts with an application in writing, called a proposal, made by the person who wants to take insurance and includes details of what they want to insure and the type of cover they require. The proposal is given to an underwriter whose job is to assess the proposal and decide:

- Whether insurance can be given or not.
- If given, what will be the terms of the policy and
- What will be the amount of premium to be charged

Premium is the amount of money or consideration that has to be paid in exchange for the insurance. When a person requesting insurance agrees to the terms offered by the insurer and pays the premium, the contract is complete and the risk commences. At this stage, an insurance policy is issued by the insurer.
The insurance policy is the evidence of the contract and states the terms and conditions of the contract, details of promises made by the insurer, obligations of the policy holder and conditions attached thereto. It also contain the following.

Any amendments to the standard policy conditions, these amendments are called endorsements and would normally be written separately and signed by the insurer.

Detail regarding what is being insured; called the subject matter of insurance and may be car, building, machinery, stock or in the case of life insurance a human life.

The sum assured which is the value of the subject matter of insurance and becomes the basis for payments made by the insurer in the event of a claim. The sum assured is the maximum amount of the insurer’s liability under the policy.

The tenure of the policy or period of insurance: This is called the term and may be as little as a few hour or as much as a year for non-life insurance products, or many years for a life insurance policy.

Exclusions: The policy may also have exclusions, which arise when the underwriter excludes some losses, perils from the cover. These are included in the terms of the policy as “Exclusion” conditions or special endorsements.

The policy will also state any conditions to the policy. There are three types of conditions for insurance policies. These are

**Condition Precedent:** Which require the insured to disclose any material facts to make sure the policy is valid.

**Condition Subsequent:** Which require notification of changes while the policy is valid. The policy may cease to operate if these conditions are not met.

**Conditions Precedent to Liability:** Which require the insured to give notice of an event happening within a specified period of time and also comply with certain stipulations prior to the occurrence of the loss; for eg. condition of dual control in a policy covering dishonesty of employees. It is important that the customer is truthful in the statement they make to the insurer. A statement (which has a bearing on the risk), regardless of whether made in writing or verbal, by the person requesting insurance is called a representation.

**Warranties:** Unlike representations, must be strictly complied with. A warranty is a promise, assurance or guarantee made by the policy holder. Warranty is promissory in nature. Breach of warranty in a general insurance policy, makes the policy voidable, even if the breach has not resulted or contributed to the loss. If a warranty is breached there will be a penalty.
Insurance Official: The way insurance premiums are calculated is highly technical. A person known as an actuary is generally responsible for calculating and certifying that the insurer’s premium rates are viable. An actuary is qualified in the technicalities of insurance with an understanding of statistics, economics, finance and investments. A good actuary will always be able to make reasonable forecasts regarding future interest rates, demographic changes, life spans etc. An actuary is responsible for making periodic valuation of funds and reserves of life insurers and to certify their solvency margins.

Short Answer Type Questions

1. Define Insurance Terminology.
2. Define Warranty.
3. Who is an Insurance Advisor.
4. Who is an Insurance official.

Long Answer Type Questions

1. Explain the Insurance Terminology with example.
Prior to 1999, during the nationalization era, Life Insurance Corporation (LIC) of India, General Insurance Corporation (GIC) of India and its four subsidiaries had the exclusive privilege of transacting insurance business in India. After 1999, post liberalization reforms were made by the then Finance Minister Dr. Manmohan Singh under the leadership prime minister P.V. Narasimha Rao. A lot of sectors were opened up for participation from private sectors and foreigners. Insurance sector was also one of them. The Insurance Act, 1983 was amended in 1990 to provide for registration of private insurers to transact insurance business in India. The insurance Regulatory and Development authority (IRDA) was set up to regulate insurance business. The IRDA allowed private insurance companies to register under the new dispensation. Foreign direct investment (FDI) of up to 26% was allowed, paving the way for domestic private companies to bring foreign companies as partners through joint ventures. The proposal to hike FDI in insurance to 49% from the current 26% is pending for approval (December 2010)
Liberalisation of the insurance sector ended the exclusive privilege of LIC, GIC and its four subsidiaries to transact insurance business in India, and ushered in competition and deeper penetration of the insurance market. As on June 2011, there are 23 life insurance companies and 24 insurance Companies transacting insurance business in India.

**Be Familiar with the Indian Insurance Market**
### 6.1 List of insurance companies in India

<table>
<thead>
<tr>
<th>No.</th>
<th>Life Insurance Company</th>
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<tbody>
<tr>
<td>1.</td>
<td>Bajaj Allianz life insurance Company Limited</td>
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<tr>
<td>2.</td>
<td>Birla Sun Life Insurance Company Limited</td>
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<tr>
<td>3.</td>
<td>HDFC standard Life Insurance Company Limited</td>
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<td>4.</td>
<td>ICICI Prudential Life Insurance Company Limited</td>
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<td>5.</td>
<td>ING Vysya Life Insurance Company Limited</td>
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<td>6.</td>
<td>Life Insurance Corporation of India</td>
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<td>7.</td>
<td>Max New York Life Insurance Company Limited</td>
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<td>8.</td>
<td>Met Life India Insurance Company Private Limited</td>
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<td>10.</td>
<td>SBI Life Insurance Company Limited</td>
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<td>11.</td>
<td>Tata AIG Life Insurance Company Limited</td>
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<td>12.</td>
<td>Reliance Life Insurance Company Limited</td>
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<td>13.</td>
<td>Aviva Life Insurance Company private Limited</td>
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<td>14.</td>
<td>Sahara India Life Insurance Company Limited</td>
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<td>15.</td>
<td>Shriram Life Insurance Company Limited</td>
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<td>16.</td>
<td>Bharti AXA Life Insurance Company Limited</td>
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<td>17.</td>
<td>Future Generali Life Insurance Company Limited</td>
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<td>18.</td>
<td>IDBI Federal Life Insurance Company Limited</td>
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<td>20.</td>
<td>Aegon Religare Life Insurance Company Limited</td>
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<td>21.</td>
<td>DLF Pramerica Life Insurance Company Limited</td>
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<td>22.</td>
<td>Star Union Dia-ichi Life Insurance Company Limited</td>
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<td>23.</td>
<td>India first Life Insurance Company Limited</td>
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List of Non Life insurance companies in India.

