SYLLABUS

Class – B.Com I Years

Subject – Banking and Insurance

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Unit-III
Subject: Insurance

Meaning of Insurance:

Insurance is a legal contract between two parties- the insurance company (insurer) and the individual (insured), wherein the insurance company promises to compensate for financial losses due to insured contingencies in return for the premiums paid by the insured individual. In simple words, insurance is a risk transfer mechanism, where you transfer your risk to the insurance company and get the cover for financial loss that you may face due to unforeseen events. And the amount that you pay for this arrangement is called premium.

Key elements of the insurance contract:

1.Offer and Acceptance -When a prospective insured goes to buy an insurance policy, they must fill out an application provided by the insurance company. If they are shopping online, they will complete a digital application. If they are working with an agent or broker, then he or she may fill this out for the customer.

The application is legally known as an offer, where the insured offers to make premium payments of a certain dollar amount in return for insurance coverage up to specific limits. Acceptance occurs when the insurance company formally issues the policy, or when the agent or broker issues a certificate of temporary coverage.

2.Legal Consideration -This represents the dollar value of the premiums that the insured agrees to pay and the dollar limit of the coverage that the insurer will provide in return. If the insurance company receives a claim that is covered in the policy, then the insurer will pay this claim.

3.Competent Parties -Insurance contracts are only valid if both parties are of sound mind and body, referred to legally as "competent parties." The insured must be at least the legal age of majority and the insurance company must be licensed in the state in which the insured lives.

4.Free Consent -Both parties in any insurance contract must enter into the contract with free consent, which means it is on their own volition. There cannot be any fraud, misrepresentation, intimidation or coercion involved when the contract is signed. The contract also cannot be signed as a result of an error.

5.Legal Purpose -All insurance contracts are required to obey the laws of the land. They must adhere to all state-specific laws that apply to the contract and cover only legal activities. A business that deals in criminal activity would not be covered according to the tenant of legal purpose. Any agreement that is made outside of those laws is null and void.

6.Insurable Interest -The insured has an insurable interest when they benefit financially from the person or thing being insured. The insured will then experience a financial loss if the item or person being insured either dies or is damaged or lost. Prospective insureds cannot get coverage on something in which they have no insurance interest.

7.Utmost Good Faith -This phrase "utmost good faith" means that both parties in any insurance contract have acted without any type of deception, omission or other form of misrepresentation and that all pertinent facts have been disclosed by both parties.

8.Material Facts -Material facts are the factors that affect the risk that is being taken. They consist of the factors that the insurance company needs to know about in order to decide whether to insure the risk or reject it. If an insured applies for life insurance, then the insurer will need to know all about the insured:'

- Age.
- Height.
- Weight.
- Health.
- Occupation.

For car insurance, the insurer needs to know:

- The insured's age.
- Driving record.
- the kind of car that is being insured.

9.Full and True Disclosure -

This means that both parties are required to completely disclose all material facts pertinent to the insurance policy. There can be no omissions, misrepresentations or twisting of the facts when filling out the application or providing the policy.

10. Duty of Both the Parties -

Both the insured and the insurer have a legal obligation, or duty to disclose all material facts accurately and correctly. The insured does this when they fill out the application, and the insurance company does this by adhering to all of the laws and rules that apply to it.

Types of insurance:

- **Life insurance:**

  As no one wants to leave their loved ones financially shattered, life coverage is one of the must-have for every individual having dependents. In case of life insurance, the sum assured or the coverage amount will be paid out to the nominee of the insured in the event of the death of the insured. Life insurance is a crucial requirement to ensure the financial well-being of your loved ones even in your absence. The coverage amount opted should be able to provide complete financial protection – to replace income loss, to repay debt and also to create a financial buffer that can be utilised by insured's family for future financial stability. Though life insurance products come in many variants, it's important to first avail the term insurance with adequate coverage.

- **Health insurance**:
  Health uncertainties are part of life. Keeping in mind the rising cost of healthcare and an increasing number of diseases, it's important to have the financial cushion to protect yourself against health contingencies. Health insurance policies are of many types such as individual health insurance, family floater health insurance, critical illness health insurance and senior citizen health insurance. It's important to have adequate health insurance coverage that can protect you from financial crisis during medical emergencies.