<table>
<thead>
<tr>
<th>No.</th>
<th>General Insurance Company</th>
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<tr>
<td>1.</td>
<td>Bajaj Allianz General life insurance Company Limited</td>
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<td>2.</td>
<td>IFFCO Tokio General Insurance Company Limited</td>
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<td>3.</td>
<td>HDFC ERGO General Insurance Company Limited</td>
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<td>4.</td>
<td>ICICI Lombard General Insurance Company Limited</td>
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<td>5.</td>
<td>The New India Assurance Company Limited</td>
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<td>6.</td>
<td>The Oriental Insurance Company Limited</td>
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<td>7.</td>
<td>Max Bupa Health Insurance Company Limited</td>
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<td>8.</td>
<td>Royal Sundaram Alliance Insurance Company Limited</td>
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<td>9.</td>
<td>United India Insurance Company Limited</td>
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<td>10.</td>
<td>SBI General Insurance Company Limited</td>
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<td>11.</td>
<td>Tata AIG General Insurance Company Limited</td>
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<td>12.</td>
<td>Reliance General Insurance Company Limited</td>
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<td>Cholamandalam MS General Insurance Company Limited</td>
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<td>15.</td>
<td>Shriram General Insurance Company Limited</td>
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<td>Bharti Axa General Insurance Company Limited</td>
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<td>17.</td>
<td>Future Generali India Insurance Company Limited</td>
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<td>18.</td>
<td>Agriculture Insurance Company Limited</td>
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<tr>
<td>19.</td>
<td>Star Health and Allied Insurance Company Limited</td>
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<td>20.</td>
<td>Apollo Munich Health Insurance Company Limited</td>
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<tr>
<td>21.</td>
<td>Universal Sampo General Insurance Company Limited</td>
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<tr>
<td>22.</td>
<td>Export Credit and Guarantee Corporation of India Limited</td>
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<tr>
<td>23.</td>
<td>Raheja QBE General Insurance Company Limited</td>
</tr>
<tr>
<td>24.</td>
<td>L&amp;T General Insurance Company Limited</td>
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</tbody>
</table>
Specialized Insurance Companies

- The **General Insurance Corporation (GIC) of India** is a national reinsurer. All insurer are obliged to reinsurer a certain portion of their Indian business with the GIC.

- Life Insurance Corporation of India and General Insurance Corporation of India are owned by the Central Government and are established by Acts of Parliament. All other insurance companies are incorporated under the Indian Companies Act.

- Export Credit and Guarantee Corporation of India, United India Insurance Company Limited, the Oriental Insurance Company Limited, the New India Assurance Company Limited, and the National Insurance Company Limited and Agriculture Insurance Company Limited are owned by the Central Government and the other Insurers are private companies.

- The Export Credit and Guarantee Insurance Company Limited is a specialized insurer for risks related to export credit.

- **Agriculture Insurance Company Limited** is a specialized insurer for risks related to agriculture insurance.

- **Apollo DKV and Star Health** are specialized insurers for risks related to health of Individual.

- **Postal Life Insurance** is run by the Government of India. It was excluded from the nationalization in 1956 and continues to remain outside the purview of the IRDA and the Insurance Act. It is a department of the Central Government transacting only life insurance business for specified classes of people.

Long Answer Type Questions

1. Explain the Principles of Insurance Market.

2. Write any ten life insurance corporation in India.

3. Write any ten general insurance corporation in India.
Structure

7.1 The insurance act 1938
7.2 IRDA Act 1999
7.3 Life Insurance Act 1956
7.4 General Insurance Act 1972
7.5 Consumer Protection Act 1986
7.6 Income Tax Act, 1961
7.7 Other Laws

7.1 The Insurance Act 1938

Important aspects

- GIC was designated as the Indian reinsurer to which all the domestic insurer were obliged to cede 20% of gross direct premium in India.

- The insurance Regulatory and Development Authority Act (IRDA) Act 1999 incorporated a new clause in section 2 of the insurance Act, 1938 under which an Indian Insurance company can carry on life insurance business or general insurance business or re-insurance business.
That to prevent flight of capital from India in the form of reinsurance premium and to ensure the development of our own strength and resources to retain the risks within the country itself, General Insurance Corporation has been made to operate only in reinsurance arena.

As per current rules Foreign Direct investment (FDI) up to 26% is allowed in the insurance sector.

Insurance is an agreement by which

- One party called the ‘insured’
- Pays a stipulated consideration called ‘premium’
- To the other party called the ‘insurer’
- In return for which the insurer agrees to pay a defined amount of money or provide a defined service
- If a covered event occurs during the policy term.