- **Motor insurance:**
  Motor insurance policies are the mandatory legal requirement in India for every vehicle owner under the Motor Vehicle Act. Be it two-wheeler, car or a commercial vehicle, its compulsory to avail third party liability motor insurance to protect oneself against the claims that may arise from another party during an accident. However, motor insurance policies come in a comprehensive package wherein your valuable assets (bike or car) are covered against the various risk of damage or loss along with the personal accidental cover to you as the owner. Keeping in mind the rising incidents of road accidents and the asset value, it's most important to have a comprehensive motor insurance policy.

- **Accident and disability insurance:**
  Accidents are unexpected and are inevitable. Sometimes accidents can result in disabilities that can further have huge impact on your earning capacity. In order to have financial stability for yourself and your family, it's important to be insured against accidents.

- **Home insurance:**
  Home is one of your most valuable possessions that also includes many precious belongings and memories. Though you try to secure it to the fullest, your property is exposed to various risks like theft, damages due to natural disasters etc. which you may not be able to mitigate completely. Hence, in order to protect your home against losses and damages that may arise due to many insurable events, availing home insurance is the most effective solution.
  Though you need to be prepared for future uncertainties by availing insurance cover, you may not need all types of insurance. The priority of any insurance product may vary depending on your individual need. Insurance is a large industry with numerous product types available to cater to every sort of need. Some of them mentioned already are of top priority for every individual. Priority of rest other

types of insurance may purely depend on your unique need or situation. Let's take a look at some of the insurance types that are of lesser priority.

- **Standalone critical illness insurance**:
  Critical illness insurance plan may not be needed for every individual, specifically, if you do not have any family history of critical illness. Critical illnesses are sometimes covered in health insurance plans and also comes as a rider along with life insurance plans. Hence, a standalone cover for critical illness depends purely on the requirement of an individual.

- **Travel insurance:**
  Travel insurance may be the priority for frequent travellers. But, it may not be needed for all. The need for insurance may vary depending on each individual's unique needs. For example, if you are planning a domestic trip and your comprehensive health insurance plan covers you across the country for any medical emergencies, travel plans may not just be needed for you. More specifically, the travel insurance plan may not be your priority if you can afford to lose your pre-paid trip expenses.
  Sometimes travel covers also come as your credit card travel benefit.
  Likewise, there are many insurance types that are not suitable or required for every individual. It's important to think about the benefits that you can reap before investing in an insurance plan.

Importance of insurance:

Insurance is a risk management tool not only benefits the individual and businesses but also benefits the society and economy in numerous ways. Following are some of the important benefits of insurance:

- **Provides peace of mind:**
  Insurance provides protection against various uncertainties that can put you or your family in financial crisis. By covering the uncertainties of human life and businesses, insurance provides a sense of security. Having life insurance gives you peace of mind that the financial stability of your family will remain intact even when you are not around. Having health insurance gives you a sense of security that you do not need to shell out all your savings in the event of medical emergencies.

- **Promotes risk control:**
  As insurance works on risk transfer mechanism, it promotes risk control activity.

- **Promotes economic growth:**

  As insurance funds are invested in various projects like water supply, power and roads etc, it contributes to the overall economic growth of the nation. Also, insurance provides employment opportunity to people. Insurance contributes to economic growth in many other ways such as getting Foreign Direct Investment, paying taxes on the profit earned and by investing in the capital market etc.

- **Distribution of risk:**

  Risk of insurance is spread across various individuals and organisation instead of concentrating on only one.

- **Helps to get loan easily:**

  There are loan facilities offered against insurance policies. In case of home loans, having an insurance cover can help to get the loan easily from the lender.

- **Inculcates savings habit**:

  There are many life insurance products that come with investment cum protection benefit. Such products inculcate a regular saving habit among individuals. Plans like endowment insurance plans help in achieving long-term financial goals. Pension plans help to receive regular income flow in older age.

- **Provides tax benefit:**

  Insured gets the tax benefits for premium paid depending on the insurance product type. For example, the premium paid towards life insurance plans qualifies for tax deduction under Section 80C of the Income Tax Act. And, the premium paid towards health insurance plans qualifies for tax deduction under Section 80D of the Income Tax Act.

Principles of Insurance:

The concept of insurance is risk distribution among a group of people. Hence, cooperation becomes the basic principle of insurance.

To ensure the proper functioning of an insurance contract, the insurer and the insured have to uphold the 7 principles of Insurances mentioned below:

Principle of Utmost Good Faith

The fundamental principle is that both the parties in an insurance contract should act in good faith towards each other, i.e. they must provide clear and concise information related to the terms and conditions of the contract.

The Insured should provide all the information related to the subject matter, and the insurer must give precise details regarding the contract.

Example – Jacob took a health insurance policy. At the time of taking insurance, he was a smoker and failed to disclose this fact. Later, he got cancer. In such a situation, the Insurance company will not be liable to bear the financial burden as Jacob concealed important facts.

Principle of Proximate Cause

This is also called the principle of 'Causa Proxima' or the nearest cause. This principle applies when the loss is the result of two or more causes. The insurance company will find the nearest cause of loss to the property. If the proximate cause is the one in which the property is insured, then the company must pay compensation. If it is not a cause the property is insured against, then no payment will be made by the insured.

Example –

Due to fire, a wall of a building was damaged, and the municipal authority ordered it to be demolished. While demolition the adjoining building was damaged. The owner of the adjoining building claimed the loss under the fire policy. The court held that fire is the nearest cause of loss to the adjoining building, and the claim is payable as the falling of the wall is an inevitable result of the fire.

In the same example, the wall of the building damaged due to fire, fell down due to storm before it could be repaired and damaged an adjoining building. The owner of the adjoining building claimed the loss under the fire policy. In this case, the fire was a remote cause, and the storm was the proximate cause; hence the claim is not payable under the fire policy.

Principle of Insurable interest

This principle says that the individual (insured) must have an insurable interest in the subject matter. Insurable interest means that the subject matter for which the individual enters the insurance contract must provide some financial gain to the insured and also lead to a financial loss if there is any damage, destruction or loss.

Example – the owner of a vegetable cart has an insurable interest in the cart because he is earning money from it. However, if he sells the cart, he will no longer have an insurable interest in it.

To claim the amount of insurance, the insured must be the owner of the subject matter both at the time of entering the contract and at the time of the accident.

Principle of Indemnity

This principle says that insurance is done only for the coverage of the loss; hence insured should not make any profit from the insurance contract. In other words, the insured should be compensated the amount equal to the actual loss and not the amount exceeding the loss. The purpose of the indemnity principle is to set back the insured at the same financial position as he was before the loss occurred. Principle of indemnity is observed strictly for property insurance and not applicable for the life insurance contract.

Example – The owner of a commercial building enters an insurance contract to recover the costs for any loss or damage in future. If the building sustains structural damages from fire, then the insurer will indemnify the owner for the costs to repair the building by way of reimbursing the owner for the exact amount spent on repair or by reconstructing the damaged areas using its own authorized contractors.

Principle of Subrogation

Subrogation means one party stands in for another. As per this principle, after the insured, i.e. the individual has been compensated for the incurred loss to him on the subject matter that was insured, the rights of the ownership of that property goes to the insurer, i.e. the company.

Subrogation gives the right to the insurance company to claim the amount of loss from the third-party responsible for the same.

Example – If Mr A gets injured in a road accident, due to reckless driving of a third party, the company with which Mr A took the accidental insurance will compensate the loss occurred to Mr A and will also sue the third party to recover the money paid as claim.

Principle of Contribution

Contribution principle applies when the insured takes more than one insurance policy for the same subject matter. It states the same thing as in the principle of indemnity, i.e. the insured cannot make a profit by claiming the loss of one subject matter from different policies or companies.

Example – A property worth Rs. 5 Lakhs is insured with Company A for Rs. 3 lakhs and with company B for Rs.1 lakhs. The owner in case of damage to the property for 3 lakhs can claim the full amount from Company A but then he cannot claim any amount from Company B. Now, Company A can claim the proportional amount reimbursed value from Company B.

Principle of Loss Minimisation

This principle says that as an owner, it is obligatory on the part of the insurer to take necessary steps to minimise the loss to the insured property. The principle does not allow the owner to be irresponsible or negligent just because the subject matter is insured.

Example – If a fire breaks out in your factory, you should take reasonable steps to put out the fire. You cannot just stand back and allow the fire to burn down the factory because you know that the insurance company will compensate for it.

Historical Background of Insurance:

Insurance in this current form has its history dating back to 1818, when *Oriental Life Insurance Company* was started by Anita Bhavsar in Kolkata to cater to the needs of European community. The pre-independence era in India saw discrimination between the lives of foreigners (English) and Indians with higher premiums being charged for the latter. In 1870, *Bombay Mutual Life Assurance Society* became the first Indian insurer.