7.2 IRDA Act 1999

Insurance Regulatory and Development Authority (IRDA) was formed by the Government of India by passing the IRDA Act, 1999 in the Parliament.

IRDA is the National agency of Government of India for the Indian Insurance industry.

It is created for the supervision and development of the insurance sector in India.

Objectives of IRDA

- Protecting the interest of the insured (i.e. the policyholders)
- Promoting orderly growth of the insurance industry.

Purpose of forming the IRDA

- To protect the interest of policyholders and to secure their fair treatment.
- To bring about speedy and orderly growth of the insurance industry (including annuity and superannuation payments), for the benefit of the common man. And to provide long term funds for accelerating growth of the economy.
- To set, promote, monitor and enforce high standards of integrity, financial soundness, fair dealing and competence of those it regulates.
To ensure that insurance customers receive precise, clear and correct information about products and services and to make them aware of their responsibilities and duties in this regard.

To ensure speedy settlement of genuine claims, to prevent insurance frauds and other malpractices and put in place effective grievance redressal machinery.

To promote fairness, transparency and orderly conduct in financial market dealing with insurance and build a reliable management information system to enforce high standards of financial soundness amongst market players.

To take action where such standards are inadequate or ineffectively enforced.

To bring about optimum amount of self-regulation in day to day working of the industry consistent with the requirements of prudential regulation.

**Duties, Powers and functions of the IRDA**

1. Subject to the provisions of this Act and any other law for the time being in force, the Authority shall have the duty to regulate, promote and ensure orderly growth of the insurance business and re-insurance business.

2. Without prejudice to the generality of the provisions contained in sub-section(1), the powers and functions of the Authority shall include:

   a. Issue to the applicant a certificate of registration, renew, modify, withdraw, suspend or cancel such registration;
   
   b. Protection of the interests of the policy holders in matters concerning assigning of policy, nomination by policy holders, insurable interest, settlement of insurance claim, surrender value of policy and other terms and conditions of contracts of insurance;
   
   c. Specifying requisite qualifications, code of conduct and practical training for intermediary or insurance intermediaries and agents;
   
   d. Specifying the code of conduct for surveyors and loss assessors;
   
   e. Promoting efficiency in the conduct of insurance business;

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**7.3 Life Insurance Corporation of India (LICI) 1956**

**Establishment of LIC**

The Life Insurance Corporation of India (LICI) was constituted on 1st September, 1956 under the LIC Act, 1956 as a wholly-owned government
corporation by nationalizing 245 private insurance companies operating from 97 centres in India. The LICI is a body corporate having a separate legal entity and a perpetual succession.

**Objectives of Life Insurance Corporation**

The following are some of the important functions of LIC:

1. **Protection against risk:** Life Insurance provides protection to the policyholders and his family by way of insuring future risks. On the death of the policyholder, the dependents get sum assured from LIC. It also provides protection to the policyholder, in his old age since he gets a substantial amount of money from LIC after expiry of the policy.

2. **Encouragement of savings:** LIC encourages people to save for security. It is a better way of making investment. It offers various policies serving various purposes. It mobilizes public savings for nation-building activities.

3. **Proper utilization of public money:** LIC invests funds in such a way as to secure maximum yield consistent with the safety of capital. It conducts business with utmost economy with the realization that the money belongs to the policyholders.

4. **Dynamic organization:** LIC develops a dynamic organization conducted in a spirit of trusteeship. It provides efficient services to the policyholders at economical rates.

5. **Boosting industrial growth:** It grants loans for setting up new industrial units. It also provides loans for expansion of existing industrial units. LIC has also invested funds in shares and debentures of many companies. It generates more employment by boosting up industrial growth.

6. **Protecting interest of policyholders:** It invests its funds in such a manner as to safeguard the interest of the policyholders to the maximum extent possible. The greater interest of the country should not however be ignored.

### 7.4 General Insurance Act 1972

An Act to provide for the acquisition and transfer of shares of Indian insurance companies and undertakings of other existing insurers in order to serve better the needs of the economy by securing the development of general insurance business in the best interests of the community and to ensure that the operation of the economic system does not result in the concentration of wealth to the common detriment, for the regulation and control of such business and for matters connected therewith or incidental thereto.
General insurance business” means fire, marine or miscellaneous insurance business, whether carried on singly or in combination with one or more of them, but does not include capital redemption business and annuity certain business;

Claims procedure in respect of a general insurance policy:

· An insured or the claimant shall give notice to the insurer of any loss arising under contract of insurance at the earliest or within such extended time as may be allowed by the insurer

· Where the insured is unable to furnish all the particulars required, by the surveyor or where the surveyor does not receive the full co-operation of the insured, the insurer or the surveyor as the case may be, shall inform in writing the insured about the delay that may result in the assessment of the claim

· If an insurer, on the receipt of a survey report, finds that it is incomplete in any respect, he shall require the surveyor under intimation to the insured, to furnish an additional report on certain specific issues as may be required by the insurer.

· The surveyor on receipt of this communication shall furnish an additional report within 3 weeks of the date of receipt of communication from the insurer.

· On receipt of the survey report or the additional survey report, as the case may be, an insurer shall within a period of 30 days offer a settlement of the claim to the insured

· Upon acceptance of an offer of settlement by the insured, the payment of the amount due shall be made within 7 days from the date of acceptance of the offer by the insured

7.5 Consumer Protection Act 1986

This act shows how the insured can resolve a dispute under consumer Protection Act, 1986 or by approaching the Ombudsman under the ‘Redressal of Public Grievances rules, 1998’

The consumer Protection Act was passed in 1986 by the Parliament. The main objective of the Act is to provide simple, speedy and inexpensive redressal to consumer grievances. Insurance services fall within the purview of this Act and every buyer or insurance, i.e. the policyholder, is a consumer.

Objective

· provide for better protection of the interest of the consumer and to establish Consumer Councils and other authorities for the settlement of consumer’s disputes and for matters connected therewith
The Act has been amended by the Consumer Protection (Amendment) Act, 2002.

**Important Features of the Act**

- It covers all goods and services.
- It covers all the sectors i.e. private, public and co-operative.
- Remedy available is simple, speedy and inexpensive.
- Provisions of the Act are in addition to and not in derogation of any other law.

**Consumer** is defined as any person who buys goods for a consideration or avails any services for a consideration.

**Service** includes banking; insurance etc. but DOES NOT includes the rendering of any service free of cost.

**Deficiency** in service means any fault, imperfection or inadequacy in the quality, nature and manner of performance in relation to any service.

- A complaint can be made to the appropriate forum in writing within the two years from the date on which the cause of action arose.

- Under the MWP Act (Married Women’s Property Act, 1874,) the policyholder, nominee, assignee, beneficiary of an insurance policy are considered as Consumers.

- Deficiency in service may relate to insurance of receipts, transfer of files and quick settlement of claims etc.

**Structure of consumer protection Act 1986**

**District Forum:** Composition: President- District Judge and two other members (1 lady member).

Jurisdiction: value of services and compensation claimed does not exceed Rs.20 lakhs.

**State Commission:** Composition: President- High Court Judge, Members not less than 2 (1 lady member) Jurisdiction; Complaints of value claimed if exceeds Rs. 20 lakhs but does not exceed Rs 1 crores.

**National Commission:** Composition: President- Supreme court Judge, Members not less than 4, 1 lady member. Jurisdiction; Original complaint where the value of services and compensation exceeds Rs.1 Crores.
Appeals:

Before the State Commission (Section 15):

- Against the order of the district Forum within a period of 30 days
- Subject to deposit of 50% of the amount awarded or Rs 25000, whichever is less

Before the National Commission (Section 19):

- Against the order of the State Commission- Appeal period 30 days.
- Subject to deposit of 50% of the amount awarded or Rs 35,000, whichever is less

Before the Supreme Court (section 23):

- Against the order of the national commission- Appeal period 30 days
- Subject to deposit of 50% of the amount awarded or Rs.50, 000 whichever is less.

Limitations: The district Forum, the State Commission, or the National Commission shall not admit complaint unless it is filed within two years from the date on which the cause of action has arisen.

Penalties: When a person against whom a complaint is made or the complainant fails to comply with the order of district forum, State and National Commission, such a person may be imprisoned for a term minimum one month to maximum three years or with fine minimum Rs 2000, to maximum Rs 10,000, or both.

7.6 Income Tax Act

“the Income Tax Act of 1961 is in force in our country and extends to the whole of India. According to this Act, every person who earns income in India has to pay tax.”

One of the important functions of a Government is to promote welfare of the people in general and the poorer section in particular. For this purpose, modern governments are working in a planned way. This envisages the Government to undertake economic activities in addition to the welfare programmes. To undertake these programmes, the Government mobilizes the funds from various sources. One of the popular sources is through taxes both direct and indirect. To remove the inequalities of income and to establish a socialistic pattern of society, direct taxes are resorted to. The examples of
direct taxes are Income tax, Wealth Tax etc. As per the Indian Constitution, Income Tax is the subject of Central Government. Out of the total amount of tax collected, “Income Tax” part is shared by both Central and state Government according to the recommendations made by the finance Commission. Education Cess and Secondary & Higher education cess will be retained by the central Government and the same will be spent for the purpose of which it is levied.

Any one living within the territories of India is liable to pay tax according to the provisions of this Act. In some situations he has to pay tax on the income earned in foreign countries also. Citizenship of a person is not the criteria for tax purpose but residential status of a person has to be taken into consideration.

The administration of the Act is looked after by a Board, constituted by the central Government known as central Board of direct taxes (C.B.D.T.). The Board functions under the supervision of Ministry of Finance, and the Income Tax department functions under the guidance and supervision of the Central Board of Direct of Taxes. The Board frames the rules which are popularly known as Income Tax Rules 1962 and issue circulars from time to time clarifying the points of doubt both to the income Tax Department and also to the general public, particularly to the assessees.

Under the existing provisions of the Constitution every year, the Union Minister for Finance present Budget to the Parliament, in which the fiscal policy of the Government is made clear. Along with the Budget a Finance Bill will be presented to the Parliament. It contains proposals in the areas of Direct Taxes. For example, the rate of taxes on the income, the mode of collecting taxes etc. When the Parliament approves the Finance Bill, it will be sent to the President of Indian Republic for his/her assent. When the President gives his assent to the Bill, then it becomes an Act.

### 7.7 Other laws

**Motor Vehicles Act, 1988.**
- Motor Insurance policy is required to cover the insured’s liability in respect of death or bodily injury of certain persons (e.g. third parties, fare-paying passengers, paid drivers, etc.) and damage to property of third parties. The limits of liabilities required to be covered are also prescribed in the Act.
- The Motor Vehicle Act also provides for the constitution of motor Accidents Claims Tribunals (MACT) by the State Governments. The objective
of this amendment is to ensure speedy settlement of claims of persons involved in Motor Vehicle accidents.