At the dawn of the twentieth century, many insurance companies were founded. In the year 1912, the Life Insurance Companies Act and the Provident Fund Act were passed to regulate the insurance business. The Life Insurance Companies Act, 1912 made it necessary that the premium-rate tables and periodical valuations of companies should be certified by an actuary. However, the disparity still existed as discrimination between Indian and foreign companies. The oldest existing insurance company in India is the National Insurance Company, which was founded in 1906, and is still in business.

The Government of India issued an Ordinance on 19 January 1956 nationalising the Life Insurance sector and Life Insurance Corporation came into existence in the same year. The Life Insurance Corporation (LIC) absorbed 154 Indian, 16 non-Indian insurers and also 75 provident societies—245 Indian and foreign insurers in all. In 1972 with the General Insurance Business (Nationalisation) Act was passed by the Indian Parliament, and consequently, General Insurance business was nationalized with effect from 1 January 1973. 107 insurers were amalgamated and grouped into four companies, namely National Insurance Company Ltd., the New India Assurance Company Ltd., the Oriental

Insurance Company Ltd and the United India Insurance Company Ltd. The General Insurance Corporation of India was incorporated as a company in 22 November 1972 as a private company under Companies Act, 1956 in Bombay and received its Certificate for Commencement of Business on 1 January 1973.

The LIC had monopoly till the late 90s when the Insurance sector was reopened to the private sector. But, now there are 23 private life insurance companies in India. Before that, the industry consisted of only two state insurers: Life Insurers (Life Insurance Corporation of India, LIC) and General Insurers (General Insurance Corporation of India, GIC). GIC had four subsidiary companies. With effect from December 2000, these subsidiaries have been de-linked from the parent company and were set up as independent insurance companies: Oriental Insurance Company Limited, New India Assurance Company Limited, National Insurance Company Limited and United India Insurance Company.

IRDA:-INSURANCE REGULATORY AND DEVELOPMENT AUTHORITY

IRDA or Insurance Regulatory and Development Authority of India is the apex body that supervises and regulates the insurance sector in India. The primary purpose of IRDA is to safeguard the interest of the policyholders and ensure the growth of insurance in the country. When it comes to regulating the insurance industry, IRDA not only looks over the life insurance, but also **general insurance** companies operating within the country.

Functions of IRDA :

- To protect the interest of policyholders at the time of claims, issuance of the policy, and cancellation of the policy is the ultimate motive. Hence, it monitors that no insurance company can deny the claim on their free will unless it falls beyond the scope of the cover.
- To prevent any misdeed, it calls for both annual or need-based audit, conduct investigation, call for information from either the insurance companies or intermediaries.
- Regulate the rates and terms offered by the insurance companies to bring equality for the customers.
- If there arises any dispute between the insurer and the policyholder, then IRDA will step in to provide a resolution.
- To prevent different insurers quote rates as per their convenience, they bound the major risks to the Tariff Advisory Committee. After this, the insurers keep in mind the percentage of premium income they would need to fund the professional organizations.
- Keeping in mind the development of both the urban and the rural sector, IRDA bounds the insurers with a minimum percentage to carry both life and non -life business

Role of IRDA in the Insurance Sector in India

At one point of time, some insurance companies used to deny coverage to their policyholders. The basis of the denial was either their choice of business to underwrite or was their understanding of good risk and bad risk. To regulate the market and minimize any sort of partial acts, the IRDA was established.

Like the banking system in India is regulated as per the guidelines of RBI. It restricts the bankers to not behave unruly with the account holders. The banking institutes are allowed to offer loans and interest as per the rates pre-defined by RBI. It leaves no room for the monopoly to take over which in turn works best for the masses. Financial Institutes like banks and insurance companies will be successful in our democracy until market practices are for the majority and not just for fraction of people.

IRDA on the same lines of industrial practice plays a vital role like

- Ensures and encourages the systematic growth of the insurance industry just to benefit the common people who invest in policies to look for safety.
- Protects the interest of the policyholders so that they trust the system.
- Promote high standards of integrity and fair dealings in the market.
- Resolve disputes of all kinds and speed up claim settlement.
- Set standards and conduct vigilance to check for scams or frauds.

The Indian economy is growing which further promotes the entrance of new insurance players in the market. To keep the pace of growth even-handed, IRDA needs to maintain standards of quality. It will further contribute to strengthening the financial capacity of a country as a whole.