- The Motor Vehicles (MV) Act, 1988 mandates payment of compensation to the victims of accidents arising out of the use of a motor vehicle, in public places by the owner or owners, as the case may.
- The MV Act provides that no person shall use a motor vehicle in public places without a policy of insurance complying with the requirements of the MV Act.
- The compensation payable to the claimants is determined by the Motor Accident Claims Tribunals (MACT) established under the MV Act.

**The MV Act, 1988; Salient Features**

- No person shall use, except as a passenger, a motor vehicle in public places, unless there is a policy of insurance complying with the requirements of the MV act, (Sec.146)
- The policy must be against any liability incurred by the insured in respect of death or bodily injury to any person or damage to any property of a third party(Sec.147)
- The insurer can be made a party to the proceedings of the motor Accident claims tribunal (Sec.149)
- When a cover note issued by an insurer is not followed by a policy within the prescribed time, the insurer is bound to notify the fact to the concerned Registering authority (Sec.147)
- A claimant is entitled to compensation of Rs. 50,000 in cases of death of Rs.25,000 in the cases of injury without burden of proof of fault on the part of the vehicle owner.(Sec 140-No fault liability)
- A claimant may also seek compensation on the basis of the structured formula prescribed in the Act.(Sec 163 A)

**Indian Railways Act, 1989**

The Act was first passed in 1890, Then Railways Act, 1989 came into effect from 1st July, 1990. Whereas, the Act deals with various aspects of railway administration, there are also provisions which are relevant to marine insurance. These provisions related to rights and liabilities of railways as carriage of goods.
The Railways Claims Tribunal Act, 1987 provides for formation of Tribunals to deal with claims for cargo loss, personal injuries, refund of excess freight etc, and prescribes procedures there under.

**Employee’s State insurance Act, 1948**

- The Employees state Insurance Act, 1948. It has been described as an Act “to provide for certain benefits to employees in cases of sickness, maternity and employment injury and to make provisions for certain other matters in relation thereof”.

- Unless Under the Act, the Employee’s State Insurance Corporation has been set up to administer the Insurance Scheme applicable to industrial employees,

- A fund is maintained consisting of contribution from the employees, employees and the Government.

**Workmen’s Compensation Act, 1923**

- Workmen’s Compensation Act, 1923 came into force on 01\(^{st}\) July, 1924.

- The Act provides for the payment by employers to their workmen of compensation for injury by accident, or disease arising out of and in the course of employment.

**Short Answer Type Questions**

1. Write briefly about Insurance Act 1938.
2. Write briefly about IRDA Act 1999.
3. Write briefly about LIC Act 1956.

**Long Answer Type Questions**

6. Explain different types of Consumer Forums
8.0 Introduction

Aims to provide you with an understanding of insurance customers, their importance, what satisfies them and how they behave differently during the course of a policy, right from the stage of purchase of insurance to making a claim. Not all customers are the same and their needs differ vastly.

8.1 Understand Who is an Insured

Without the insured there will, of course, be no insurance. We have seen that the insured has been relatively easily identifiable in the past – perhaps a merchant who wants marine insurance or a guild member who wants his family to be looked after in the event of death.

In modern marketing, this is being taken even further into recognizable groups. Marketing is all about segmentation between the various customers,
no longer is blanket Tele-marketing relevant or cost-effective. The aim is to identify niche customers and approach them with the products/solutions relevant to them. In fact, some insurers restrict themselves solely to particular niches-the best examples in India being then health insurers. But in other markets, this could be as specialist as Classic Cars, Bloodstock (Racehorses), Fine Arts, etc.

a. Retail : Individual/Personal

Here we are talking about the individuals in their personal capacity. The major products brought by individuals include:

- **Personal Accident, Motor:** Third Party Cover is a compulsory insurance in most countries.
- **Health:** This will vary from hospitalization treatment costs to full medical reimbursement
- **Building and Contents:** not so common in India yet, compared to other parts of the world, but fast catching up.

b. Retail : Small and Medium Enterprises (SME)

In many ways, this is similar to the segment mentioned above with major share of sales now being via the web. Much of it again is seen as a commoditised market- frequently via a Packaged Product, where risks can be group into relatively simple underwriting sectors such as:

- Small shops
- Offices
- Restaurants and cafes
- Hotels
Many ways, this is similar to the segment mentioned above with major share excluding obvious heavy risks such as woodworking, fireworks, risks with international links etc. Underwriting is simplified and terms and conditions are common across most covers.

c. Corporate

The third general sector is the corporate market (ex SMEs). This is almost exclusively the province of the professional insurance brokers in major markets such as US, Europe, Australia, etc. Over 90% of the corporate market is in the broker province. It can be sub-divided on the basis of sector (for example specialization in sectors like energy, finance, leisure markets, etc.) or size (for example. Mid-size companies. Companies having national footprint, MNC’s etc.) Here the classes are big enough to require and warrant individual underwriting and pricing.

8.2 Understand the different types of customers and how they differ

Definition: A customer is a person who buys goods or services that a business has to offer. Customers are usually people who are not part of the business. In order to be successful, a business must produce goods or services that meet the needs of the customers, keeping in mind their interest and concerns.

Customer differences

Not all customers are outsiders. The terms ‘internal customer’ is one which is commonly used in management. This expression refers to the interrelationship of the departments, i.e. the work output of one department being an input for another department in the same organization. Although there is no purchase of goods or service, the department providing the output needs to keep in mind the interests and concerns of its internal customer.

A customer’s needs and interests will change with each different transaction he makes. For example, when a person goes to a bank to make a fixed deposit, his needs and interests will be different as compared to when he is buying furniture or a house. Although it is the same person making the purchases, he as a customer, will be very different in each scenario as his needs, interests and concerns are different in each case.

How insurance customers are different

When customers make purchases, especially when purchasing tangible goods, there is, in most cases an immediate sense of gratification or satisfaction from that purchase.
Even in the case of purchases of services, such as holiday’s bookings, there is the same sense of pleasure from the purchase. The purchasing of insurance is very different to this, as it does not give the customer any immediate sense of pleasure; they receive nothing tangible from the purchase. In most cases, the customer needs to wait for some time, before the benefit of the insurance purchase can be experienced. During this time, customers may doubt the wisdom of their insurance purchase. The benefits of insurance often come in a period of distress for a customer and they may wish that the benefit they receive from insurance may not be necessary. The wait for the benefit from life insurance may be very long, and the person who buys the policy may not be the one who will benefit from it.

Diagram: Necessity to buy general Insurance

- In the case of motor insurance the law requires it
- Lenders, such as banks require insurance of mortgaged goods as additional security
- Trade Practices - Insurance is a condition in commercial contracts

Diagram: Necessity to buy general Insurance

In the case of life insurance, the customer may not see the necessity of Insurance. There is always a tendency to ignore the need, as customers do not like to think they will die in the foreseeable future and as such defer the decision. They are more focused on their immediate needs, even if there are not essential, over the needs of the future. There may also be a tendency to leave things to fate.

Because so few people realize that insurance is a necessity, you should be wary of someone who shows a keenness to be insured. They may not be insurable and any possibility of a moral hazard should be looked into carefully.
8.3 Understand customer mindset and customer satisfaction

The changing mindsets of customers

The mindset of a customer differs the course of the policy. The customer mindset when they are taking the policy can be very different from their mindset at the time of a claim.

In the case of life insurance, the customer who buys the policy may not be the same customer who is making a claim on the policy. The real value of life insurance is experienced at the time of claim. There are three types of customers in life insurance and each one has a different mindset. These are:

a. The person who buys the policy: their mindset at the time of purchase may be one of reluctance to set aside money which they could spend on other things that would provide more immediate enjoyment. They may also doubt the wisdom of their choice at the start of the policy.

b. The person collecting the maturity proceeds: they will be happy that they have survived and also may regret that they did not put their money to better use.

c. The person who receives the death claim: this person while dealing with the death of a loved one will also be feeling relieved from anxiety, knowing
they are receiving money (perhaps wishing it was more) and also will be grateful for the help received.

**Example**

A woman is claiming on her husband’s life insurance policy due to his untimely death. The customer has never had to deal with an insurance company before, as her husband handled all these transactions. She is unsure of what to do and what the process is for claiming. In this case the insurance officer has to explain the process to the widow and also tell her what she needs to do have the claim paid. He would also need to inform her about the forms she needs to fill out. It is also the role of the insurance officer to provide support to the widow as she goes through this process in unsettling times.

The person benefiting from a death claim is a distressed person, their future is uncertain without the insured person and they are unsure of when the claim will be settled. It is during this time, when the procedures involved in settling the death claim are being carried out and various documents are being asked for, that the person may feel the insurance company is not being helpful. The way the insurance officer handles this situation will determine if the word of mouth publicity for the insurer is positive or negative. Providing comfort and support will help ensure that this publicity is positive. The greatest endorsement for life insurance is the smile on the face of a window while receiving a claim cheque at a time when people are harassing her for payment of what is owed to them. The mindset of general insurance customers is not that different to life insurance customers. In general insurance, the claimant is likely to be the same person who bought the insurance cover. The mindsets would be different at the two times. These are:

- **The person buying insurance**: their mindset would be of reluctance and committing themselves to the minimum amount of cover. They may be patronizing and self-confident, as this time they do not see the need for insurance.

- **The person at claim time**: The client experiences some relief that he has insured his subject matter. However he is a distressed client as he is insecure about the whole procedure. Their mindset would be to get the maximum amount possible from the insurer. They may be anxious and demanding and perhaps angry that the loss is not being fully compensated.

**What satisfies customers?**

Customers are happy when:

- They are recognized and respected
The role of intermediaries is to keep the customers satisfied. Agents and brokers also are responsible to make sure that the customer is satisfied, when policies are taken. They should do so while the policies are in force, not just when a claim arises. These are considered servicing activities. Servicing activities make sure that the customer is not attracted to another insurance company. Servicing activities are more important in life insurance due to the amount of time the policy runs for. During this time, there may be people telling the policy holder that another insurance company is better, their policies are better, the rates are better, people don’t do this for any advantage, it is personal opinion only.

Question:

Maintaining customer satisfaction while policies are in force is called

a. Servicing activities
b. Customer orientation
c. Customer satisfaction
d. Customer identification

8.4 Importance of Ethical Behaviour

Being ethical in business is about doing the right thing, such as not lying or stealing, but being honest. A lot of attention is focused on ethics in today’s business world as there have been numerous reports of unethical behavior and practices in companies. Bank funds being misused by the management; officials gaining personal benefits by improper use of their authority are a few examples of these. In today’s society, people who are trusted by the community to perform responsible and authoritative tasks are seen to have betrayed trust.

There has been increased discussion about accountability and corporate governance, which together are called Ethics in Business. The Right to information Act, 2005 and the development of Public Interest Litigation (PIL) have assumed considerable importance as ways of achieving better accountability
and governance. The foundation of good governance is ethical behaviour. When people perform their duties conscientiously and sincerely, the result is good governance. Unethical behaviour shows little concern for others and a high concern for self. When people try to serve their own self-interest using their own position, their behaviour is unethical. It is not unethical to look after your own interests but it is wrong to do so at the expense of others or using your official authority to gain such interests.

The business of insurance is based on trust. Policyholders entrust their savings to an insurer, trusting it to look after these funds and to look after their interests and those of their dependants in later years. In general insurance, policyholders trust that in the event of a claim, the insurer will keep up their promise of compensation. Propriety and ethical issues are important in insurance. These issues relate to trust and a breach of trust amounts to cheating. Things go wrong when incorrect information is given to potential policyholders in an attempt to get them to buy insurance. This is also known as mis-selling.

The code of ethics spelt out by the IRDA in the various regulations is directed towards ethical behaviour. It is important to know every clause in the code of conduct to ensure there is no violation of the code. If the insurer and their representatives always kept the interests of the potential policyholder in mind, compliance would be automatic. Unethical behaviour happens when the benefits of self are considered more important than the benefits to the policyholders and when the officers of insurers become more concerned with targets of the business instead of needs of the policyholders.

Some characteristics of good ethical behaviour include:

- Placing the best interests of the customer above one’s own direct or indirect benefits
- Keeping in the strictest confidence all business and personal information regarding a customer’s affairs
- Making full and adequate disclosure of all facts to allow customers to make informed decisions

There is a possibility for ethics to be compromised in the following situation:

- Having to choose between two plans, one of which has considerably less premium or commission than the other
- Temptation to recommend discontinuing an existing policy and taking a new one
Becoming aware of circumstances that, if known to the insurer could adversely affect the interests of the customer or the beneficiaries of a claim

Question

What are accountability and corporate governance together called?

a. Ethics in Business
b. Freedom of Information
c. Public Interest Litigation
d. Good governance

Summary

· A customer is a person who buys goods or services that a business has to offer.

· The term internal customer is used to describe the work output of one department being an input for the work of another department in the same organization and the interrelationship of departments.

· The mindset of a customer will differ during the course of the policy.

· The code of ethics spelt out by the IRDA in various regulations is directed towards ethical behaviour.

· Unethical behaviour is when the benefits of self are considered more important than the benefits to the policyholder.

· Being ethical in business is about doing the right thing, such as not lying or stealing, but being honest.

Short Answer Type Questions

1. Who is Insurance Customer?

2. Explain different types of Insurance Customers.
9.0 Introduction

Risk Management Aims to provide you with an understanding of risk management, the different types of risks (such as physical and financial), actual losses and consequential losses, how risks are managed and the techniques used to reduce losses.

Example:

ABC international was a company manufacturing high quality specialized computer accessories. One of their machines was an imported one. Which was supplied by a company who had a huge waiting list of clients. They were insured for Fire and Burglary and Machinery Breakdown but had not envisaged the delay in beginning the production due to loss of the same. There was a major fire which destroyed all their equipments and stock. However, there was a long delay restarting operations which resulted into huge business losses. The delay was mostly due to importing the specialized machine from abroad. ABC had never thought about alternative sources of procurement etc. They had not thought
about Loss of Profits. They had only restricted themselves to material damages. It is thus essential risk to be managed to ensure that any loss does not adversely affect business and not only physical objects but also the consequential losses are insured. It is important, when assessing risk, to look at the ‘whole picture’.

9.1 Risk Management

There are four ways to manage risks.

Diagram: 1 Ways of Managing Risks

When risk is retained, it is implied that the cost of the damage will be met out of internal resources. Organizations can meet these costs in two ways:

- From the current revenue, as and when losses occur
- Create a special fund specifically to meet these costs in future

The advantage of creating a special fund is that the costs are spread out between the good and the bad years as the size of the damage in any one year cannot be predicted.

In practice, risks are managed using a mix of all the alternatives. None of the alternatives are mutually exclusive. For example, attempts to reduce and prevent risk will continue to occur after transfer has been arranged. This is because invariably the loss will be more than the insurer will compensate for.
Retention and transfer may appear mutually exclusive but they are not. Through systems of excess, retentions are possible from what has been transferred to insurers. The relevant considerations are costs and feasibility.

Cost include not only the amount of rupees required to be spent on implement the alternative, but also the potential loss of revenue and costs associated with negative publicity for the products. Prevention of risks may be perceived to cost too much however, when compared to the overall benefits the cost of prevention is never ‘too much’. The objectives will influence the decision on how much is ‘too much’.

**Example: Scenario 1.**

Makers of passenger aircraft attempt to make sure none of the parts of the aircraft fail. They provide systems to take over and ensure the safety of everyone on board. If a part fails. It is possible for a four engine plane to fly with one engine only and if the last engine fails the aircraft can still keep flying for a distance. Aircraft carry enough fuel to reach their destination, and to fly from that destination to another airport if needed. All these cost are additional costs, incurred to prevent a crash. These additional costs are incurred because, apart from the moral obligation, the costs associated with a crash (such as fewer orders for aircrafts and customers for the airline) are perceived to be much larger.

**Scenario: 2**

Factories maintain inventories of essential spares to avoid break down of critical machines. This is to reduce the delays in repairs and therefore reduce consequential losses of production, revenue and profit.

**Scenario: 3**

Critical information is backed up or duplicated as it is too important to be lost under any circumstances.

### 9.2 Loss Reduction Techniques

There are financial risks related to financial resources. Some of the reasons for this are:

- Fluctuations in the stock market
- Exchange rate fluctuations
- Political disturbances
Hedging is a technical term used to describe spreading of risk among different avenues that are unlikely to be affected in the same way by the same cause.

Methods used in individual establishments to reduce physical risks include:

- Early detection system
- Automatic responses to dangerous situations through instrumentations
- Regular drill (mock drills) to test the readiness of people and system to meet accidents.

It is often noticed that while these valuable detection systems are installed; they are not properly maintained and as a result they do not work properly when they are needed.

Loss reduction techniques include:

- **Separation:** this involves isolating subjects exposed to the same risk.

Examples of separation include:

a. **Keeping** inventories in different places

b. the ‘**KEEP AWAY FROM**’ instructions that are found on gas cylinders, flammable materials and Dangerous medicines.

c. Carriers of goods separating cargo which may ignite or contaminate if placed within a certain proximity of something else
· **Duplication**: this involves keeping ‘back up’ copies so that any loss will neither interrupt business nor be irretrievable.

· **Diversification**: this involves spreading risks across which may not be affected equally or at the same time. Diversification is possible in business (making products which are in demand at different times or products for different markets) and in investments (not investing all funds in one company)

Retention and transfer are referred to as risk financing techniques- they seek to make good the losses. Other than insurance; risk transfer techniques include:

· **Indemnity agreements**: where one party agrees to compensate another party for losses they may incur, Indemnities are common when the risk is attributable to the behaviour of the indemnifying party.

· **Hedging**: where a financial transaction is made to offset the loss in another. This is done when the risks in the two transactions are considered reciprocal or moving in opposite directions.

Implementation and monitoring of risk management techniques, excluding financial alternatives. Must have the total involvement of all personnel concerned with the operation. They must be trained in the technique decided upon and must understand what the proposed actions are trying to achieve as well as the consequences of neglect.

**Example**

A watchman at an oil storage depot caused a major fire when he was smoking in the depot. The watchman was aware that smoking was banned in the depot and so hid in a corner before lighting his cigarette. His concern was not getting caught breaking the rules.

This example shows that even though personnel are aware of the rules, they also must understand why the rules are in place and what the consequences of breaking the rules are:

The choice of alternatives for risk management should focus on its consequences or impact on others. It is wrong to discharge effluents into a river in order to avoid risks in one’s premises. When products are found to be defective, producers usually resort to one of the following:

· Withdraw the entire product from the market until it is tested for safety and quality standards
Insurance and Marketing

- Blame others- some blame bottles, retailers or distributors for improper storage. Others blame competitors for causing problems.

Ethical considerations are as important as the financial and technical considerations.

Ethical Consideration

Financial and Technical Consideration

Diagram 2: Ethical and Financial Considerations

Studies have been carried out of the characteristics of various kinds of risks. These studies help to make appropriate decisions regarding management of identified risks. The techniques used to manage flood related risks would be different from the techniques used to manage fire, burglary or machine breakdown risks.

Even after the risk has been transferred to an insurer, there are still alternatives to be considered. These relate to the extent of deductibles, layering (the expression used when insurance programmes are arranged in layers, each layer representing increased liabilities) etc. Each of these have different cost implications and also depend on the analysis of PML and MPL.

Every insurer has a limit to its risk bearing capacity and therefore cannot insure as much risk as is offered by the market. The capacity of the insurer is related to their capital and reserves. Business that is beyond the insurer’s capacity is managed through reinsurance arrangements.

9.3 Risk retention for individuals

Risk management as a subject of study evolved formally as a function of business enterprise. The principles of risk management apply to individuals as well, but in a less complicated manner. An example of this is balancing multiple demands and choosing between different investment and savings options. Regardless of having insurance, the risk does not disappear.
Example

In the case of the life of an individual, there is an option to transfer the risk to an insurer by way of a life insurance policy or he risk can be retained by not taking life insurance. In the event of untimely death of the individual, if the risk has not been transferred to an insurer, the surviving dependents bear the burnt of coping with the loss of income. The risk has then effectively been transferred to the dependents. How would the individual’s decision to retain risk impact the surviving dependents?

- They may be required to dispose off assets such as cars, motorcycles etc, which may be seen as less important in the immediate situation.
- Housewives may need to learn new skills in order to start working, possibly in jobs that are beneath their status.
- The family may need to move to a new dwelling in new surroundings to avoid the disrespect of their reduced status in life.
- Children may need to forego their education in order to support the family.

Without Insurance, business may need to be closed down if the proprietor dies suddenly. The shop burns down or there is a major burglary. The immediate problem would be repaying debtors and financiers who would want to collect outstanding debts. When houses collapse either due to poor construction or an earthquake, families have been thrown into the street with no shelter. Rebuilding a house or a business again is neither easy nor quick, even with the benefit of insurance money. Without insurance money it is even more difficult.

**Short Answer Type Questions**

1. What is meant by Risk Retention?

**Long Answer Type Questions**

1. Explain briefly about Risk Management.